DAILY JOURNAL CORP
Form 10-Q
May 10, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

or

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

For the transition period from _______________ to _____________________

Commission File Number 0-14665

DAILY JOURNAL CORPORATION

(Exact name of registrant as specified in its charter)

South Carolina	95-4133299
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
915 East First Street Los Angeles, California	90012-4050
(Address of principal executive offices)	(Zip code)

(213) 229-5300

(Registrant's telephone number, including area code)

None

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes: X No:

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer:	Accelerated Filer:	X
Non-accelerated Filer:	Smaller Reporting Company:	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: No: X

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Class	Outstanding at April 30, 2016
Common Stock, par value $ .01 per share	1,380,746 shares

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DAILY JOURNAL CORPORATION

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PART I

Item 1. FINANCIAL STATEMENTS

DAILY JOURNAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31 2016	**September 30** 2015
ASSETS		
Current assets		
Cash and cash equivalents	$9,228,000	$15,617,000
Marketable securities at fair value, including common stocks of $154,960,000 and bonds of $7,571,000 at March 31, 2016 and common stocks of $158,705,000 and bonds of $7,336,000 at September 30, 2015	162,531,000	166,041,000
Accounts receivable, less allowance for doubtful accounts of $250,000 at March 31, 2016 and September 30, 2015	6,123,000	5,673,000
Inventories	38,000	48,000
Prepaid expenses and other assets	664,000	684,000
Income tax receivable	352,000	765,000
Total current assets	178,936,000	188,828,000
Property, plant and equipment, at cost		
Land, buildings and improvements	16,283,000	12,773,000
Furniture, office equipment and computer software	2,754,000	2,655,000
Machinery and equipment	1,864,000	1,864,000
	20,901,000	17,292,000
Less accumulated depreciation	(8,641,000)	(8,335,000)
	12,260,000	8,957,000
Intangibles, net	10,472,000	12,990,000
Goodwill	13,400,000	13,400,000
Deferred income taxes, net	6,894,000	4,021,000
	$221,962,000	$228,196,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$2,617,000	$4,212,000
Accrued liabilities	2,790,000	2,919,000
Note payable collateralized by real estate	107,000	---
Deferred subscriptions	3,491,000	3,474,000
Deferred installation contracts	6,133,000	7,820,000

Deferred maintenance agreements and others	6,796,000	6,815,000
Deferred income taxes, net	39,798,000	40,641,000
Total current liabilities	61,732,000	65,881,000
Long term liabilities		
Investment margin account borrowings	29,493,000	29,493,000
Note payable collateralized by real estate	2,127,000	---
Deferred maintenance agreements	234,000	551,000
Income tax payable	2,866,000	2,991,000
Accrued interest and penalty for uncertain and unrecognized tax benefits	682,000	633,000
Accrued liabilities	102,000	47,000
Total long term liabilities	35,504,000	33,715,000
Commitments and contingencies (Note 10)	---	---
Shareholders' equity		
Preferred stock, $.01 par value, 5,000,000 shares authorized and no shares issued	---	---
Common stock, $.01 par value, 5,000,000 shares authorized; 1,805,053 shares issued, including 424,307 treasury shares, at March 31, 2016 and September 30, 2015	14,000	14,000
Additional paid-in capital	1,755,000	1,755,000
Retained earnings	59,368,000	59,111,000
Accumulated other comprehensive income	63,589,000	67,720,000
Total shareholders' equity	124,726,000	128,600,000
	$221,962,000	$228,196,000

See accompanying Notes to Consolidated Financial Statements

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	Three months ended March 31 2016		2015	
Revenues				
Advertising	$	2,346,000	$	2,549,000
Circulation		1,458,000		1,460,000
Advertising service fees and other		644,000		650,000
Licensing and maintenance fees		4,107,000		3,680,000
Consulting fees		1,664,000		1,418,000
Other public service fees		1,223,000		1,635,000
		11,442,000		11,392,000
Costs and expenses				
Salaries and employee benefits		7,029,000		6,771,000
Other outside services		813,000		835,000
Postage and delivery expenses		292,000		312,000
Newsprint and printing expenses		219,000		258,000
Depreciation and amortization		1,428,000		1,367,000
Other general and administrative expenses		2,237,000		2,815,000
		12,018,000		12,358,000
Loss from operations		(576,000)		(966,000)
Other income (expense)				
Dividends and interest income		833,000		860,000
Other income and capital gains		14,000		14,000
Interest expense		(94,000)		(55,000)
		(25,000)		(24,000)

Interest expense accrued for uncertain and unrecognized tax benefits						
Income (loss) before income taxes		152,000			(171,000	)
Benefit from (provision for) income taxes		55,000			675,000	
Net income	$	207,000		$	504,000	
Weighted average number of common shares outstanding - basic and diluted		1,380,746			1,380,746	
Basic and diluted net income per share	$	.15		$	.37	
Comprehensive loss						
Net income	$	207,000		$	504,000	
Net decrease in unrealized appreciation of marketable securities (net of taxes)		(10,058,000	)		(802,000	)
	$	(9,851,000	)	$	(298,000	)

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	Six months ended March 31	
	2016	2015
Revenues		
Advertising	$4,667,000	$5,253,000
Circulation	2,964,000	2,984,000
Advertising service fees and other	1,294,000	1,335,000
Licensing and maintenance fees	7,754,000	7,437,000
Consulting fees	3,040,000	2,610,000
Other public service fees	2,538,000	3,096,000
	22,257,000	22,715,000
Costs and expenses		
Salaries and employee benefits	13,677,000	13,383,000
Other outside services	1,677,000	1,682,000
Postage and delivery expenses	578,000	644,000
Newsprint and printing expenses	436,000	600,000
Depreciation and amortization	2,843,000	2,727,000
Other general and administrative expenses	4,584,000	5,006,000
	23,795,000	24,042,000
Loss from operations	(1,538,000)	(1,327,000)
Other income (expense)		
Dividends and interest income	1,736,000	1,688,000
Other income and capital gains	30,000	32,000
Interest expenses	(162,000)	(112,000)
Interest expense accrued for uncertain and unrecognized tax benefits	(49,000)	(44,000)
Income before taxes	17,000	237,000
Benefit from income taxes	240,000	700,000
Net income	$257,000	$937,000
Weighted average number of common shares outstanding - basic and diluted	1,380,746	1,380,746
Basic and diluted net income per share	$.19	$.68
Comprehensive loss		
Net income	$257,000	$937,000
Net decrease in unrealized appreciation of marketable securities (net of taxes)	(4,131,000)	(4,444,000)
	$(3,874,000)	$(3,507,000)

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six months ended March 31	
	2016	2015
Cash flows from operating activities		
Net income	$257,000	$937,000
Adjustments to reconcile net income to net cash used for (provided by) operations		
Depreciation and amortization	2,843,000	2,727,000
Gains on sales of marketable securities	---	(4,000)
Deferred income taxes	(498,000)	(862,000)
Discounts earned on bonds	(1,000)	(2,000)
Changes in assets and liabilities		
(Increase) decrease in current assets		
Accounts receivable, net	(450,000)	2,003,000
Inventories	10,000	13,000
Prepaid expenses and other assets	20,000	139,000
Income tax receivable	413,000	1,183,000
Increase (decrease) in liabilities		
Accounts payable	(1,595,000)	23,000
Accrued liabilities	(25,000)	(31,000)
Income taxes	(125,000)	(123,000)
Deferred subscriptions	17,000	11,000
Deferred maintenance agreements and others	(336,000)	(1,578,000)
Deferred installation contracts	(1,687,000)	(672,000)
Net cash (used for) provided by operating activities	(1,157,000)	3,764,000
Cash flows from investing activities		
Sales of marketable securities	---	4,044,000
Purchases of marketable securities	(3,838,000)	(10,977,000)
Purchases of property, plant and equipment, including the Logan Utah office building	(3,628,000)	(386,000)
Net cash used for investing activities	(7,466,000)	(7,319,000)
Cash flows from financing activities		
Note payable collateralized by real estate	2,260,000	---
Payment of loan principal	(26,000)	---
Net cash provided by financing activities	2,234,000	---
Decrease in cash and cash equivalents	(6,389,000)	(3,555,000)
Cash and cash equivalents		

Beginning of period	15,617,000	15,410,000
End of period	$9,228,000	$11,855,000
Interest paid during period	$158,000	$112,000
Net income taxes refunded during period	$(29,000)	$(899,000)

See accompanying Notes to Consolidated Financial Statements.

DAILY JOURNAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - The Corporation and Operations

Daily Journal Corporation (the “Company”) publishes newspapers and web sites covering California and Arizona and produces several specialized information services. It also serves as a newspaper representative specializing in public notice advertising.

Journal Technologies, Inc. (“Journal Technologies”), a wholly-owned subsidiary, includes as of October 1, 2014, the combined operations of Sustain Technologies, Inc. (“Sustain”), a wholly-owned subsidiary since 2008; New Dawn Technologies, Inc. (“New Dawn”), acquired in December 2012; and ISD Technologies, Inc. (“ISD”), acquired in September 2013. Journal Technologies supplies case management software systems and related products to courts, prosecutor and public defender offices, probation departments and other justice agencies, including administrative law organizations, city and county governments and bar associations. These organizations use the Journal Technologies family of products to help manage cases and information electronically, to interface with other critical justice partners and to extend electronic services to bar members and the public, including a website to pay traffic citations online. These products are licensed to more than 500 organizations in 41 states and internationally.

Essentially all of the Company’s operations are based in California, Arizona and Utah.

Note 2 - Basis of Presentation

In the opinion of the Company, the accompanying interim unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of its financial position as of March 31, 2016, its results of operations for the three- and six-month periods ended March 31, 2016 and 2015 and its cash flows for the six-month periods ended March 31, 2016 and 2015. The results of operations for the three and six months ended March 31, 2016 are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Certain reclassifications of previously reported amounts have been made to conform to the current year’s presentation.

Note 3 - Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. This update requires that all leases be recognized by lessees on the balance sheet through a right-of-use asset and corresponding lease liability, including today's operating leases. This standard is required to be adopted for annual periods beginning after December 15, 2018, including interim periods within that annual period, which is the Company's fiscal year 2020. The Company has not yet evaluated what impact, if any, the adoption of this guidance may have on its financial condition, results of operations or disclosures.

In addition, the Company will evaluate other new accounting pronouncements as detailed in its Annual Report on Form 10-K for the year ended September 30, 2015.

Note 4 - Basic and Diluted Income Per Share

The Company does not have any common stock equivalents, and therefore the basic and diluted income per share are the same.

Note 5 - Intangible Assets

Intangible Assets

	March 31, 2016			September 30, 2015		
	Customer Relationships	Developed Technology	Total	Customer Relationships	Developed Technology	Total
Gross intangible	$22,104,000	$2,525,000	$24,629,000	$22,104,000	$2,525,000	$24,629,000
Accumulated amortization	(12,672,000)	(1,485,000)	(14,157,000)	(10,406,000)	(1,233,000)	(11,639,000)
	$9,432,000	$1,040,000	$10,472,000	$11,698,000	$1,292,000	$12,990,000

These identifiable intangible assets are being amortized over five years or less for financial statement purposes due to the short life cycle of technology that customer relationships depend on, and over a 15-year period on a straight-line basis for tax purposes. The intangible amortization expenses were $2,518,000 and $1,259,000 for the six- and three-month periods ended March 31, 2016, respectively, as compared with $2,448,000 and $1,224,000 in the prior year periods.

Note 6 – Goodwill

The Company accounts for goodwill in accordance with Accounting Standards Codification (ASC) 350, *Intangibles — Goodwill and Other*. Goodwill, which is not amortized for financial statement purposes, is amortized over a 15-year period for tax purposes, but evaluated for impairment annually, or whenever events or changes in circumstances indicate that the value may not be recoverable. Considered factors for potential goodwill impairment evaluation with respect to Journal Technologies include the current year's business profitability before intangible amortization, fluctuations of revenues, changes in the marketplace, the status of deferred installation contracts and new business, among other things.

In addition, ASU 2011-08, *Intangible – Goodwill and Others -- Testing Goodwill for Impairment*, allows for the option of performing a qualitative assessment before calculating the fair value of a reporting unit. If it is determined based on qualitative factors that there is no impairment to goodwill, then the fair value of a reporting unit is not needed. If a quantitative analysis is required and the unit's carrying amount exceeds its fair value, then the second step is performed to measure the amount of potential impairment. The Company's annual goodwill impairment analysis in fiscal 2015 did not result in an impairment charge based on the qualitative assessment. There was no indicator of impairment during the six-month periods ended March 31, 2016 and 2015.

Note 7 – Revenue Recognition

For the Company's traditional publishing business (the "Traditional Business"), proceeds from the sale of subscriptions for newspapers, court rule books and other publications and other services are recorded as deferred revenue and are included in earned revenue only when the services are provided, generally over the subscription term. Advertising revenues are recognized when advertisements are published and are net of commissions.

Journal Technologies recognizes revenues in accordance with the provisions of ASC 985-605, *Software—Revenue Recognition* and ASC 605-35 *Construction-Type and Production-Type Contracts*. Revenues from leases of software products are recognized over the life of the lease while revenues from software product sales are generally recognized upon delivery, installation or acceptance pursuant to a signed agreement. Revenues from annual license and maintenance contracts generally call for Journal Technologies to provide software updates and upgrades to customers and are recognized ratably over the maintenance period. Consulting and other services are recognized upon acceptance by the customers under the completed contract method. The Company elects to use the completed contract method because each customer's acceptance is unpredictable and reliable estimates of the progress towards completion cannot be made. Only after a customer's acceptance of a completed project are customer advances generally no longer at risk of refund and are therefore considered earned.

The Company has established Vendor Specific Objective Evidence (VSOE) of fair value of the annual maintenance because a substantial majority of the Journal Technologies' actual maintenance renewals is within a narrow range of pricing as a percentage of the underlying license fees for the legacy contracts and is deemed substantive. Approximately 60% and 58% of the Company's revenues during the six months ended March 31, 2016 and 2015, respectively, were derived from Journal Technologies.

Note 8 - Income Taxes

For the six months ended March 31, 2016, the Company recorded an income tax benefit of $240,000 on pretax profit of $17,000. The income tax benefit was the result of applying the effective tax rate anticipated for fiscal 2016 to pretax income for the six-month period ended March 31, 2016. The effective tax rate was lower than the statutory rate primarily due to the dividends received deduction and the domestic production activity deduction. On pretax income of $237,000 for the six months ended March 31, 2015, the Company recorded an income tax benefit of $700,000 which was the net result of applying the effective tax rate anticipated for fiscal 2015 to pretax income for the six months ended March 31, 2015. The Company's effective tax rate was -1,412% and -295% for the six months ended March 31, 2016 and 2015, respectively. The Company files federal income tax returns in the United States and with various state jurisdictions and is no longer subject to examinations for fiscal years before fiscal 2012 with regard to federal income taxes and fiscal 2011 for state income taxes.

At March 31, 2016, the Company had an accrued liability of approximately $2,866,000 for uncertain and unrecognized tax benefits relating to an acquisition in fiscal 2013, after a reduction of $378,000 resulting from the recognition of deferred revenues and from the amortization of goodwill for tax purposes. The Company does not anticipate a significant increase or decrease in this liability in the next twelve months. If recognized, it is expected that these unrecognized tax benefits would not have a significant impact to the Company's effective tax rate. During the six-month periods ended March 31, 2016 and 2015, interest expenses of approximately $49,000 and $44,000, respectively, were recorded as "interest expense accrued for uncertain and unrecognized tax benefits" in the Consolidated Statements of Comprehensive Loss.

Note 9 - Investments in Marketable Securities

Investments in marketable securities categorized as “available-for-sale” are stated at fair value. The Company uses quoted prices in active markets for identical assets (consistent with the Level 1 definition in the fair value hierarchy) to measure the fair value of its investments on a recurring basis pursuant to ASC 820, *Fair Value Measurement*. As of March 31, 2016 and September 30, 2015, an unrealized gain of $104,149,000 and $111,498,000, respectively, was recorded before taxes of $40,060,000 and $43,278,000, respectively, in “Accumulated other comprehensive income” in the accompanying Consolidated Balance Sheets. Most of the unrealized gains were in the common stocks of three U.S. financial institutions.

Investments in equity securities and securities with fixed maturity as of March 31, 2016 and September 30, 2015 are summarized below.

	March 31, 2016 (Unaudited)			September 30, 2015		
	Aggregate fair value	Amortized/ Adjusted cost basis	Pretax unrealized gains	Aggregate fair value	Amortized/ Adjusted cost basis	Pretax unrealized gains
Marketable securities						
Common stocks	$154,960,000	$53,442,000	$101,518,000	$158,705,000	$49,604,000	$109,101,000
Bonds	7,571,000	4,940,000	2,631,000	7,336,000	4,939,000	2,397,000
Total	$162,531,000	$58,382,000	$104,149,000	$166,041,000	$54,543,000	$111,498,000

All investments are classified as “Current assets” because they are available for sale at any time. The bonds mature in 2039.

As of March 31, 2016, the Company performed an evaluation for an equity security with a fair value below cost to determine if the unrealized loss was other-than-temporary. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer and the Company’s ability and intent to hold the security until fair value recovers. The assessment of the ability and intent to hold this security to recovery focuses on liquidity needs, asset/liability management objectives and security portfolio objectives. Based on the result of the evaluation, the Company concluded that as of March 31, 2016, the unrealized loss related to the equity security it owns was temporary.

Note 10 - Debt and Commitments and Contingencies

In December 2012, the Company borrowed from its investment margin account the purchase price of $14 million for the New Dawn acquisition, and in September 2013, it borrowed another $15.5 million for the ISD acquisition, in each case pledging its marketable securities as collateral. The interest rate for these investment margin account borrowings fluctuates based on the Federal Funds Rate plus 50 basis points with interest only payable monthly. The interest rate as of March 31, 2016 was 1%. These investment margin account borrowings do not mature.

In November 2015, the Company purchased a 30,700 square foot office building constructed in 1998 on about 3.6 acres in Logan, Utah that had been previously leased by Journal Technologies. The Company paid $1.24 million and financed the balance with a real estate bank loan of $2.26 million which bears a fixed interest rate of 4.66% and is repayable in equal monthly installments of about $17,600 through 2030. This loan is secured by the Logan facility and can be paid off at any time without prepayment penalty.

The Company owns its facilities in Los Angeles and leases space for its other Daily Journal offices under operating leases which expire at various dates through fiscal 2020. The Company is responsible for a portion of maintenance, insurance and property tax expenses relating to these leased properties and certain other leased properties. Rental expenses were $415,000 and $165,000 for the six- and three-month periods ended March 31, 2016, respectively, as compared with $588,000 and $305,000 in the prior year periods.

From time to time, the Company is subject to litigation arising in the normal course of its business. While it is not possible to predict the results of such litigation, management does not believe the ultimate outcome of these matters will have a material effect on the Company’s financial position or results of operations or cash flows.

Note 11 - Operating Segments

The Company's reportable segments are: (i) the Traditional Business and (ii) Journal Technologies. All inter-segment transactions were eliminated. Summarized financial information concerning the Company's reportable segments is shown in the following table:

	Reportable Segments			
	Traditional Business	Journal Technologies	Corporate income and expenses	Total
Six months ended March 31, 2016				
Revenues				
Advertising	$4,667,000	$---	$---	$4,667,000
Circulation	2,964,000	---	---	2,964,000
Advertising service fees and other	1,294,000	---	---	1,294,000
Licensing and maintenance fees	---	7,754,000	---	7,754,000
Consulting fees	---	3,040,000	---	3,040,000
Other public service fees	---	2,538,000	---	2,538,000
Operating expenses	8,775,000	15,020,000	---	23,795,000
Income (loss) from operations	150,000	(1,688,000)	---	(1,538,000)
Dividends and interest income	---	---	1,736,000	1,736,000
Other income	21,000	---	9,000	30,000
Interest expenses on note payable collateralized by real estate and margin loans	(36,000)	---	(126,000)	(162,000)
Interest expense accrued for uncertain and unrecognized tax benefits	---	(49,000)	---	(49,000)
Pretax income (loss)	135,000	(1,737,000)	1,619,000	17,000
Income tax (expense) benefit	(165,000)	670,000	(265,000)	240,000
Net income (loss)	(30,000)	(1,067,000)	1,354,000	257,000
Total assets	16,946,000	42,485,000	162,531,000	221,962,000
Capital expenditures, including purchase of Logan building	3,625,000	3,000	---	3,628,000
Amortization of intangible assets	71,000	2,447,000	---	2,518,000

	Reportable Segments			
	Traditional Business	Journal Technologies	Corporate income and expenses	Total
Six months ended March 31, 2015				

Investment in equity investment affiliates

Investee companies that are not consolidated, but over which we exercise significant influence, are accounted for under the equity method of accounting in accordance with ASC Topic 323 "Equity Method and Joint Ventures". Whether or not we exercise significant influence with respect to an Investee depends on an evaluation of several factors including, among others, representation on the investee companies' board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee companies. Under the equity method of accounting, an investee company's accounts are not reflected within our consolidated balance sheets and statements of income and comprehensive income; however, our share of the earnings or losses of the investee company is reflected in the caption "Share of earnings (losses) in equity investment affiliates" in the consolidated statements of income and comprehensive income. Our carrying value (including advance to the investees) in equity method investee companies is reflected in the caption "Investment in and advance to equity investment affiliates" in our consolidated balance sheets.

When our carrying value in an equity method investee company is reduced to zero, no further losses are recorded in our consolidated financial statements unless we guaranteed obligations of the investee company or have committed additional funding. When the investee company subsequently reports income, we will not record its share of such income until it equals the amount of its share of losses not previously recognized.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of acquisitions of interests in our subsidiaries.

Goodwill is not depreciated or amortized but is tested for impairment at the reporting unit level at least on an annual basis, and between annual tests when an event occurs or circumstances change that could indicate that the asset might be impaired. The test consists of two steps. First, identify potential impairment by comparing the fair value of the reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired. Second, if there is impairment identified in the first step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with Topic 805, "Business Combinations."

Application of a goodwill impairment test requires significant management judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. The judgment in estimating the fair value of reporting units includes estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

Deconsolidation

We accounted for deconsolidation of subsidiaries in accordance with ASC Topic 810 "Consolidation".

In accordance with ASC Topic 810-10-40-5, the parent shall account for the deconsolidation of a subsidiary by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of all of the following:

1. The fair value of any consideration received;

2. The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated;

3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.

b. The carrying amount of the former subsidiary's assets and liabilities.

Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary

We accounted for changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary in accordance with ASC Topic 810 "Consolidation", subtopic 10, which requires the transaction be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent and reallocated the subsidiary's accumulated comprehensive income, if any, among the parent and the noncontrolling interest through an adjustment to the parent's equity.

Revenue recognition

Our revenue recognition policies are in compliance with ASC Topic 605. In accordance with ASC Topic 605, revenues are recognized when all four of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) the service has been rendered, (iii) the fees are fixed or determinable, and (iv) collectability is reasonably assured.

Sales include revenues from reselling of advertising time purchased from TV stations, internet advertising and providing related value added technical services, reselling of internet advertising spaces and other advertisement related resources. No revenue from advertising-for-advertising barter transactions was recognized because the transactions did not meet the criteria for recognition in ASC Topic 605, subtopic 20. Advertising contracts establish the fixed price and advertising services to be provided. Pursuant to advertising contracts, we provide advertisement placements in different formats, including but not limited to banners, links, logos, buttons, rich media and content integration. Revenue is recognized ratably over the period the advertising is provided and, as such, we consider the services to have been delivered. We treat all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Value added technical services are provided based on two types of contracts: (i) fixed price and (ii) fixed price with minimum performance threshold. For contracts with fixed price term, revenue is recognized on a pro-rata basis over the engaged service period. For fixed price contracts with minimum performance threshold, revenue is recognized when the specified performance criteria is met. Based upon our credit assessments of our customers prior to entering into contracts, we determine if collectability is reasonably assured. In situations where

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collectability is not deemed to be reasonably assured, we recognize revenue upon receipt of cash from customers, only after services have been provided and all other criteria for revenue recognition have been met.

Taxation

1. Income tax

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

We adopt ASC Topic 740-10-25-5 through 740-10-25-7 and 740-10-25-13, which prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. For the year ended December 31, 2011 and 2010, we did not have any interest and penalties associated with tax positions and did not have any significant unrecognized uncertain tax positions.

i). We were incorporated in the State of Nevada. Under the current laws of Nevada we are not subject to state corporate income tax. We became a holding company and do not conduct any substantial operations of our own after the Share Exchange. No provision for federal corporate income tax has been made in our financial statements as no assessable profits for the year ended December 31, 2011 and 2010, or any prior periods. We do not provide for U.S. taxes or foreign withholding taxes on undistributed earnings from non-U.S. subsidiaries and VIEs because such earnings are intended to be reinvested indefinitely. If undistributed earnings were distributed, foreign tax credits could become available under current law to reduce the resulting U.S. income tax liability.

ii). China Net BVI was incorporated in the British Virgin Islands (“BVI”). Under the current laws of the BVI, we are not subject to tax on income or capital gains. Additionally, upon payments of dividends by China Net BVI to us, no BVI withholding tax will be imposed.

iii). China Net HK was incorporated in Hong Kong and does not conduct any substantial operations of its own. No provision for Hong Kong profits tax have been made in our financial statements as no assessable profits for the year ended December 31, 2011 and 2010, or any prior periods. Additionally, upon payments of dividends by China Net HK to its sole shareholder, China Net BVI, no Hong Kong withholding tax will be imposed.

iv). Our PRC operating subsidiary and VIEs, being incorporated in the PRC, are governed by the income tax law of the PRC and are subject to PRC enterprise income tax (“EIT”). Effective from January 1, 2008, the EIT rate of PRC was changed from 33% of to 25%, and applies to both domestic and foreign invested enterprises.

- Rise King WFOE is a software company qualified by the related PRC governmental authorities and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a two-year EIT exemption from its first profitable year and a 50% reduction of its applicable EIT rate, which is 25% to 12.5% of its taxable income for the succeeding three years. Rise King WFOE had a net loss for the year ended December 31, 2008 and its first profitable year was fiscal year 2009 which has been verified by the local tax bureau by accepting the application filed by us. Therefore, it was approved to be entitled to a two-year EIT exemption for fiscal year 2009 through fiscal year 2010 and a 50%

reduction of its applicable EIT rate which is 25% to 12.5% for fiscal year 2011 through fiscal year 2013. After fiscal year 2013, the applicable income tax rate of Rise King WFOE will be 25% under the current EIT law of PRC. Therefore, for the year ended December 31, 2011 and 2010, the applicable income tax rate for Rise King WFOE was 12.5% and nil%, respectively.

- Business Opportunity Online was qualified as a High and New Technology Enterprise in Beijing High-Tech Zone in 2005 and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a three-year EIT exemption for fiscal year 2005 through fiscal year 2007 and a 50% reduction of its applicable EIT rate, which is 15% to 7.5% for the following three years from fiscal year 2008 through fiscal year 2010. However, in March 2007, a new enterprise income tax law (the "New EIT") of PRC was enacted which was effective on January 1, 2008. Subsequently, on April 14, 2008, relevant governmental regulatory authorities released new qualification criteria, application procedures and assessment processes for "High and New Technology Enterprise" status under the New EIT which would entitle the re-qualified and approved entities to a favorable statutory tax rate of 15%. Business Opportunity Online re-applied its qualification for a High and New Technology Enterprise in 2008 to the related PRC regulatory authorities. With an effective date of September 4, 2009, Business Opportunity Online obtained the approval of its reassessment of the qualification as a "High and New Technology Enterprise" under the New EIT law and was approved again by the local tax authorities to be entitled to a favorable statutory tax rate of 15%. Under the previous EIT laws and regulations, High and New Technology Enterprises enjoyed a favorable tax rate of 15% and were exempted from income tax for three years beginning with their first year of operations, and were entitled to a 50% tax reduction to 7.5% for the subsequent three years and 15% thereafter. The current EIT Law provides grandfathering treatment for enterprises that were (1) qualified as High and New Technology Enterprises under the previous EIT laws, and (2) established before March 16, 2007, if they continue to meet the criteria for High and New Technology Enterprises under the current EIT Law. The grandfathering provision allows Business Opportunity Online to continue enjoying their unexpired tax holidays provided by the previous EIT laws and regulations, as it was established in December 2004 and qualified as a High and New Technology Enterprises under the previous EIT laws in 2005. After the expiration of the current tax holiday as of December 31, 2010, the applicable income tax rate of Business Opportunity Online increased to 15%, the standard preferential income tax rate for a High and New Technology Enterprise. Therefore, for the year ended December 31, 2011 and 2010, the applicable income tax rate for Business Opportunity Online was 15% and 7.5%, respectively. Business Opportunity Online's High and New Technology Enterprise certificate will expire on September 4, 2012 and subject to an administrative review by the relevant PRC governmental regulatory authorities for obtaining the renewed certificate. As confirmed with the local tax authorities of Beijing, the PRC, if Business Opportunity Online fails to pass the administrative review, the enacted tax rate will be increased to 25% starting from January 1, 2012. Business Opportunity Online assessed the situation and concluded that more likely than not it will be able to pass this administrative review and continue to enjoy the 15% preferential income tax rate as a High and New Technology Enterprise.

- Business Opportunity Online Hubei, Hubei CNET and Zhao Shang Ke Hubei were all incorporated in Xiaotian Industrial Park of Xiaogan Economic Development Zone in Xiaogan City, Hubei province of the PRC in 2011. These operating entities have been approved by the related local government authorities to apply the deemed income tax method for its computation of income tax expense for the year ended December 31, 2011. Under the deemed income tax method, the deemed profit is calculated based on 10% of the total revenue and the applicable income tax rate is 25%. Therefore, the income tax expenses under the deemed income tax method is calculated as 2.5% of the total revenue recognized for the year ended December 31, 2011 for each of these operating entities. In December 2011, the local tax authorities of these operating entities informed the Company, that they will cancel the current applicable deemed income tax method for computation of income tax expenses starting from January 1, 2012 for these entities, but may refund certain amount of the income tax paid by these operating entities as an local subsidy to these entities. Therefore, the applicable income tax rate for these operating entities will be 25% starting from January 1, 2012.

- The applicable income tax rate for the rest of our PRC operating entities was 25% for the years ended December 31, 2011 and 2010.

- The New EIT also imposed a 10% withholding income tax for dividends distributed by a foreign invested enterprise to its immediate holding company outside China, which were exempted under the previous enterprise income tax law and rules. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% rate. Rise King WFOE is owned by an intermediate holding company in Hong Kong and will be entitled to the 5% preferential withholding tax rate upon distribution of the dividends to this intermediate holding company.

For the year ended December 31, 2011 and 2010, all of the preferential income tax treatments enjoyed by our PRC subsidiary and VIEs were based on the current applicable laws and regulations of the PRC and approved by the related government regulatory authorities and local tax authorities where our respective PRC subsidiary and VIEs operate. Rise King WFOE, Business Opportunity Online, Business Opportunity Online Hubei, Hubei CNET and Zhao Shang Ke Hubei were most affected by these preferential income tax treatments within the structure of us. The preferential income tax treatments are subject to change in accordance with the PRC government economic development policies and regulations. These preferential income tax treatments are mainly determined by the regulation and policies of the PRC government in the context of the overall economic policy and strategy. As a result, the uncertainty of theses preferential income tax treatments are subject to, but not limited to, the PRC government policy on supporting any specific industry's development under the outlook and strategy of overall macroeconomic development.

2. Business tax and relevant surcharges

Revenue of advertisement services are subject to 5.5% business tax and 3% cultural industry development surcharge of the net service income after deducting amount paid to ending media promulgators. Revenue of internet technical support services is subjected to 5.5% business tax. Business tax charged was included in cost of sales.

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08 — "Intangibles — Goodwill and Other". The amendments in this update will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of the provisions in ASU 2011-08 will have no material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12 — "Comprehensive Income". The amendments in this update supersede certain pending paragraphs in ASU No. 2011-05, to effectively defer only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the Board time to consider the presentation requirements for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities. The amendments in this update are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The adoption of the provisions in ASU 2011-12 will have no material impact on our consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on our consolidated financial position and results of operations upon adoption.

A. RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2011 AND 2010

The following table sets forth a summary, for the periods indicated, of our consolidated results of operations. Our historical results presented below are not necessarily indicative of the results that may be expected for any future period. All amounts, except number of shares and per share data, are presented in thousands of US dollars.

	Year ended December 31,	
	2011	2010
	US$	US$
Sales	$ 28,105	$ 40,423
From unrelated parties	626	1,164
From related parties	28,731	41,587
Cost of sales	12,027	18,970
Gross margin	16,704	22,617
Operating expenses		
Selling expenses	3,506	3,403
General and administrative expenses	7,904	3,460
Research and development expenses	2,132	907
	13,542	7,770
Income from operations	3,162	14,847
Other income (expenses)		
Changes in fair value of warrants	-	1,861
Changes in fair value of contingent consideration receivables	(70)	-
Interest income	13	13
Gain on deconsolidation of subsidiaries	925	-
Other income	5	6
	873	1,880
Income before income tax expense, equity method investments and noncontrolling interests	4,035	16,727
Income tax expense	1,035	352
Income before equity method investments and noncontrolling interests	3,000	16,375
Share of losses in equity investment affiliates	(219)	-
Net income	2,781	16,375
Net loss attributable to noncontrolling interests	214	214
Net income attributable to ChinaNet Online Holdings, Inc.	2,995	16,589
Dividend of Series A convertible preferred stock	(407)	(794)
Net income attributable to common stockholders of ChinaNet Online Holdings, Inc.	$2,588	$15,795
Earnings per share		
Earnings per common share		
Basic	$0.14	$0.94
Diluted	$0.14	$0.79

Weighted average number of common shares outstanding:		
Basic	18,545,609	16,778,176
Diluted	18,759,240	20,896,061

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NON-GAAP MEASURES

To supplement the audited consolidated statement of income and comprehensive income presented in accordance with GAAP, we are also providing non-GAAP measures of income from operations, income before income tax expenses, net income, net income attributable to us, net income attributable to our common stockholders and basic and diluted earnings per share for the year ended December 31, 2011 and 2010, which are adjusted from results based on GAAP to exclude the non-cash gain and expenses recorded, which related to the gain on deconsolidation of subsidiaries, the related deferred income tax expenses, changes in fair value of contingent consideration receivables related to the “make-good” provisions upon acquisition of VIEs, and non-cash share-based compensation expenses recognized for the restricted stock and common stock purchase options issued to our management, directors and employees on November 30, 2011 for the year ended December 31, 2011, and the non-cash gain recorded for the fair value changes of the warrants we issued in our August 2009 financing for the year ended December 31, 2010. The non-GAAP financial measures are provided to enhance the investors' overall understanding of our current performance in on-going core operations as well as prospects for the future. These measures should be considered in addition to results prepared and presented in accordance with GAAP, but should not be considered a substitute for or superior to GAAP results. We use both GAAP and non-GAAP information in evaluating our operating business results internally and therefore deemed it important to provide all of this information to investors.

The following table presents reconciliations of our non-GAAP financial measures to the audited consolidated statements of income and comprehensive income for the years ended December 31, 2011 and 2010 (all amounts, except number of shares and per share data, are presented in thousands of US dollars):

	Year Ended December 31,			
	2011		2010	
	GAAP US$	NON GAAP US$	GAAP US$	NONGAAP US$
Gross Profit	$16,704	$ 16,704	$22,617	$ 22,617
Operating expenses				
Selling expenses	3,506	2,827	3,403	3,403
General and administrative expenses	7,904	6,647	3,460	3,460
Research and development expenses	2,132	1,461	907	907
	13,542		7,770	7,770
		10,935		
Income from operations	$3,162		$14,847	14,847
Adjusted income from operations		$ 5,769		
Other income (expenses):				
Changes in fair value of warrants	-	-	1,861	-
Changes in fair value of contingent consideration receivables	(70)	-	-	-
Interest income	13	13	13	13
Gain on deconsolidation of subsidiaries	925	-	-	-
Other income	5	5	6	6
	873		1,880	
		18		19
Income before income tax expense, equity method investments and noncontrolling interests	4,035		16,727	

Adjusted income before income tax expense, equity method investments and noncontrolling interests		5,787		14,866
Income tax expense	1,035	827	352	352

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Income before equity method investments and noncontrolling interests	3,000		16,375	
Adjusted income before equity method investments and noncontrolling interests		4,960		14,514
Share of losses in equity investment affiliates	(219)	(219)	-	-
Net income	2,781		16,375	
Adjusted net income		4,741		14,514
Net loss attributable to noncontrolling interest	214	214	214	214
Net income attributable to ChinaNet Online Holdings, Inc.	2,995		16,589	
Adjusted net income attributable to ChinaNet Online Holdings, Inc.		4,955		14,728
Dividend for series A convertible preferred stock	(407)	(407)	(794)	(794)
Net income attributable to common shareholders of ChinaNet Online	$2,588		$15,795	
Adjusted net income attributable to common shareholders of ChinaNet Online		$4,548		$13,934
Earnings per common share-Basic	$0.14		$0.94	
Adjusted earnings per common share-Basic		$0.25		$0.83
	$0.14			
Earnings per common share-Diluted			$0.79	
Adjusted earnings per common share-Diluted		$0.24		$0.70
Weighted average number of common shares outstanding:				
Basic	18,545,609	18,545,609	16,778,176	16,778,176
Diluted	18,759,240(1)	20,384,766(2)	20,896,061	20,896,061

(1) For the year ended December 31, 2011, the effect of the 1,625,526 incremental shares resulted from assumed conversion of the convertible preferred stock was not included, because its effect was anti-dilutive under GAAP measures.

(2) For the year ended December 31, 2011, the effect of the 1,625,526 incremental shares resulted from assumed conversion of the convertible preferred stock was included, because the effect was dilutive for not including the non-cash gain and expenses related to the non-recurring transactions incurred under NON-GAAP measures.

REVENUE

Beginning on January 1, 2011, we combined the Internet Advertisement Resources Reselling segment and the Internet Information Management segment with the Internet Advertisement segment, due to the fact that the relative percentages of these two combined segments' financial performance were immaterial and will continue to be immaterial to our consolidated financial results going forward. Certain prior period amounts have been re-grouped to conform to the current period presentation. As a result of the acquisition of Quanzhou Zhi Yuan, Quanzhou Tianxi Shun He and the launch of Zhao Shang Ke Hubei, we also now operate in an additional reportable business segment, Brand Management and Sales Channel Building.

The following tables set forth a breakdown of our total revenue, divided into five segments for the periods indicated, with inter-segment transactions eliminated:

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Revenue type	Year ended December 31, 2011 (Amounts expressed in thousands of US dollars, except percentages)			2010		
Internet advertisement	$ 15,359	53.4	%	$ 14,685	35.3	%
Technical services	4,622	16.1	%	13,878	33.4	%
TV advertisement	6,434	22.4	%	12,493	30.0	%
Bank kiosks	487	1.7	%	531	1.3	%
Brand management and sales channel building	1,829	6.4	%	-	-	%
Total	$ 28,731	100	%	$ 41,587	100	%

Revenue type	Year ended December 31, 2011 (Amounts expressed in thousands of US dollars, except percentages)			2010		
Internet advertisement	$ 15,359	100	%	$ 14,685	100	%
—From unrelated parties	14,947	97	%	14,342	98	%
—From related parties	412	3	%	343	2	%
Technical services	4,622	100	%	13,878	100	%
—From unrelated parties	4,451	96	%	13,064	94	%
—From related parties	171	4	%	814	6	%
TV advertisement	6,434	100	%	12,493	100	%
—From unrelated parties	6,434	100	%	12,486	99.9	%
—From related parties	-	-	%	7	0.1	%
Bank kiosks	487	100	%	531	100	%
—From unrelated parties	487	100	%	531	100	%
—From related parties	-	-	%	-	-	%
Brand management and sales channel building	1,829	100	%	-	-	%
—From unrelated parties	1,786	98	%	-	-	%
—From related parties	43	2	%	-	-	%
Total	$ 28,731	100	%	$ 41,587	100	%
—From unrelated parties	28,105	98	%	$ 40,423	97	%
—From related parties	626	2	%	$ 1,164	3	%

Total Revenues: Our total revenues decreased to US$28.7 million for the year ended December 31, 2011 from US$41.6 million for the year ended December 31, 2010, representing a 31% decrease.

We derive the majority of our advertising service revenues from the sale of advertising space on our internet portals and by providing the related technical support and services, internet marketing service and content management services to unrelated third parties and to certain related parties. We also derive revenue from the sale of advertising time purchased from different TV programs. We report our advertising service revenues between related and unrelated parties because historically approximately 3%-5% of our advertising service revenues came from clients related to certain shareholders of our PRC operating entities. Our advertising services to related parties were provided in the ordinary course of business on the same terms as those provided to our unrelated advertising clients. In fiscal year of 2011, we continued to execute our strategy of focusing on internet advertising and marketing business and the related value-added technical services, which constituted approximately 70% of our total net revenue and achieved gross margins of 69% for the year ended December 31, 2011, as compared to 69% of the total net revenue and 76% of the gross margin achieved for the same period of last year.

Our advertising service revenues are recorded net of any sales discounts. Sales discounts include volume discounts and other customary incentives offered to our small and medium-sized franchise and merchant clients, including providing them with additional advertising time for their advertisements if we have unused space available on our websites and represent the difference between our official list price and the amount we actually charge our clients. We typically sign service contracts with our small and medium-sized franchisor and other clients that require us to place the advertisements on our portal websites in specified locations on the sites and for agreed periods; and/or

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place the advertisements onto our purchased advertisement time during specific TV programs for agreed periods. We recognize revenues as the advertisement airs over the contractual term based on the schedule agreed upon with our clients.

As a result of the research and development activities conducted and managed by Rise King WFOE, beginning in December 2009, our WFOE began providing a number of value added technical services and management systems to our internet advertisement customers, which services enhance the quality and performance of the internet advertising services provided by Business Opportunity Online. These value added technical services are primarily online technical management systems and platforms. Customers use these technical services to analyze, monitor and manage their advertisements on our key advertising portal, 28.com, their other traffic generating activities and their online marketing campaign activities. Revenues generated by Rise King WFOE are from the provision of technical and management systems including tools, databases and services developed and managed by Rise King WFOE to analyze, monitor and manage a customer’s advertisements on our key advertising portal, 28.com, their traffic generating activities, and their online marketing campaign activities. Most of these services are based on fixed price terms; revenues are then generated and recognized from the use of the online management system and tools on a periodic basis, together with the satisfaction of other applicable performance thresholds, if specified. Rise King WFOE’s customers are similar to our internet advertising customers, with over 70% of the WFOE’s customers also being customers of our internet advertisement services. The other 30% of Rise King WFOE’s customers do not directly advertise on our web portal but use Rise King WFOE’s management systems and the internet information collected from our key advertising web portal to monitor and manage their traffic generating activities and online marketing campaign activities. These value added technical services, operated and managed by Rise King WFOE, are primarily developed and offered as additions to the internet advertisement services provided by Business Opportunity Online. The revenue generating activities conducted by Rise King WFOE are not prohibited under the known and existing PRC laws and regulations, as our WFOE is providing value-added technical services to our clients, and is not engaged in the internet advertising business or any other business that is subject to obtaining an Internet Content Provider License. For the internet advertisement services conducted by our VIE, Business Opportunity Online, customers use our internet advertising portal, www. 28.com, to place internet advertisements in different formats, such as: banners, links, logos, buttons, as well as mini-sites. Customers get internet visits and messages from their advertisements placed on our portal. For the value added technical services provided by our WFOE, customers primarily use the technical and management systems offered by it to analyze, monitor and manage their advertisements and traffic generating activities on our advertising portal. For example, Rise King WFOE’s customers can use our management tools to obtain analysis of messages and sales leads received from their internet adverting.

The tables below summarize the revenues, cost of sales, gross margin and net income generated from each of our VIEs and subsidiaries for the year ended December 31, 2011 and 2010, respectively.

For the year ended December 31, 2011:

Name of subsidiary or VIE	Revenue from unrelated parties $('000)	Revenue from related parties $('000)	Revenue from inter-company $ ('000)	Total $('000)
Rise King WFOE	4,451	171	-	4,622
Business Opportunity Online and subsidiaries	20,191	455	-	20,646
Beijing CNET Online and subsidiaries	3,460	-	14	3,474
Shanghai Jing Yang	3	-	-	3
Inter-co., elimination	-		(14)	(14)
Total revenue	28,105	626	-	28,731

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For the year ended December 31, 2011:

Name of subsidiary or VIE	Cost of Sales $ ('000)	Gross Margin $ ('000)
Rise King WFOE	254	4,368
Business Opportunity Online and subsidiaries	9,980	10,666
Beijing CNET Online and subsidiaries	1,807	1,667
Shanghai Jing Yang	-	3
Inter-co., elimination	(14)	-
Total	12,027	16,704

For the year ended December 31, 2011:

Name of subsidiary or VIE	Net Income $ ('000)
Rise King WFOE	594
Business Opportunity Online and subsidiaries	5,935
Beijing CNET Online and subsidiaries	(113)
Shanghai Jing Yang	27
ChinaNet Online Holdings, Inc.	(3,662)
Total net income before allocation to the noncontrolling interest	2,781

For the year ended December 31, 2010:

Name of subsidiary or VIE	Revenue from unrelated parties $ ('000)	Revenue from related parties $ ('000)	Revenue from inter-company $ ('000)	Total $ ('000)
Rise King WFOE	13,064	814	596	14,474
Business Opportunity Online	16,931	343	-	17,274
Beijing CNET Online	10,428	7	-	10,435
Inter-co., elimination	-	-	(596)	(596)
Total revenue	40,423	1,164	-	41,587

For the year ended December 31, 2010:

Name of subsidiary or VIE	Cost of Sales $ ('000)	Gross Margin $ ('000)
Rise King WFOE	681	13,793
Business Opportunity Online	8,395	8,879
Beijing CNET Online	9,890	545
Inter-co., elimination	-	(596)
Shenzhen Mingshan	4	(4)
Total	18,970	22,617

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For the year ended December 31, 2010

Name of subsidiary or VIE	Net Income $ ('000)
Rise King WFOE	12,149
Business Opportunity Online	3,923
Beijing CNET Online	24
Shenzhen Mingshan	(436)
ChinaNet Online Holdings, Inc.	(1,146)
Changes in fair value of warrant	1,861
Total net income before allocation to the noncontrolling interest	16,375

Management considers revenues generated from internet advertising and the related technical services as one aggregate business operation and relies upon the consolidated results of all the operations in this business unit, when making decisions about allocating resources and assessing performance.

- Internet advertising revenues for the year ended December 31, 2011 were approximately US$15.4 million as compared to US$14.7 million for the same period in 2010, representing an increase of 5%. The increase in internet advertising revenue was primarily due to a slight increase in the overall average spending of our internet advertising customers in 2011 as compared to 2010. Although our clients reduced their total advertising spending, most of them retained their basic advertising service and reduced their subscription on value-added technical services in response to the economic downturn in the PRC that began in the second half of 2011. In the meantime, we gradually gained some new clients as a result of the efforts we made in some new cities through our newly formed operating entities. However, their contribution to our revenue was limited in 2011. We also have gradually gained new clients on liansuo.com and presently there are approximately 4,000 clients listed on the site on a free trial period. While clients were using liansuo.com for free, it further expanded our exposure to larger clients, providing a new array of income source.

- Revenues generated from technical services offered by Rise King WFOE were US$4.6 million for the year ended December 31, 2011, as compared to US$13.9 million for the same period in 2010. Due to the Chinese government's monetary policy of increasing interest rates and tightening the money supply, and other economic difficulties that unexpectedly began in the second quarter of 2011, many of our clients, including our branded clients, who are mostly SMEs, reduced their advertising spending significantly in response to the overall economic situation in China. The decrease in our internet advertising related technical services revenue for the year ended December 31, 2011 as compared with the same period in 2010 was primarily due to a decrease in the average revenue per client by approximately 50%. In addition, some of our clients terminated the subscription of these services in the second half of 2011.

- We had a 49% decrease in TV advertising revenue to US$6.4 million for the year ended December 31, 2011 from US$12.5 million for the same period in 2010. We generated this US$6.4 million of TV advertising revenue by selling approximately 6,040 minutes of advertising time that we purchased from different provincial TV stations as compared with approximately 14,420 minutes of advertising time that we sold in the same period of 2010. The decrease in revenue we generated from the TV advertisement segment for the year ended December 31, 2011 as compared to the same period in 2010 were a direct result of the decrease of approximately 8,380 total minutes of TV advertising time sold in the year of 2011 as compared to 14,420 minutes sold in 2010. Increases in demand for TV advertising were relatively limited due to much higher cost as compared to other advertising channels, such as Internet advertising and print advertising, which resulted in lower demand from our customers for this service. Beginning in the middle of the fiscal year 2010, due to the increase in the cost per minute charged by the TV stations, which cost was passed on to our end customers, our clients' demand for the TV advertising service decreased significantly. We had to decrease our selling price in order to sell all of the TV minutes purchased from the TV stations, which led to a low gross profit margin of approximately 4% for this segment for the year ended December 31, 2010. In response to this decreased demand, for the year ended December 31, 2011, we reduced the business scope of the TV division, which was integrated into our overall advertising and marketing platform and provided to the existing Internet client base as one of the additional communication channels. We only kept a limited quantity of TV time slots with a relatively lower cost per minute, which led to more affordable prices for our customers and to a better match for our customers' needs and cost budgets. Accordingly, along with the gradual increase in our selling price during 2011 as compared to 2010, the gross profit margin of this segment improved significantly for the year ended December 31, 2011 to approximately 19% as compared with 4% for the prior year. We will continue to monitor the demand from our customers for this segment, and purchase additional TV advertisement time, if necessary.

- For the year ended December 31, 2011, we earned approximately US$0.49 million of revenue from the bank kiosk business segment as compared to approximately US$0.53 million for the same period in 2010. The bank kiosk advertising business is still in the very early stages of development and many details still need to be further analyzed and finalized before we allocate more capital to this business unit. It was not a significant contributor to revenue for either the year ended December 31, 2011 or 2010. Management currently believes that this business is unlikely to expand and some of the technology used in this business unit will be fully integrated into the overall advertising and marketing platform.

- As a result of the acquisition of Quanzhou Zhi Yuan, Quanzhou Tian Xi Shun He and the launch of Zhao Shang Ke Hubei, we operated our business in one more reportable business segment, Brand management and sales channel building segment. For the year ended December 31, 2011, we provided this service to approximately 60 customers and achieved approximately US$1.8 million of revenue from this segment. Upon deconsolidation of Zhao Shang Ke Hubei in December 2011, only Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He's revenue will be included in this segment in the future periods.

Cost of revenues

Beginning on January 1, 2011, we combined the Internet Advertisement Resources Reselling segment and the Internet Information Management segment with the Internet Advertisement segment, due to the fact that the relative percentage of these two combined segments' financial performances were immaterial and will continue to be immaterial to our consolidated financial results going forward. Certain prior period amounts have been re-grouped to conform to the current period presentation. As a result of the acquisition of Quanzhou Zhi Yuan, Quanzhou Tianxi Shun He and the launch of Zhao Shang Ke Hubei, we operate in an additional reportable business segment, Brand Management and Sales Channel Building.

Our cost of revenue consisted of costs directly related to the offering of our advertising services, technical services, marketing services and brand management and sales channel building services. The following table sets forth our cost of revenues, divided into five segments, by amount and gross profit ratio for the periods indicated, with inter-segment transactions eliminated:

	Year ended December 31,					
	2011			2010		
	(Amounts expressed in thousands of US dollars, except percentages)					
	Revenue	Cost	GP ratio	Revenue	Cost	GP ratio
Internet advertisement	$15,359	6,033	61 %	$14,685	$6,266	57 %
Technical service	4,622	254	95 %	13,878	613	95 %
TV advertisement	6,434	5,233	19 %	12,493	11,974	4 %
Bank kiosk	487	42	91 %	531	45	92 %
Brand management and sales channel building	1,829	465	75 %	-	-	- %
Others	-	-	-	-	72	N/A
Total	$28,731	$12,027	58 %	$41,587	$18,970	54 %

Cost of revenues: Our total cost of revenues decreased to US$12.0 million for the year ended December 31, 2011 from US$19.0 million for the same period in 2010. This was mainly due to the decrease in costs associated with our TV advertisement business segment, which was in line with the decrease in our TV advertisement revenue. Our cost of revenues related to the offering of our advertising and marketing services primarily consists of internet resources purchased from other portal websites and technical services providers related to lead generation, sponsored search, TV advertisement time costs purchased from TV stations, direct labor cost associated with providing services and business taxes and surcharges.

- Cost associated with obtaining internet resources was the largest component of our cost of revenue for internet advertisement, accounting for approximately 80% of our total internet advertisement cost of sales. We purchased these internet resources from other well-known portal websites in China, such as: Baidu, Google and Tecent (QQ). Our purchasing of these internet resources in large volumes for ultimate use by our customers allowed us to negotiate discounts with our suppliers. The majority of the resources purchased were used by the internet advertising unit to attract more internet traffic to our advertising portals, assist our internet advertisement clients to obtain more diversified exposure and to generate more visits to their advertisements and mini-sites placed on our portal websites. For the years ended 2011 and 2010, our total cost of sales for internet advertising was US$6.0 million and US$6.3 million, respectively. The decrease in our cost of sales for internet advertising revenue was mainly due to a decreased volume of internet resources that we purchased to match the decreasing demands, and such decreases were partially offset by the increase in the purchase price of such resources as compared in 2010.

- Beginning in December 2009, our WFOE began providing a number of value added technical services to our internet advertisement customers. The direct cost of sales for the WFOE's technical services revenue recognized by our WFOE was primarily the PRC business tax expenses, which was approximately 5% of the total technical service revenue recognized by Rise King WFOE. The decrease in the business tax expenses incurred by our WFOE in 2011 was in line with the decrease in the technical services revenue earned by our WFOE in 2011 as compared to that in 2010.

- TV advertisement time cost is the largest component of cost of revenue for TV advertisement revenue. We purchase TV advertisement time from different provincial TV stations and resell it to our TV advertisement clients. Our TV advertisement time cost was approximately US$5.2 million and US$12.0 million for the years ended December 31, 2011 and 2010, respectively. The significant decrease in our total TV advertisement time cost in year 2011 was mainly due to the decrease of the approximately 8,380 total minutes we purchased and resold in year 2011 as compared to year 2010. However, our gross profit margin for this segment increased to 19% for the year ended December 31, 2011 as compared to 4% for the same period of 2010. This improvement was primarily due to the efficiency of purchasing TV time on a more cost effective basis while simultaneously matching our customers' needs. In addition, we only kept the TV advertising time from the stations that can be purchased on a more affordable cost basis as compared with the selling price that our customers can afford.

- Cost recognized for Brand management and sales channel building business segment mainly consisted of director labor cost for providing these services to our customers and the related business tax and surcharges.

Gross Profit

As a result of the foregoing, our gross profit was US$16.7 million for the year ended December 31, 2011 as compared to US$22.6 million for the same period in 2010. Along with the improvement of the gross profit margin of our TV advertisement segment and the gross profit generated from our newly established business segment, Brand management and sales channel building, our overall gross margin increased to 58% for the year ended December 31, 2011 as compared with 54% for the same period in 2010.

Operating Expenses and Net Income

Our operating expenses consist of selling expenses, general and administrative expenses and research and development expenses. The following tables set forth our operating expenses, divided into their major categories by amount and as a percentage of our total revenues for the periods indicated.

	Years ended December 31, 2011			Years ended December 31, 2010		
	(Amounts expressed in thousands of US dollars, except percentages)					
	Amount	% of total revenue		Amount	% of total revenue	
Total Revenue	$ 28,731	100	%	$ 41,587	100	%
Gross Profit	16,704	58	%	22,617	54	%
Selling expenses	3,506	12	%	3,403	8	%
General and administrative expenses	7,904	28	%	3,460	8	%
Research and development expenses	2,132	7	%	907	2	%
Total operating expenses	13,542	47	%	$ 7,770	19	%

Operating Expenses: Our operating expenses increased to US$13.5 million for the year ended December 31, 2011 from US$7.8 million for the same period of 2010.

- Selling expenses: Selling expenses increased to US$3.5 million for the year ended December 31, 2011 from US$3.4 million for the same period of 2010. Our selling expenses primarily consist of advertising expenses for brand development that we pay to TV stations and other media outlets for the promotion and marketing of our advertising web portals, other advertising and promotional expenses, website server hosting and broadband leasing expenses, staff salaries, staff benefits, performance bonuses, travelling expenses and communication expenses of our sales department. For the year ended December 31, 2011, the change in our selling expenses was mainly due to the following reasons: (1) the increase in the share-based compensation expenses in relation to the restricted stock and common stock purchase options issued to members of our sales department of approximately US$0.68 million; (2) the increase in staff salary, bonus, benefit expenses and other general selling expenses, such as entertainment expenses, travelling expenses and communication expenses of approximately US$0.08 million, due to expansion of our sales department through newly formed and acquired VIEs in 2011; and (3) our brand development advertising expenses for our advertising web portals decreased by approximately US$0.65 million. We do not believe that brand-building expenses will continue to be a significant portion of our selling expenses on a going-forward basis, because, through the investment we made in brand building over the last three years, we have achieved our expected results. Our key advertising web portal, 28.com has brand recognition as one of the most popular Chinese internet portals providing advertising and marketing services and other value-added services to SMEs, particularly for small and medium-sized franchisors, in the PRC. Beginning in fiscal year 2010, management decided to gradually reduce such costs due to the significant increase in the costs of TV advertising.

- General and administrative expenses: General and administrative expenses increased to US$7.9 million for the year ended December 31, 2011 as compared to US$3.5 million for the same period in 2010. Our general and administrative expenses primarily consist of salaries and benefits for management, accounting and administrative personnel, office rentals, depreciation of office equipment, professional service fees, maintenance, utilities and other office expenses. The change in our general and administrative expenses for the year ended December 31, 2011 was mainly due to the following reasons: (1) the increase in the share-based compensation expenses in relation to the restricted stock and common stock purchase options issued to our management, directors and employees on November 30, 2011, of approximately US$1.26 million; (2) the increase in the bad debts provision of approximately US$2.58 million, which related to the account receivable balances of our internet advertising and the related technical services business segments, which had an aging over 6 to 9 months and the overdue contract execution deposits related to our TV advertising segment; (3) the increase in the amortization expenses related to the intangible assets identified in the acquisitions of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He of approximately US$0.37 million; (4) the decrease of general and administrative expenses of Shenzhen Mingshan, which was deconsolidated from us in early 2011 of approximately US$0.27 million; and (5) the increase in salary expenses and other general administrative expenses of the newly formed and acquired VIEs in 2011 of approximately US$0.44 million.

- Research and development expenses: Research and development expenses increased to US$2.1 million for the year ended December 31, 2011 from US$0.9 million for the same period of 2010. Our research and development expenses primarily consist of salaries and benefits for the research and development staff, equipment depreciation

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expenses, and office utilities and supplies allocated to our research and development department. The increase in our research and development expenses for the year ended December 31, 2011 was mainly due to the following reasons: (1) the increase in the share-based compensation expenses in relation to the restricted stock and common stock purchase options issued to members of our research and development department of approximately US$0.67 million; (2) the increase in the amortization expenses of cloud-computing based software technologies we acquired in 2011 of approximately US$0.07 million; and (3) the increase of salary, staff benefit expenses and other R&D expenses of approximately US$0.46 million due to expansion of our research and development department in 2011. We expect that our research and development expenses will increase in future periods as we continue to expand, optimize and enhance the technology of our portal websites, upgrade our advertising and internet management software and develop our cloud-computing based management tools. In the next three to five years, we expect our research and development expenses to be within the range of four percent to six percent of our total revenues.

Operating Profit: As a result of the foregoing, our operating profit decreased to US$3.2 million for the year ended December 31, 2011 from US$14.8 million for the same period of 2010.

Changes in Fair Value of Warrants: We originally accounted for our warrants issued to investors and placement agent in our August 2009 financing as derivative liabilities under ASC Topic 815 “Derivatives and Hedging”, because it contains a “Down-round” protection that were applicable if we were to issue new shares of common stock or common stock equivalents at a price per share less than the exercise price of the Warrants. The “Down-round protection” provision is not considered to be an input to the fair value of a fixed-for-fixed option on equity shares which lead to the Warrants to fail to be qualified as indexed to the Company’s own stock and then fail to meet the scope exceptions of ASC Topic 815. Therefore, we accounted for the Warrants as derivative liabilities under ASC Topic 815. Pursuant to ASC Topic 815, derivative should be measured at fair value and re-measured at fair value with changes in fair value recorded in earnings at each reporting period. On March 29, 2010, we and the holders of the Warrants entered into agreements to amend certain provisions of the Warrants. The amendment to the investor and placement agent warrants removes the “Down-round protection” rights. In addition, the amendment to the warrants added a provision to grant the holders of a majority of the warrants an approval right until December 31, 2010, over any new issuance of shares of common stock or common stock equivalents at a price per share less than the exercise price of the warrants. As a result of this amendment, the Warrants issued in the August 2009 financing were qualified as indexed to our own stock and then met the scope exceptions of ASC Topic 815, and were eligible to be reclassified as equity. In accordance with ASC Topic 815, the classification of a contract should be reassessed at each balance sheet date. If the classification required under this ASC changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification. If a contract is reclassified from an asset or a liability to equity, gains or losses recorded to account for the contract at fair value during the period that the contract was classified as an asset or a liability should not be reversed. Therefore, we re-measured the fair value of the Warrants as of March 29, 2010, the date of the event that caused the classification, which was approximately US$7.7 million and reclassified the amount to equity as additional paid-in capital. The gain of the changes in fair value during the period that the Warrants were classified as a derivative liability for the year ended December 31, 2010, which was approximately US$1.86 million was recorded in earnings for the year ended December 31, 2010.

Changes in Fair Value of Contingent Consideration Receivables: According to the acquisition agreements we entered into with Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He, if audited pretax profit for 2011 and 2012 increases by less than 30% compared to that of the prior year, the sellers shall compensate us for the difference between the target pretax profit and actual results achieved in cash. Fair value of the contingent consideration receivable as of the respective acquisition date of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He was approximately US$0.05 million and US$0.06 million, respectively. As Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He have both achieved their respective target pre-tax profit for the year ended December 31, 2011, they will not compensate us any cash in accordance with the acquisition agreement. We reassessed the fair value of these contingent consideration receivables as of December 31, 2011 for the respective make good arrangement of these acquirees for the year ended December 31, 2012, based on their respective historical performance and other relevant assumptions. The changes in the fair value of these contingent consideration receivables of approximately US$0.07 million for the year ended December 31, 2011 was included in our consolidated statement of income and comprehensive income.

Gain on deconsolidation of subsidiaries: The deconsolidation of Shenzhen Mingshan and Zhao Shang Ke Hubei that occurred on January 6, 2011 and December 29, 2011, respectively, were accounted for in accordance with ASC Topic 810 “Consolidation”. We recognized a gain of approximately US$0.23 million upon deconsolidation of Shenzhen Mingshan and a gain of approximately US$0.69 million upon deconsolidation of Zhao Shang Ke Hubei in our consolidated statements of income and comprehensive income for the year ended December 31, 2011, with a corresponding increase to the carrying value of the investment in Shenzhen Mingshan and Zhao Shang Ke Hubei, respectively, in our consolidated balance sheet. These deconsolidation gains represented the excess of the fair value of our retained equity interest in Shenzhen Mingshan and Zhao Shang Ke Hubei over its respective carrying value as of the respective date of deconsolidation.

Income before income tax expense, equity method investments and noncontrolling interests: As a result of the foregoing, our income before income tax expenses, equity method investment and noncontrolling interest decreased to US$4.0 million for the year ended December 31, 2011 from US$16.7 million for the same period in 2010.

Income Tax expenses: We recognized an income tax expense of approximately US$1.04 million and US$0.35 million for the year ended December 31, 2011 and 2010, respectively. The increase in income tax expenses was mainly due to the increase in the effective income tax rates of our PRC operating entities, Business Opportunity Online and Rise King WFOE for the year ended December 31, 2011 as compared to those for the same period of 2010, due to expiration of the tax holidays. For fiscal year 2011, the applicable income tax rate for Business Opportunity Online and Rise King WFOE were 15% and 12.5%, respectively. For fiscal year 2010, the applicable income tax rates for these two operating entities were 7.5% and nil%, respectively. For the year ended December 31, 2011, our income tax expenses also included an approximately US$0.21 million deferred income tax expenses in relation to the approximately US$0.93 million gain on deconsolidation of subsidiaries recognized for the year ended December 31, 2011, an approximately US$0.09 million deferred income tax benefit in relation to the approximately US$0.37 million amortization expenses of the intangible assets identified upon acquisition of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He for the year ended December 31, 2011 and an approximately US$0.09 million deferred income tax benefit in relation to the approximately US$0.36 million net operating loss carry forward incurred by our PRC operating VIEs, which we consider likely to be able to be utilized with respect to future earnings of the entities to which the operating losses relate.

Income before equity method investments and noncontrolling interests: As a result of the foregoing, our income before equity method investment and noncontrolling interest decreased to US$3.0 million for the year ended December 31, 2011 from US$16.4 million for the same period of 2010.

Share of earnings (losses) in equity investment affiliates: We acquired a 49% equity interest in Beijing Yang Guang in December 2010. In August 2011, we transferred our 49% equity interest in Beijing Yang Guang to its majority shareholder. Our pro-rata share of earnings recognized in the aggregate for the period when we held the 49% equity interest in Beijing Yang Guang was approximately US$0.03 million, which was received as distribution of earnings from Beijing Yang Guang in early November 2011. Shenzhen Mingshan used to be 51% owned by one of our operating VIEs and was a consolidated entity of our company from its date of incorporation through January 6, 2011. On January 6, 2011, an independent third party investor invested RMB15,000,000 (approximately US$2,356,749) to Shenzhen Mingshan in exchange for a 60% equity interest in Shenzhen Mingshan, and our share of equity interest decreased from 51% to 20.4% accordingly. Shenzhen Mingshan then became an equity investment affiliate of ours. Accordingly, we recognized our pro-rata share of losses in Shenzhen Mingshan immediately after the deconsolidation, which was approximately US$0.25 million for the year ended December 31, 2011 with a corresponding decrease to the carrying value of long term investment in Shenzhen Mingshan. Given the foregoing, net amount recognized as share of losses in equity investment affiliates was approximately US$0.22 million for the year ended December 31, 2011.

Net Income: As a result of the foregoing, our net income decreased to US$2.8 million for the year ended December 31, 2011 from US$16.4 million for the same period of 2010. Excluding the non-cash gain recognized for deconsolidation of subsidiaries of approximately US$0.93 million, the related deferred income tax expenses of approximately US$0.21 million, the non-cash expenses of share-based compensation recognized for the restricted stock and common stock purchase options issued on November 30, 2011 of approximately US$2.6 million and the non-cash charge of the changes in fair value of the contingent consideration receivables of approximately US$0.07

million for the year ended December 31, 2011; and the non-cash gain in relation to the changes in fair value of warrants of US$1.86 million for the year ended December 31, 2010, we achieved adjusted Non-GAAP net income amounting to US$4.7 million and US$14.5 million for the years ended December 31, 2011 and 2010, respectively.

Loss attributable to noncontrolling interest: Shenzhen Mingshan was 51% owned by Business Opportunity Online upon incorporation until it was deconsolidated from us in January 2011. Quanzhou Tian Xi Shun He was 51% owned by Beijing CNET Online upon acquisition before it became a wholly-owned subsidiary of Beijing CNET Online in June 2011. Zhao Shang Ke Hubei was 51% owned by Business Opportunity Online Hubei upon incorporation until it was deconsolidated from us in December 2011. Beijing Chuang Fu Tian Xia and Sheng Tian Hubei were 51% owned by Business Opportunity Online and Business Opportunity Online Hubei, respectively, upon incorporation. Accordingly, net losses incurred by these entities during the period when they were majority-owned subsidiaries of our PRC VIEs were allocated between their respective shareholders based on their respective percentage of the ownership in these entities for the year ended December 31, 2011 and 2010. For the year ended December 31, 2011, the net losses allocated to the noncontrolling interest of Quanzhou Tian Xi Shun He, Zhao Shang Ke Hubei, Beijing Chuang Fu Tian Xia and Sheng Tian Hubei were approximately US$0.21 million. For the year ended December 31, 2010, net loss allocated to the noncontrolling interest of Shenzhen Mingshan was also approximately US$0.21 million.

Net income attributable to ChinaNet Online Holdings, Inc.: Total net income as adjusted by the net loss attributable to the noncontrolling interest shareholders as discussed above yields the net income attributable to ChinaNet Online Holdings, Inc. Our net income attributable to ChinaNet Online Holdings, Inc. decreased to US$3.0 million for the year ended December 31, 2011 from US$16.6 million for the same period of 2010. Adjusted Non-GAAP net income attributable to ChinaNet Online Holdings, Inc. which excludes the previously discussed non-cash gains or expenses recognized for non-recurring transactions for the year ended December 31, 2011 and 2010, was approximately US$5.0 million and US$14.7 million for the year ended December 31, 2011 and 2010, respectively.

Dividend for Series A convertible preferred stock: Cash dividend to Series A convertible stock holders was calculated at the per annum rate of 10% of the liquidation preference amount of the Series A preferred stock which was US$2.5 per share and the actual number of days each share outstanding within each of the reporting period. The cash dividends we accrued for the Series A convertible preferred stock were approximately US$0.41 million and US$0.79 million for the years ended December 31, 2011 and 2010, respectively.

Net income attributable to ChinaNet's common shareholders: Net income attributable to ChinaNet's common shareholders represents the net income after allocation to noncontrolling interests minus the cash dividend accrued for Series A convertible preferred stock. Our net income attributable to ChinaNet's common shareholders decreased to US$2.6 million for the year ended December 31, 2011 from US$15.8 million for the same period of 2010. Adjusted Non-GAAP net income attributable to ChinaNet's common shareholders, which excludes the previously discussed non-cash gains or expenses recognized for non-recurring transactions, was approximately US$4.5 million and US$13.9 million for the years ended December 31, 2011 and 2010, respectively.

B. LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents represent cash on hand and deposits held at call with banks. We consider all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents. As of December 31, 2011, we had cash and cash equivalents of approximately US$10.7 million.

Our liquidity needs include (i) net cash used in operating activities that consists of (a) cash required to fund the initial build-out and continued expansion of our network and (b) our working capital needs, which include deposits and advance payment to TV advertising slots and internet resource providers, payment of our operating expenses and financing of our accounts receivable; and (ii) net cash used in investing activities that consist of the payment for acquisitions to further expand our business and client base, investment in software technologies to enhance the functionality of the management tools provided by our advertising portals and investment in other general office equipment. To date, we have financed our liquidity need primarily through proceeds from our operating activities generated in prior years.

The following table provides detailed information about our net cash flow for the periods indicated:

	Year ended December 31, 2011	2010
	Amounts in thousands of US dollars	
Net cash (used in)/provided by operating activities	$ (603)	$ 11,582
Net cash used in investing activities	(6,084)	(9,373)
Net cash provided by/(used in) financing activities	1,482	(767)
Effect of foreign currency exchange rate changes on cash	310	231
Net (decrease)/increase in cash and cash equivalents	$ (4,895)	$ 1,673

Net cash (used in)/provided by operating activities:

For the year ended December 31, 2011, our net cash used in operating activities of approximate US$0.6 million were primarily attributable to:

(1) net income excluding approximately US$0.9 million non-cash gain recognized upon deconsolidation of subsidiaries, US$2.58 million of non-cash charge of bad debts provisions, US$2.9 million of non-cash share-based compensation expenses, which primarily resulted from the 2,000,000 shares of restricted stock and 885,440 shares of common stock purchase options issued to our management and employees on November 30, 2011 and US$1.3 million of other non-cash expenses of depreciation, amortizations and our share of losses in equity investment affiliates of approximately US$8.7 million;

(2) the receipt of cash from operations from changes in operating assets and liabilities such as:

- Other receivables decreased by approximately US$5.3 million, which was mainly due to the collection of the third party loans and the partial collection of the loan made for the production of the TV series “Xiao Zhan Feng Yun”;

- accounts payable, other payables and accrued payroll and other accruals increased by approximately U$S0.7 million; and

- taxes payable increased by approximately US$0.8 million.

(3) offset by the use from operations from changes in operating assets and liabilities such as:

- accounts receivable and due from related parties for the advertising services provided increased by approximately US$2.2 million;

- prepayments and deposits to suppliers increased by approximately US$11.2 million, mainly due to the prepayments and deposits paid for the TV advertisement time purchase agreements signed for year 2012;

- advance from customers and due to related parties for advertising services to be provided decreased by approximately US$1.7 million;

- due to director and due to Control Group decreased by approximately US$0.7 million, as in year 2011, we settled the balances due to them for the cost and operating expenses paid by them on behalf of the company in previous years; and

- we also paid approximately US$0.2 million for other current assets.

For the year ended December 31, 2010, our net cash provided by operating activities of approximate US$11.6 million were primarily attributable to:

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(1) net income excluding the US$1.86 million of non-cash gain recorded for the changes in fair value of warrants and the US$0.8 million of non-cash expenses of depreciation, amortization and share-based compensation expenses of approximately US$15.3 million;

(2) the receipt of cash from operations from changes in operating assets and liabilities such as:

- advance from customers increased by approximately US$1.1 million;

- due to related parties and due to director increased by approximately US$0.7 million;

- accrued payroll and other accruals increased by approximately US$0.3 million;

- taxes payable increased by approximately US$0.1 million; and

- prepayment to suppliers decreased by approximately US$0.9 million;

(3) offset by the use from operations from changes in operating assets and liabilities such as:

- accounts receivable and due to related parties for the advertising services provided increased by approximately US$0.7 million;

- other receivables increased by approximately US$5.0 million, which mainly due to the increase of the temporary loans lent to third parties and the approximate US$3.8 million loan for marketing campaign activities to the production of a TV series of “Xiao Zhang Feng Yun”. This TV series is produced for the commemoration of “The Republican Revolution of 1911”, we would be shown during the credit at the closing of each episode with our logo presented and also shown as a separate card during the closing before the credit screen; and

- we also settled the amount due to control group for approximately US$1.1 million for the cost and expenses paid by them on behalf of our company in previous years.

Net cash used in investing activities:

For the year ended December 31, 2011, our net cash used in investing activities included the following transactions: (1) we paid approximately US$9.7 million in connection with the acquisitions incurred during the year, including the acquisitions of a 100% equity interest of Quanzhou Zhi Yuan and a 51% equity interest of Quanzhou Tian Xi Shun He in January 2011, the acquisition of the remaining 49% equity interest in Quanzhou Tian Xi Shun He in June 2011 and the acquisition of a 51% equity interest in Sou Yi Lian Mei in December 2011; (2) total cash acquired from the above acquisitions recorded as cash inflow from investing activities during the year was approximately US$0.3 million, (3) we paid approximately US$1.7 million to our equity investment affiliates during the year, including an additional US$1.5 million working capital loan to Beijing Yang Guang in the first quarter of 2011 and an approximately US$0.2 million additional cash investment to ShenZhen Mingshan in the third quarter of 2011; (4) from August to December 2011, after we disposed our investment in Beijing Yang Guang, we collected approximately US$8.9 million in the aggregate for (i) the cash consideration of the disposal of the 49% equity interest in Beijing Yang Guang; (ii) our pro-rata share of earnings generated from Beijing Yang Guang during the period when we held the 49% equity interest in it; and (iii) all of the outstanding working capital loans lent to Beijing Yang Guang in 2010 and 2011; (5) cash effect of deconsolidation of Shenzhen Mingshan and Zhao Shang Ke Hubei recorded as cash outflow from investing activities during the year was approximately US$1.7 million, which represented the cash balance of the deconsolidated subsidiaries as of their respective deconsolidation dates; (6) we also invested approximately US$0.7 million in fixed assets and approximately US$1.4 million in intangible assets, which investments were primarily related to the cloud-computing based software technologies purchased during the year. In the aggregate, these transactions resulted in a net cash outflow from investing activities of approximately US$6.1 million for the year ended December 31, 2011.

For the year ended December 31, 2010, our net cash used in investing activities included the following transactions: (1) we prepaid approximately US$1.5 million as deposit for the acquisition of a 100% equity interest in Quanzhou Zhi Yuan and a 51% equity interest in Quanzhou Tian Xi Shun He. These two acquisitions were

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subsequently consummated in the first quarter of 2011; (2) we paid approximately US$1.1 million and acquired a 49% equity interest in a newly established company, Beijing Yang Guang; (3) after the acquisition of a 49% equity interest in Beijing Yang Guang, we lent Beijing Yang Guang approximately US$5.9 million to provide sustainable level of its working capital for the expansion of TV advertisement business; (4) we also invested approximately US$1.1 million in fixed assets for the year ended December 31, 2010, including approximately US$0.5 million for the purchase of new bank kiosk equipment; and (5) as a result of the acquisition of Shanghai Jing Yang, we consolidated approximately US$0.2 million cash from this VIE, which was recorded as cash inflow from investing activities during the year. In the aggregate, these transactions resulted in a net cash outflow from investing activities of approximately US$9.4 million for the year ended December 31, 2010.

Net cash provided by/ (used in) financing activities:

For the year ended December 31, 2011, our net cash provided by financing activities was approximately US$1.5 million which mainly consisted of the following transactions: (1) cash dividends paid to our preferred stockholders of approximately US$0.7 million; (2) cash contributed by the noncontrolling interest shareholders of our newly formed VIEs of approximately US$0.4 million in connection with the establishment of these VIEs in 2011; (3) we received approximately US$1.5 million from the two new investors of Zhao Shang Ke Hubei in advance before it was deconsolidated from us, which was recorded as cash inflow from financing activities during the year; and (4) we, through one of our VIEs borrowed approximately US$0.2 million working capital loan from Zhao Shang Ke Hubei, which was also recorded as cash inflow from financing activities during the year.

For the year ended December 31, 2010, our net cash used in financing activities was approximately US$0.77 million which mainly consisted of the following transactions: (1) cash dividends paid to our preferred stockholders of approximately US$0.91 million; and (2) cash contributed by the noncontrolling interest shareholders of Shenzhen Mingshan of approximately US$0.15 million in connection with the establishment of the company.

Restricted Net Assets

As most of our operations are conducted through our PRC subsidiary and VIEs, our ability to pay dividends is primarily dependent on receiving distributions of funds from our PRC subsidiary and VIEs. Relevant PRC statutory laws and regulations permit payments of dividends by our PRC subsidiary and VIEs only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations and after it has met the PRC requirements for appropriation to statutory reserves. Paid in capital of the PRC subsidiary and VIEs included in our consolidated net assets are also not distributable for dividend purposes.

In accordance with the PRC regulations on Enterprises with Foreign Investment, a WFOE established in the PRC is required to provide certain statutory reserves, namely general reserve fund, the enterprise expansion fund and staff welfare and bonus fund which are appropriated from net profit as reported in the enterprise’s PRC statutory accounts. A WFOE is required to allocate at least 10% of its annual after-tax profit to the general reserve until such reserve has reached 50% of its registered capital based on the enterprise’s PRC statutory accounts. Appropriations to the enterprise expansion fund and staff welfare and bonus fund are at the discretion of the board of directors. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. Rise King WFOE is subject to the above mandated restrictions on distributable profits. Additionally, in accordance with the Company Law of the PRC, a domestic enterprise is required to provide a statutory common reserve of at least 10% of its annual after-tax profit until such reserve has reached 50% of its registered capital based on the enterprise’s PRC statutory accounts. A domestic enterprise is also required to provide for a discretionary surplus reserve, at the discretion of the board of directors. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. All of the Company’s PRC VIEs are subject to the above mandated restrictions on distributable profits.

As a result of these PRC laws and regulations, our PRC subsidiary and VIEs are restricted in their ability to transfer a portion of their net assets to us. As of December 31, 2011 and 2010, net assets restricted in the aggregate, which includes paid-in capital and statutory reserve funds of our PRC subsidiary and VIEs that are included in our consolidated net assets, was approximately US$4.7 million and US$3.4 million, respectively.

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The New PRC Enterprise Income Tax ("EIT") Law, which was effected on January 1, 2008, also imposed a 10% withholding income tax for dividends distributed by a foreign invested enterprise to its immediate holding company outside China, which were exempted under the previous EIT law. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% rate. Rise King WFOE is invested by its immediate holding company in Hong Kong and will be entitled to the 5% preferential withholding tax rate upon distribution of the dividends to its immediate holding company.

The ability of our PRC subsidiaries to make dividends and other payments to us may also be restricted by changes in applicable foreign exchange and other laws and regulations.

Foreign currency exchange regulation in China is primarily governed by the following rules:

- Foreign Exchange Administration Rules (1996), as amended in August 2008, or the Exchange Rules;

- Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules.

Currently, under the Administration Rules, Renminbi is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the State Administration of Foreign Exchange (the "SAFE") is obtained and prior registration with the SAFE is made. Foreign-invested enterprises like Rise King WFOE that need foreign exchange for the distribution of profits to its shareholders may effect payment from their foreign exchange accounts or purchase and pay foreign exchange rates at the designated foreign exchange banks to their foreign shareholders by producing board resolutions for such profit distribution. Based on their needs, foreign-invested enterprises are permitted to open foreign exchange settlement accounts for current account receipts and payments of foreign exchange along with specialized accounts for capital account receipts and payments of foreign exchange at certain designated foreign exchange banks.

Although the current Exchange Rules allow the convertibility of Chinese Renminbi into foreign currency for current account items, conversion of Chinese Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of SAFE, which is under the authority of the People's Bank of China. These approvals, however, do not guarantee the availability of foreign currency conversion. We cannot be sure that it will be able to obtain all required conversion approvals for our operations or the Chinese regulatory authorities will not impose greater restrictions on the convertibility of Chinese Renminbi in the future. Currently, most of our retained earnings are generated in Renminbi. Any future restrictions on currency exchanges may limit our ability to use retained earnings generated in Renminbi to make dividends or other payments in U.S. dollars or fund possible business activities outside China.

As of December 31, 2011 and 2010, there were approximately US$34.0 million and US$26.8 million retained earnings in the aggregate, respectively, which were generated by our PRC subsidiary and VIEs in Renminbi included in our consolidated net assets, aside from US$2.2 million and US$1.6 million statutory reserve funds as of December 31, 2011 and 2010, respectively, that may be affected by increased restrictions on currency exchanges in the future and accordingly may further limit our PRC subsidiary' or VIEs' ability to make dividends or other payments in U.S. dollars to us, in addition to the approximately US$4.7 million and US$3.4 million restricted net assets as of December 31, 2011 and 2010, respectively, as discussed above.

C. Off-Balance Sheet Arrangements

None.

D. Tabular Disclosure of Contractual Obligations

The following table sets forth our company's contractual obligations as of December 31, 2011:

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	Server hosting and board-band lease US$('000)	Purchase of TV advertisement time US$('000)	Total US$('000)
Year ended December 31,			
-2012	110	32,941	33,051
-Thereafter	-	-	-
Total	110	32,941	33,051

ITEM 7B. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to include disclosure under this Item.

ITEM 8FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Financial Statements

Our consolidated financial statements and the notes thereto begin on page F-1 of this Annual Report.

ITEM 9CHANGES IN AND DISAGREEMENTS WITH ACCOUNTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

The practice of Bernstein & Pinchuk LLP ("B&P"), our company's independent registered public accounting firm, entered into a joint venture agreement with Marcum LLP and formed Marcum Bernstein & Pinchuk LLP ("MarcumBP") in a transaction pursuant to which B&P merged its China operations into MarcumBP and certain of the professional staff of B&P joined MarcumBP as employees of MarcumBP ("the "Merger"). Accordingly, and solely as a result of the Merger, effective April 14, 2011, B&P effectively resigned as our company's independent registered public accounting firm and MarcumBP became our company's independent registered public accounting firm. This change in our company's independent registered public accounting firm was approved by the Audit Committee of our company's Board of Directors.

There were no disagreements with Marcum BP and BP on accounting and financial disclosures during the period that they serviced as our company's independent registered public accounting firm, respectively.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of management, including our chief executive officer and the chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of December 31, 2011. Based on this evaluation, our chief executive officer and chief financial officer concluded as of December 31, 2011 that our disclosure controls and procedures were effective such that the material information required to be included in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to our company, including our consolidating subsidiaries and VIEs, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

Management's Report on Internal Control over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, management conducted an evaluation of the effectiveness of its internal control over financial reporting as of December 31, 2011. The framework on which such evaluation was based is contained in the report entitled "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Report"). Based on that evaluation and the criteria set forth in the COSO Report, management concluded that its internal control over financial reporting was effective as of December 31, 2011.

Changes in Internal Controls over Financial Reporting

There were no significant changes in our internal controls over financial reporting identified in connection with this evaluation that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Management Process to Assess the Effectiveness of Internal Control over Financial Reporting

To comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, the Company followed a comprehensive compliance process across our major operations to evaluate our internal control over financial reporting, engaging employees at all levels of the organization. Our internal control environment includes a corporate-wide attitude of integrity and control consciousness. This is exemplified by our ethics education program that includes long-standing principles and policies on ethical business conduct that require employees to maintain the highest ethical and legal standards in the conduct of our business. We have distributed the Board of Directors approved policy on ethics and code of business conduct to all employees and required them to study and abide by the policy. We encourage any employee may report suspected violations of law or our policy. The internal control system further includes careful selection and training of supervisory and management personnel, appropriate delegation of authority and division of responsibility, dissemination of accounting and business policies throughout the Company, and an extensive program of internal audits with management follow-up. Our Board of Directors, assisted by the Audit Committee, monitors the integrity of our financial statements and financial reporting procedures, the performance of our internal audit function and independent auditors, and other matters set forth in its charter. The Committee, which currently consists of three independent directors, meets regularly with representatives of management, and with the independent auditors and the Internal Auditor, with and without management representatives in attendance, to review their activities.

Attestation Report of the Registered Public Accounting Firm

This Annual Report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. As a smaller reporting company, management's report is not subject to attestation by our registered public accounting firm.

ITEM 9B. OTHER INFORMATION

There is no information required to be disclosed in a report on Form 8-K during the fourth quarter of the year covered by this Form 10-K but not reported.

PART III.

Certain information required by Part III is omitted from this Annual Report on Form 10-K since we intend to file our definitive Proxy Statement for our next Annual Meeting of Stockholders, pursuant to Regulation 14A of the

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Securities Exchange Act of 1934, as amended (the "Proxy Statement"), within 120 days of the end of the fiscal year covered by this report, and certain information to be included in the Proxy Statement is incorporated herein by reference.

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information set forth in the Proxy Statement under the captions Election of Directors—Nominees of the Board of Directors; Election of Directors—Section 16(a) Beneficial Ownership Compliance; Election of Directors—Board Operations, last paragraph; and Election of Directors—Board Committees—Audit Committee—first sentence of first paragraph and second sentence of second paragraph and Election of Directors—Board Committees—Nominating and Corporate Governance Committee—last paragraph is incorporated herein by reference.

ITEM 11 EXECUTIVE COMPENSATION

The information set forth in the Proxy Statement under the captions Election of Directors—Executive Compensation is incorporated herein by reference.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information set forth in the Proxy Statement under the caption Security Ownership of Certain Beneficial Owners and Management is incorporated herein by reference.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the caption Election of Directors—Nominees of the Board of Directors identifying the directors and in the last paragraph under that caption, and the information under the caption Election of Directors—Certain Relationships and Related Transactions is incorporated herein by reference.

ITEM 14 PRINCIPAL ACCOUNTANT FEE AND SERVICES

The information set forth in the Proxy Statement under the captions Ratification of the Appointment of Independent Accountants—Services and Fees of Independent Accountants and Ratification of the Appointment of Independent Accountants—Pre-Approval of Services is incorporated herein by reference.

PART IV.

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

a) The following are filed with this report:

(1) The financial statements listed on the Financial Statement's Table of Contents

(2) Not applicable

(3) The exhibits referred to below, which include the following managerial contracts or compensatory plans or arrangements:

2.1 Share Exchange Agreement, dated as of June 26, 2009, by and among Emazing Interactive, Inc., G. Edward Hancock, China Net Online Media Group Limited, and the shareholders of China Net Online Media Group Limited.(1)

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2.2 Escrow Agreement, dated as of June 8, 2009, by and between Emazing Interactive, Inc., China Net Online Media Group Limited, Edward Hancock and Leser, Hunter, Taubman & Taubman. (1)

2.3 Agreement and Plan of Merger (2)

3.1 Articles of Incorporation of Emazing Interactive, Inc., as amended (1)

3.2 Articles of Merger. (2)

3.3 By-laws. (4)

4.1 Registration Rights Agreement, dated as of June 26, 2009, by and among Emazing Interactive, Inc. and certain stockholders listed therein. (1)

4.2 Form of Series A-1 Warrant. (3)

4.3 Form of Series A-2 Warrant. (3)

4.4 Registration Rights Agreement, dated as of August 21, 2009. (3)

4.5* 2011 Omnibus Securities and Incentive Plan (9)

10.1 Exclusive Business Cooperation Agreement, dated October 8, 2008, by and between Rise King Century Technology Development (Beijing) Co., Ltd. and Beijing CNET Online Advertising Co., Ltd. (1)

10.2 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Handong Cheng with respect to Mr. Cheng’s equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.3 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Xuanfu Liu with respect to Mr. Liu’s equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.4 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Li Sun with respect to Ms. Sun’s equity interest in Beijing CNET Online Advertising Co., Ltd.(1)

10.5 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Handong Cheng with respect to Mr. Cheng’s equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.6 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Xuanfu Liu with respect to Mr. Liu’s equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.7 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Beijing CNET Online Advertising Co., Ltd. and Li Sun with respect to Ms. Sun’s equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

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10.8 Power of Attorney of Handong Cheng, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his agent and attorney in connection with his equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.9 Power of Attorney of Xuanfu Liu, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his agent and attorney in connection with his equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.10 Power of Attorney of Li Sun, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as her agent and attorney in connection with her equity interest in Beijing CNET Online Advertising Co., Ltd. (1)

10.11 Exclusive Business Cooperation Agreement, dated October 8, 2008, by and between Rise King Century Technology Development (Beijing) Co., Ltd. and Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.12 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Handong Cheng with respect to Mr. Cheng's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.13 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Xuanfu Liu with respect to Mr. Liu's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.14 Exclusive Option Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Li Sun with respect to Ms. Sun's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.15 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Handong Cheng with respect to Mr. Cheng's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.16 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Xuanfu Liu with respect to Mr. Liu's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.17 Equity Interest Pledge Agreement, dated as of October 8, 2008, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Business Opportunity Online (Beijing) Network Technology Co., Ltd. and Li Sun with respect to Ms. Sun's equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.18 Power of Attorney of Handong Cheng, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his agent and attorney in connection with his equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.19 Power of Attorney of Xuanfu Liu, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his agent and attorney in connection with his equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.20 Power of Attorney of Li Sun, dated as of October 8, 2008, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as her agent and attorney in connection with her equity interest in Business Opportunity Online (Beijing) Network Technology Co., Ltd. (1)

10.21 Entrustment Agreement, dated June 5, 2009, by and between Rise King Investments Limited and Handong Cheng, Xuanfu Liu and Li Sun. (1)

10.22 Share Transfer Agreement, dated April 28, 2009, by and between Yang Li and Handong Cheng (1)

10.23 Share Transfer Agreement, dated April 28, 2009, by and between Yang Li and Xuanfu Liu (1)

10.24 Share Transfer Agreement, dated April 28, 2009, by and between Yang Li and Li Sun (1)

10.25 Internet Banking Experiencing All-in-One Engine Strategic Cooperation Agreement, dated August 7, 2008, by and between Henan Branch of China Construction Bank and Shanghai Borongdingsi Computer Technology Co., Ltd. (1)

10.26 Cooperation Agreement, dated July 8, 2008, by and between Beijing CNET Online Advertising Co., Ltd. and Shanghai Borongdingsi Computer Technology Co., Ltd. (1)

10.27 Supplemental Agreement to the Cooperation Agreement, dated December 10, 2008, by and between Beijing CNET Online Advertising Co., Ltd. and Shanghai Borongdingsi Computer Technology Co., Ltd. (1)

10.28 Office Lease Agreement, dated January 1, 2009, by and between Beijing YuQuanHuiGu Realty Management Ltd. Co. and Business Opportunity Online (Beijing) Network Technology Ltd. Co. (1)

10.29 Office Lease Agreement, dated January 1, 2009, by and between Beijing YuQuanHuiGu Realty Management Ltd. Co. and Beijing CNET Online Advertising Co., Ltd. (1)

10.30 Office Lease Agreement, dated January 1, 2009, by and between Beijing YuQuanHuiGu Realty Management Ltd. Co. and Rise King Century Technology Development (Beijing) Co., Ltd. (1)

10.31 Securities Purchase Agreement, dated as of August 21, 2009. (3)

10.32 Securities Escrow Agreement, dated as of August 21, 2009. (3)

10.33* Independent Director Agreement effective as of November 30, 2009 by and between the Company and Douglas MacLellan. (5)

10.34* Independent Director Agreement effective as of November 30, 2009 by and between the Company and Mototaka Watanabe. (5)

10.35* Independent Director Agreement effective as of November 30, 2009 by and between the Company and Zhiqing Chen. (5)

10.36 Warrant Amendment Agreement

10.37 Exclusive Business Cooperation Agreement, dated as of December 6, 2010, by and between Rise King Century Technology Development (Beijing) Co., Ltd. and Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

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10.38 Exclusive Option Agreement, dated as of December 6, 2010, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Wei Yanmin and Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.39 Exclusive Option Agreement, dated as of December 6, 2010, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Wu Huamin and Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.40 Equity Interest Pledge Agreement dated as of December 6, 2010, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Wei Yanmin and Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.41 Equity Interest Pledge Agreement dated as of December 6, 2010, by and among Rise King Century Technology Development (Beijing) Co., Ltd., Wu Huamin and Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.42 Power of Attorney of Wei Yanmin, dated as of December 6, 2010, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his exclusive agent and attorney in connection with his equity interest in Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.43 Power of Attorney of Wu Huamin, dated as of December 6, 2010, appointing Rise King Century Technology Development (Beijing) Co., Ltd. as his exclusive agent and attorney in connection with his equity interest in Rise King (Shanghai) Advertisement & Media Co., Ltd. (8)

10.44 Equity Transfer Agreement, dated as of December 15, 2011, Among Business Opportunity Online (Hubei) Network Technology Co., Ltd., Liu Yihang, Wei Yanmin and Soo Yi Lian Mei Network Technology (Beijing) Co. Ltd. (10)

14 Code of Ethics (6)

21.1 Subsidiaries of the Registrant (7)

23.1 Consent of Marcum Bernstein & Pinchuk LLP

23.2 Consent of Bernstein & Pinchuk LLP

31.1 Certification pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. +

31.2 Certification pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. +

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. +

\+ Filed herewith

* Denotes managerial contracts or compensatory plans or arrangements:

(1) Incorporated by reference herein to the Report on Form 8-K filed on July 2, 2009.

(2) Incorporated by reference herein to the Company’s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 24, 2009.

(3) Incorporated by reference herein to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 27, 2009.

(4) Incorporated by reference herein to the Company's Registration Statement on Form SB-1 filed with the Securities and Exchange Commission on October 20, 2006.

(5) Incorporated by reference herein to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 2, 2009.

(6) Incorporated by reference herein to the Company's Current Report on Form 8-K filed on December 21, 2009

(7) Incorporated by reference herein to the Company's Registration Statement on Form S-1 filed on September 22, 2009.

(8) Incorporated by reference herein to the Company's Annual Report on Form 10-K filed on March 31, 2011.

(9) Incorporated by reference herein to the Company's Registration Statement on Form S-1 filed on May 11, 2011.

(10) Incorporated by reference herein to the Company's Current Report on Form 8-K filed on December 16, 2011.

(b) The exhibits listed on the Exhibit Index are filed as part of this report.

(c) Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

ChinaNet Online Holdings, Inc.

Dated: April 16, 2012	By:	/s/ Handong Cheng
	Name:	Handong Cheng
	Title:	Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: April 16, 2012	By:	/s/ Handong Cheng
	Name:	Handong Cheng
	Title:	Chairman and Chief Executive Officer (Principal Executive Officer)
Dated: April 16, 2012	By:	/s/ Zhige Zhang
	Name:	Zhige Zhang
	Title:	Chief Financial Officer (Principal Financial Officer) and Director
Dated: April 16, 2012	By:	/s/ Zhiqing Chen
	Name:	Zhiqing Chen
	Title:	Director
Dated: April 16, 2012	By:	/s/ Mototaka Watanabe
	Name:	Mototaka Watanabe
	Title:	Director
Dated: April 16, 2012	By:	/s/ Douglas MacLellan
	Name:	Douglas MacLellan
	Title:	Director

CHINANET ONLINE HOLDINGS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Audit Committee of the Board of Directors and Shareholders of
ChinaNet Online Holdings, Inc.

We have audited the accompanying consolidated balance sheet of ChinaNet Online Holdings, Inc. and Subsidiaries (the “Company”) as of December 31, 2011, and the related consolidated statements of income and comprehensive income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company, as of December 31, 2011, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Marcum Bernstein & Pinchuk LLP
New York, New York
April 16, 2012

NEW YORK OFFICE • 7 Penn Plaza • Suite 830 • New York, New York 10001 • Phone 646.442.4845 • Fax 646.349

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
ChinaNet Online Holdings, Inc.

We have audited the accompanying consolidated balance sheets of ChinaNet Online Holdings, Inc. and Subsidiaries ("the Company") as of December 31, 2010, and the related consolidated statements of income and comprehensive income, changes in equity and cash flows for the year ended December 31, 2010. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and the results of its operations and its cash flows for the year ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America.

/s/ Bernstein & Pinchuk LLP
New York, New York
March 31, 2011, except for revised disclosures in Note 1, 2, 22, 27 and 28, which is dated February 29, 2012

CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of December 31, 2011 (US $)	2010 (US $)
Assets		
Current assets:		
Cash and cash equivalents	$10,695	$15,590
Accounts receivable, net	4,444	4,319
Other receivables, net	3,631	7,811
Prepayment and deposit to suppliers	15,360	3,325
Due from related parties	324	185
Deposit for acquisitions	-	1,512
Contingent consideration receivables	159	-
Other current assets	129	31
Total current assets	34,742	32,773
Investment in and advance to equity investment affiliates	1,396	7,162
Property and equipment, net	1,902	2,010
Intangible assets, net	8,151	51
Goodwill	10,999	-
Deferred tax assets-non current	92	-
Total Assets	$57,282	$41,996
Liabilities and Equity		
Current liabilities:		
Accounts payable *	$268	$174
Advances from customers *	724	2,120
Accrued payroll and other accruals *	616	470
Due to equity investment affiliate *	220	-
Due to related parties *	161	291
Due to Control Group *	-	81
Due to director	-	559
Payable for acquisition *	550	-
Taxes payable *	5,040	2,193
Other payables *	114	10
Dividend payable	5	255
Total current liabilities	7,698	6,153

CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED BALANCE SHEETS (CONTINUED)
(In thousands, except for number of shares and per share data)

	As of December 31, 2011 (US $)	2010 (US $)
Long-term liabilities:		
Deferred tax liability-non current *	1,893	-
Long-term borrowing from director	137	132
Total Liabilities	9,728	6,285
Commitments and contingencies		
Equity:		
Series A convertible preferred stock (US$0.001 par value; authorized 8,000,000 shares; issued and outstanding Nil and 2,877,600 shares at December 31, 2011 and 2010, respectively; aggregate liquidation preference amount: $5 and $7,449, including accrued but unpaid dividends of $5 and $255, at December 31, 2011 and 2010, respectively.	-	3
Common stock (US$0.001 par value; authorized 50,000,000 shares; issued and outstanding 22,146,540 shares and 17,102,320 shares at December 31, 2011 and 2010, respectively)	22	17
Additional paid-in capital	20,747	18,614
Statutory reserves	2,117	1,587
Retained earnings	16,688	14,630
Accumulated other comprehensive income	2,132	930
Total ChinaNet Online Holdings, Inc.’s stockholders’ equity	41,706	35,781
Noncontrolling interests	5,848	(70)
Total equity	47,554	35,711
Total Liabilities and Equity	$57,282	$41,996

*All of the VIEs' assets can be used to settle obligations of its primary beneficiary. Liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company’s general assets (Note 2).

See notes to consolidated financial statements

CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands)

	Year ended December 31, 2011 (US $)	2010 (US $)
Sales		
From unrelated parties	$ 28,105	$ 40,423
From related parties	626	1,164
	28,731	41,587
Cost of sales	12,027	18,970
Gross margin	16,704	22,617
Operating expenses		
Selling expenses	3,506	3,403
General and administrative expenses	7,904	3,460
Research and development expenses	2,132	907
	13,542	7,770
Income from operations	3,162	14,847
Other income (expenses)		
Changes in fair value of warrants	-	1,861
Changes in fair value of contingent consideration receivables	(70)	-
Interest income	13	13
Gain on deconsolidation of subsidiaries	925	-
Other income	5	6
	873	1,880
Income before income tax expense, equity method investments and noncontrolling interests	4,035	16,727
Income tax expense	1,035	352
Income before equity method investments and noncontrolling interests	3,000	16,375
Share of losses in equity investment affiliates	(219)	-
Net income	2,781	16,375
Net loss attributable to noncontrolling interests	214	214
Net income attributable to ChinaNet Online Holdings, Inc.	2,995	16,589

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CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME CONTINUED
(In thousands, except for number of shares and per share data)

	Year ended December 31, 2011 (US $)	2010 (US $)
Net income attributable to ChinaNet Online Holdings, Inc.	$2,995	$16,589
Dividend of Series A convertible preferred stock	(407)	(794)
Net income attributable to common stockholders of ChinaNet Online Holdings, Inc.	$2,588	$15,795
Earnings per share		
Earnings per common share		
Basic	$0.14	$0.94
Diluted	$0.14	$0.79
Weighted average number of common shares outstanding:		
Basic	18,545,609	16,778,176
Diluted	18,759,240	20,896,061
Comprehensive Income		
Net income	2,781	16,375
Foreign currency translation gain	1,254	813
	$4,035	$17,188
Comprehensive Income		
Comprehensive loss attributable to noncontrolling interest	(162)	(214)
Comprehensive income attributable to ChinaNet's Online Holdings, Inc.	4,197	17,402
	$4,035	$17,188

See notes to consolidated financial statements

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CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended December 31, 2011 (US $)	2010 (US $)
Cash flows from operating activities		
Net income	$ 2,781	$ 16,375
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,012	465
Share-based compensation expenses	2,900	337
Changes in fair value of warrants	-	(1,861)
Changes in fair value of contingent consideration receivables	70	-
Allowances for doubtful debts	2,583	-
Share of losses in equity investment affiliates	219	-
Gain on deconsolidation of subsidiaries	(925)	-
Gain on disposal of property and equipment	(3)	-
Deferred taxes	27	-
Changes in operating assets and liabilities		
Accounts receivable	(2,100)	(1,013)
Other receivables	5,276	(4,961)
Prepayment and deposit to suppliers	(11,247)	905
Due from related parties	(130)	315
Other current assets	(197)	1
Accounts payable	27	(123)
Advances from customers	(1,575)	1,146
Accrued payroll and other accruals	166	271
Due to Control Group	(82)	(1,073)
Due to director	(559)	559
Due to related parties	(139)	112
Other payables	490	(17)
Taxes payable	803	144
Net cash (used in) provided by operating activities	(603)	11,582
Cash flows from investing activities		
Purchases of vehicles and office equipment	(741)	(1,001)
Purchase of intangible assets	(1,445)	(60)
Cash from acquisition of VIEs	330	148
Cash effect on deconsolidation of VIEs	(1,670)	-
Long-term investment in and advance to equity investment affiliates	(1,712)	(6,985)
Payment for acquisition of VIEs	(9,731)	(1,475)
Disposal of investment in and loan repayment from equity investment affiliate	8,885	-
Net cash used in investing activities	(6,084)	(9,373)

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CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(In thousands)

	Year ended December 31, 2011 (US $)	2010 (US $)
Cash flows from financing activities		
Cash investment contributed by noncontrolling interests	378	145
Dividend paid to convertible preferred stockholders	(657)	(912)
Short-term loan borrowed from equity investment affiliate	216	-
Capital contributions received in advance from new shareholders of Zhao Shang Ke Hubei before deconsolidation	1,545	-
Net cash provided by (used in) financing activities	1,482	(767)
Effect of exchange rate fluctuation on cash and cash equivalents	310	231
Net (decrease) / increase in cash and cash equivalents	(4,895)	1,673
Cash and cash equivalents at beginning of year	15,590	13,917
Cash and cash equivalents at end of year	$ 10,695	$ 15,590
Supplemental disclosure of cash flow information		
Income taxes paid	$ 319	$ 1,434
Income taxes refunded	$ -	$ 928
Non-cash transactions:		
Warrant liability reclassify to additional paid in capital	$ -	$ 7,703
Restricted stock and options granted for future service	$ 6	$ 299

See notes to consolidated financial statements

CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(In thousands, except for number of shares)

	Total stockholders' equity									
	Series A convertible preferred stock		Common Stock		Additional paid-in capital	Statutory reserves	Retained earnings	Accumulated other comprehensive income	Non-Controlling Interests	Total Equity
	Number of shares	Amount	Number of shares	Amount						
		(US $)		(US $)	(US $)	(US $)	(US $)	(US $)	(US $)	(US $)
Balance, January 1, 2010	4,121,600	4	15,828,320	16	10,574	372	50	117	-	11,133
Reclassification of warrant liabilities	-	-	-	-	7,703	-	-	-	-	7,703
Share based compensation related to services	-	-	-	-	156	-	-	-	-	156
Restricted shares issued for services	-	-	30,000	-	111	-	-	-	-	111
Restricted shares granted for services	-	-	-	-	70	-	-	-	-	70
Preferred stock converted into common stock	(1,244,000)	(1)	1,244,000	1	-	-	-	-	-	-
Preferred stock dividend	-	-	-	-	-	-	(794)	-	-	(794)
Noncontrolling equity interests in a newly formed VIE	-	-	-	-	-	-	-	-	144	144
Net income for the year	-	-	-	-	-	-	16,589	-	(214)	16,375
Appropriation of statutory reserves	-	-	-	-	-	1,215	(1,215)	-	-	-
Foreign currency translation adjustment	-	-	-	-	-	-	-	813	-	813
Balance, December 31, 2010	2,877,600	3	17,102,320	17	18,614	1,587	14,630	930	(70)	35,711
	(2,877,600)	(3)	2,877,600	3	-	-	-	-	-	-

Preferred stock converted into common stock										
Share based compensation related to services	-	-	-	-	141	-	-	-	-	141
Restricted shares issued for services	-	-	60,000	-	152	-	-	-	-	152

See notes to consolidated financial statements

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CHINANET ONLINE HOLDINGS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (CONTINUED)
(In thousands, except for number of shares)

	Total stockholders' equity									
	Series A convertible preferred stock		Common Stock		Additional paid-in capital	Statutory reserves	Retained earnings	Accumulated other comprehensive income	Non-Controlling Interests	Total Equity
	Number of shares	Amount (US $)	Number of shares	Amount (US $)	(US $)	(US $)	(US $)	(US $)		(US $)
Restricted stock and options issued to management, employees and directors on November 30, 2011	-	-	2,000,000	2	2,605	-	-	-	-	2,607
Share issued under the Warrant Tender Offer on December 30, 2011	-	-	106,620	-	-	-	-	-	-	-
Noncontrolling equity interests in acquired VIEs	-	-	-	-	-	-	-	-	6,054	6,054
Noncontrolling equity interests in newly formed VIEs	-	-	-	-	(703)	-	-	-	1,079	376
Deconsolidation of VIEs	-	-	-	-	-	-	-	-	(20)	(20)
Purchased of noncontrolling interests in a VIE	-	-	-	-	(62)	-	-	-	(1,033)	(1,095)
Net income for the year	-	-	-	-	-	-	2,995	-	(214)	2,781
Appropriation of statutory reserves	-	-	-	-	-	530	(530)	-	-	-
Preferred stock dividend	-	-	-	-	-	-	(407)	-	-	(407)
Foreign currency translation adjustment	-	-	-	-	-	-	-	1,202	52	1,254
	-	-	22,146,540	22	20,747	2,117	16,688	2,132	5,848	47,554

Balance, December 31, 2011

See notes to consolidated financial statements

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CHINANET ONLINE HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and nature of operations

ChinaNet Online Holdings, Inc. (formerly known as Emazing Interactive, Inc.), (the "Company"), was incorporated in the State of Texas in April 2006 and re-domiciled to become a Nevada corporation in October 2006. From the date of the Company's incorporation until June 26, 2009, when the Company consummated the Share Exchange, the Company's activities were primarily concentrated in web server access and company branding in hosting web based e-games.

On June 26, 2009, the Company entered into a Share Exchange Agreement (the "Exchange Agreement"), with (i) China Net Online Media Group Limited, a company organized under the laws of British Virgin Islands ("China Net BVI"), (ii) China Net BVI's shareholders, Allglad Limited, a British Virgin Islands company ("Allglad"), Growgain Limited, a British Virgin Islands company ("Growgain"), Rise King Investments Limited, a British Virgin Islands company ("Rise King BVI"), Star (China) Holdings Limited, a British Virgin Islands company ("Star"), Surplus Elegant Investment Limited, a British Virgin Islands company ("Surplus"), Clear Jolly Holdings Limited, a British Virgin Islands company ("Clear" and together with Allglad, Growgain, Rise King BVI, Star and Surplus, the "China Net BVI Shareholders"), who together owned shares constituting 100% of the issued and outstanding ordinary shares of China Net BVI (the "China Net BVI Shares") and (iii) G. Edward Hancock, the principal stockholder of the Company at that time. Pursuant to the terms of the Exchange Agreement, the China Net BVI Shareholders transferred to the Company all of the China Net BVI Shares in exchange for the issuance of 13,790,800 shares (the "Exchange Shares") in the aggregate of the Company's common stock (the "Share Exchange"). As a result of the Share Exchange, China Net BVI became a wholly owned subsidiary of the Company and the Company is now a holding company, which, through certain contractual arrangements with operating companies in the People's Republic of China (the "PRC"), is engaged in providing advertising, marketing, communication and brand management and sales channel building services to small and medium companies in China through www.28.com (the portal website of the Company's PRC operating entity), TV media and bank kiosks.

The Company's wholly owned subsidiary, China Net BVI was incorporated in the British Virgin Islands on August 13, 2007. On April 11, 2008, China Net BVI became the parent holding company of a group of companies comprised of CNET Online Technology Limited, a Hong Kong company ("China Net HK"), which established and is the parent company of Rise King Century Technology Development (Beijing) Co., Ltd., a wholly foreign-owned enterprise ("WFOE") established in the PRC ("Rise King WFOE"). The Company refers to the transactions that resulted in China Net BVI becoming an indirect parent company of Rise King WFOE as the "Offshore Restructuring."

PRC regulations prohibit direct foreign ownership of business entities providing internet content, or ICP services in the PRC, and restrict foreign ownership of business entities engaging in advertisement business. In October 2008, a series of contractual arrangements (the "Contractual Agreements" or "VIE Agreements") were entered into among Rise King WFOE and Business Opportunity Online (Beijing) Network Technology Co., Ltd. ("Business Opportunity Online"), Beijing CNET Online Advertising Co., Ltd. ("Beijing CNET Online") (collectively the "PRC Operating Entities") and its common individual owners (the "PRC Shareholders" or the "Control Group"). The Contractual Agreements allowed China Net BVI, through Rise King WFOE, to, among other things, secure significant rights to influence the PRC Operating Entities' business operations, policies and management, approve all matters requiring shareholder approval, and receive 100% of the income earned by the PRC Operating Entities. In return, Rise King WFOE provides consulting services to the PRC Operating Entities. In addition, to ensure that the PRC Operating Entities and the PRC Shareholders perform their obligations under the Contractual Arrangements, the PRC Shareholders have pledged all of their equity interests in the PRC Operating Entities to Rise King WFOE. They also entered into an option agreement with Rise King WFOE which provides that at such time as when the current restrictions under PRC law on foreign ownership of Chinese companies engaging in the Internet content, information services or advertising business in China are lifted, Rise King WFOE may exercise its option to purchase the equity interests in the PRC Operating Entities, directly (See Note 2 for significant terms of these Contractual Arrangements).

At the time the above Contractual Agreements were entered into, the controlling shareholder of China Net BVI was Rise King BVI, who holds 55% of the Company's common stock. The sole registered shareholder of Rise King BVI was Mr. Yang Li, who owned 10,000 shares of common stock of Rise King BVI, which constituted all of the issued and outstanding shares of Rise King BVI. Mr. Yang Li entered into slow-walk agreements with each of the Control Group individuals, pursuant to which, upon the satisfaction of certain conditions, the Control Group individuals had the option to purchase the 10,000 shares of Rise King BVI, (4,600 by Mr. Handong Cheng, 3,600 by Mr. Xuanfu Liu and 1,800 by Ms. Li Sun, acting as nominee for Mr. Zhang Zhige) held by Mr. Yang Li, at a purchase price of US$ 1 per share (the par value of Rise King BVI's common stock). Under the terms of the slow-walk agreement, the Control Group had the right to purchase the shares as follows: (1) one-third of the shares when China Net BVI and its PRC subsidiary and VIEs ("the Group") generates at least RMB 100,000,000 of the gross revenue for twelve months commencing on January 1, 2009 and ending on December 31, 2009 (the "Performance Period I"); (2) one-third of the shares when the Group generates at least RMB 60,000,000 of the gross revenue for six months commencing on January 1, 2010 and ending on June 30, 2010 (the "Performance Period II); (3) one-third of the shares when the Group generates at least RMB 60,000,000 of the gross revenue for six months commencing on July 1, 2010 and ending on December 31, 2010 (the "Performance Period III"). Each Control Group individual had the right to purchase one-third of the total number of shares that he or she was eligible to purchase under the slow-walk agreement upon the satisfaction of each condition described above.

CHINANET ONLINE HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Control Group individuals also entered an Entrustment Agreement with Rise King BVI, pursuant to which, based on the 55% equity interest held in the Group, Rise King BVI entrusted the Control Group to manage the Group companies by irrevocably authorizing the Control Group to act on behalf of Rise King BVI, as the exclusive agents and attorneys with respect to all matters concerning Rise King BVI’s holdings in the Group, during the term of the Entrustment Agreement. The Control Group agreed and confirmed that he or she would act in concert with one another when exercising the rights authorized to them in this Agreement. The Entrustment Period commenced on the execution date of the agreement and was effective for a period of ten years, until its termination, as discussed below.

As described above, each of Mssrs. Handong Cheng, and Xuanfu Liu and Ms. Li Sun entered into Share Transfer Agreements (slow-walk agreement) with Mr. Yang Li, the sole shareholder of Rise King BVI, which beneficially owns an aggregate of 7,434,940 shares of the Company’s Common Stock, (the “Subject Shares”). On March 30, 2011, pursuant to the terms of the Share Transfer Agreement, Ms. Li Sun transferred her right to acquire 18% of the shares of Rise King BVI under the Share Transfer Agreement to Mr. Zhige Zhang, the chief financial officer of the Company. On March 30, 2011, each of Mssrs. Handong Cheng, Xuanfu Liu and Zhige Zhang (the “PRC Persons”) exercised their right to purchase the outstanding stock of Rise King BVI. On the same date, the Entrustment Agreement originally entered into among Rise King BVI and the Control Group was terminated. As a result of these transactions, the ownership of Rise King BVI was transferred from Mr. Yang Li to the PRC Persons. Rise King BVI has sole voting and dispositive power over the Subject Shares. The PRC Persons may be deemed to share voting power over the shares as a result of their collective ownership of all of the outstanding stock of Rise King BVI and are now the controlling shareholders of Rise King BVI.

Pursuant to the above Contractual Agreements, all of the equity owners' rights and obligations of the VIEs were assigned to Rise King WFOE, which resulted in the equity owners lacking the ability to make decisions that have a significant effect on the VIEs, and Rise King WFOE's ability to extract the profits from the operation of the VIEs, and assume the residual benefits of the VIEs. Because Rise King WFOE and its indirect parent are the sole interest holders of the VIEs, the Company included the assets, liabilities, revenues and expenses of the VIEs in its consolidated financial statements, which is consistent with the provisions of FASB Accounting Standards Codification ("ASC") Topic 810 “Consolidation”, subtopic 10.

As a result of the Share Exchange on June 26, 2009, the former China Net BVI shareholders owned a majority of the common stock of the Company. The transaction was regarded as a reverse acquisition whereby China Net BVI was considered to be the accounting acquirer as its shareholders retained control of the Company after the Share Exchange, although the Company is the legal parent company. The share exchange was treated as a recapitalization of the Company. As such, China Net BVI (and its historical financial statements) is the continuing entity for financial reporting purposes. Following the Share Exchange, the company changed its name from Emazing Interactive, Inc. to ChinaNet Online Holdings, Inc. The financial statements have been prepared as if China Net BVI had always been the reporting company and then on the share exchange date, had changed its name and reorganized its capital stock.

As of the date of the Share Exchange, through the above Contractual Agreements, the Company operates its business in China primarily through Business Opportunity Online and Beijing CNET Online. Beijing CNET Online owns 51% of Shanghai Borongdingsi Computer Technology Co., Ltd. (“Shanghai Borongdingsi”). Business Opportunity Online, Beijing CNET Online and Shanghai Borongdingsi, were incorporated on December 8, 2004, January 27, 2003 and August 3, 2005, respectively.

Shanghai Borongdingsi is 51% owned by Beijing CNET Online. Beijing CNET Online and Shanghai Borongdingsi entered into a cooperation agreement in June 2008, followed up with a supplementary agreement in December 2008, to conduct bank kiosk advertisement business. The business is based on a bank kiosk cooperation agreement between Shanghai Borongdingsi and Henan provincial branch of China Construction Bank which allows Shanghai Borongdingsi or its designated party to conduct in-door advertisement business within the business outlets throughout Henan Province. The bank kiosk cooperation agreement has a term of eight years starting August 2008. However, Shanghai Borongdingsi was not able to conduct the advertisement business as a stand-alone business due to the lack of an advertisement business license and supporting financial resources. Pursuant to the aforementioned cooperation agreements, Beijing CNET Online committed to purchase equipment, and to provide working capital, technical and other related support to Shanghai Borongdingsi. Beijing CNET Online owns the equipment used in the kiosk business, is entitled to sign contracts in its name on behalf of the business, and holds the right to collect the advertisement revenue generated from the bank kiosk business exclusively until the recovery of the cost of purchase of the equipment. Thereafter, Beijing CNET Online has agreed to distribute 49% of the succeeding net profit generated from the bank kiosk advertising business, if any, to the minority shareholders of Shanghai Borongdingsi.

CHINANET ONLINE HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On June 24, 2010, one of the Company's VIEs, Business Opportunity Online, together with three other individuals, who were not affiliated with the Company, formed a new company, Shenzhen City Mingshan Network Technology Co., Ltd. ("Shenzhen Mingshan"). The registered capital and paid-in capital of Shenzhen Mingshan was RMB10,000,000 and RMB5,000,000, respectively. Shenzhen Mingshan is 51% owned by Business Opportunity Online and 49% owned collectively by the other three individuals. Shenzhen Mingshan is located in Shenzhen City, Guangdong Province of the PRC and is primarily engaged in developing and designing of internet based software, online games and the related operating websites and providing related internet and information technology services necessary to operate such games and websites. On January 6, 2011, as approved by the shareholders of Shenzhen Mingshan, an independent third party investor, who was not affiliated with the Company or any of its affiliates, invested RMB15,000,000 (approximately US$2,356,749) cash into Shenzhen Mingshan in exchange for a 60% equity interest in Shenzhen Mingshan, and Shenzhen Mingshan's registered capital and paid-in capital increased from RMB10,000,000 (approximately US$1,571,166) and RMB5,000,000 (approximately US$785,583) to RMB25,000,000 (approximately US$3,927,915) and RMB20,000,000 (approximately US$3,142,332), respectively. Therefore, beginning on January 6, 2011, the new investor became the majority shareholder of Shenzhen Mingshan. The Company's share of the equity interest in ShenZhen Mingshan decreased from 51% to 20.4% and the Company ceased to have a controlling financial interest in ShenZhen Mingshan, but still retains an investment in, and significant influence over, Shenzhen Mingshan.

On December 6, 2010, Rise King WFOE entered into a series of exclusive contractual arrangements, which were similar to the Contractual Agreements discussed above, with Rise King (Shanghai) Advertisement Media Co., Ltd. ("Shanghai Jing Yang"), a company incorporated under the PRC laws in December 2009 and primarily engaged in advertisement business, pursuant to which the Company, through its wholly owned subsidiary, Rise King WFOE obtained all of the equity owners' rights and obligations of Shanghai Jing Yang, and the ability to extract the profits from the operation and assume the residual benefits of Shanghai Jing Yang, and hence became the sole interest holder of Shanghai Jing Yang. As of the date these contractual agreements were entered into, Shanghai Jing Yang had not establish any resources to conducted any business activities by itself and the carrying amount of the net assets of Shanghai Jing Yang which was all cash and cash equivalents approximate fair values due to their short maturities. Therefore, Shanghai Jing Yang's accounts were included in the Company's consolidated financial statements with no goodwill recognized in accordance to ASC Topic 810 "Consolidation".

On December 8, 2010, the Company, through one of its VIEs, Shanghai Jing Yang acquired a 49% interest in a newly established company, Beijing Yang Guang Media Investment Co., Ltd. ("Beijing Yang Guang") for cash consideration of RMB 7,350,000 (approximately US$1,154,807), which represents 49% of Beijing Yang Guang's paid-in capital and net assets of RMB15,000,000 (approximately US$2,356,749). Beijing Yang Guang had not commenced its operations as of December 8, 2010 and the carrying amount of the net assets of Beijing Yang Guang which were mainly consist of cash and cash equivalents and other receivables approximate fair values due to their short maturities. Therefore, the cash consideration paid was accounted for as investment in an equity investment affiliate in accordance with ASC Topic 323 "Equity Method and Joint Ventures". In August, 2011, Shanghai Jing Yang sold back its 49% equity interest in Beijing Yang Guang to the majority shareholder of Beijing Yang Guang for cash consideration of RMB7,350,000, which was equal to the consideration paid when Shanghai Jing Yang acquired the 49% equity interest in December 2010.

The Company, through one of its VIEs, Beijing CNET Online, entered into an equity interest acquisition agreement with the shareholders of Quanzhou Zhi Yuan Marketing Planning Co., Ltd. ("Quanzhou Zhi Yuan") and Quanzhou Tian Xi Shun He Advertisement Co., Ltd. ("Quanzhou Tian Xi Shun He"), (collectively "the acquirees") on December 18, 2010 and December 22, 2010, to acquire a 100% equity interest in Quanzhou Zhi Yuan and a 51% equity interest in Quanzhou Tian Xi Shun He, for cash consideration of RMB9,500,000 (approximately US$1,492,608) and

RMB7,500,000 (approximately US$1,178,374), respectively. The acquisition was subsequently approved by, and registered with, the relevant PRC government authorities of Quanzhou City, Fujian province of PRC on January 4, 2011 and February 23, 2011, respectively. Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He are both independent advertising companies based in Fujian province of the PRC, which provide comprehensive branding and marketing services to over fifty small to medium sized companies focused primarily in the sportswear and clothing industry. In June 2011, Beijing CNET Online entered into an additional agreement with the noncontrolling interest of Quanzhou Tian Xi Shun He to purchase the remaining 49% equity interest in Quanzhou Tian Xi Shun He for cash consideration of RMB7,200,000 (approximately US$1,131,239). On June 27, 2011, this transaction was approved by, and registered with, the relevant PRC government authorities of Quanzhou City, Fujian province of PRC. Quanzhou Tian Xi Shun He became a wholly owned subsidiary of Beijing CNET Online accordingly.

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On January 28, 2011, one of the Company's VIEs, Business Opportunity Online, formed a new wholly owned subsidiary, Business Opportunity Online (Hubei) Network Technology Co., Ltd. ("Business Opportunity Online Hubei"). The registered capital and paid in capital of Business Opportunity Online Hubei is RMB2,000,000 (approximately US$314,233). Business Opportunity Online Hubei is primarily engaged in internet advertisement design, production and promulgation.

On March 1, 2011, one of the Company's VIEs, Business Opportunity Online, together with an individual, who was not affiliated with the Company, formed a new company, Beijing Chuang Fu Tian Xia Network Technology Co., Ltd. ("Beijing Chuang Fu Tian Xia"). The registered capital and paid in capital of Beijing Chuang Fu Tian Xia is RMB1,000,000 (approximately US$157,117). Business Opportunity Online and the co-founding individual invested RMB510,000 (approximately US$80,130) and RMB490,000 (approximately US$76,987) cash in Beijing Chuang Fu Tian Xia, respectively, representing 51% and 49% of the equity interests in Beijing Chuang Fu Tian Xi, respectively. In addition to capital investment, the co-founding individual is required to provide the controlled domain names, www.liansuo.com and www.chuangye.com to be registered under the established company. Beijing Chuang Fu Tian Xia is primarily engaged in providing and operating internet advertising, marketing and communication services to small and medium companies through the websites associated the above mentioned domain names.

On April 18, 2011, the Company, through one of its VIEs, Business Opportunity Online Hubei formed a new wholly owned company, Hubei CNET Advertising Media Co., Ltd. ("Hubei CNET"). The registered capital and paid in capital of Hubei CNET is RMB1,000,000 (approximately US$157,117). Hubei CNET is primarily engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

On April 18, 2011, one of the Company's VIEs, Business Opportunity Online Hubei, together with an individual, who was not affiliated with the Company, formed a new company, Zhao Shang Ke Network Technology (Hubei) Co., Ltd. ("Zhao Shang Ke Hubei"). The registered capital of Zhao Shang Ke Hubei is RMB2,000,000 (approximately US$314,233). Business Opportunity Online Hubei and the co-founding individual invested RMB1,020,000 (approximately US$160,259) and RMB980,000 (approximately US$153,974) cash in Zhao Shang Ke Hubei, respectively, and owned 51% and 49% of the equity interests in Zhao Shang Ke Hubei, respectively. Zhao Shang Ke Hubei is primarily engaged in providing advertisement design, production, promulgation and sales channels building services. On December 29, 2011, as approved by the shareholders of Zhao Shang Ke Hubei, two independent third party investors, who were not affiliated with the Company or any of its affiliates, invested RMB10,000,000 (approximately US$1,571,166) cash into Zhao Shang Ke Hubei in exchange for an aggregate 50% equity interest in Zhao Shang Ke Hubei in the enlarged registered capital. As a result of this cash investment, the registered capital and paid in capital of Zhao Shang Ke Hubei increased to RMB4,000,000 (approximately US$628,466) from RMB2,000,000 (approximately US$314,233), the additional cash investment of RMB8,000,000 (approximately US$1,256,933) was credited as additional paid-in capital of Zhao Shang Ke Hubei. Therefore, beginning on December 29, 2011, the Company's share of the equity interest in Zhao Shang Ke Hubei decreased from 51% to 25.5% and ceased to have a controlling financial interest in Zhao Shang Ke Hubei but still retained an investment in, and significant influence over, Zhao Shang Ke Hubei.

On July 1, 2011, one of the Company's VIEs, Quanzhou Zhi Yuan, formed a new wholly owned company, Xin Qi Yuan Advertisement Planning (Hubei) Co., Ltd. ("Xin Qi Yuan Hubei"). The registered capital and paid in capital of Xin Qi Yuan Hubei is RMB100,000 (approximately US$15,712). Xin Qi Yuan Hubei is primarily engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

On July 1, 2011, one of the Company's VIEs, Quanzhou Tian Xi Shun He, formed a new wholly owned company, Mu Lin Sen Advertisement (Hubei) Co., Ltd. ("Mu Lin Sen Hubei"). The registered capital and paid in capital of Mu Lin Sen Hubei is RMB100,000 (approximately US$15,712). Mu Lin Sen Hubei is primarily engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

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On July 1, 2011, one of the Company's VIEs, Business Opportunity Online Hubei, together with an individual who is not affiliated with the Company, formed a new company, Sheng Tian Network Technology (Hubei) Co., Ltd. ("Sheng Tian Hubei"). The registered capital and paid in capital of Sheng Tian Hubei is RMB2,000,000 (approximately US$314,233). Business Opportunity Online Hubei and the co-founding individual invested RMB1,020,000 (approximately US$160,259) and RMB980,000 (approximately US$153,974) cash in Sheng Tian Hubei, respectively, and owned 51% and 49% of the equity interests in Sheng Tian Hubei, respectively. Sheng Tian Hubei is primarily engaged in computer system design, development and promotion; software development and promotion, and providing the related technical consultancy services.

On September 5, 2011, one of the Company's VIEs, Business Opportunity Online Hubei, formed a new wholly owned company, Chongqing Business Opportunity Online Technology Co., Ltd. ("Business Opportunity Online Chongqing"). The registered capital and paid in capital of Business Opportunity Online Chongqing is RMB2,000,000 (approximately US$314,233). Business Opportunity Online Chongqing is primarily engaged in internet advertisement design, production and promulgation.

On December 15, 2011, one of the Company's VIEs, Business Opportunity Online Hubei entered into an equity transfer agreement with Sou Yi Lian Mei Network Technology (Beijing) Co. Ltd., ("Sou Yi Lian Mei") and its shareholders, to acquire a 51% equity interest in Sou Yi Lian Mei for cash consideration of RMB51,600,000 (approximately US$8,107,216). Sou Yi Lian Mei is based in Beijing, China, and is primary engaged in providing online advertising and marketing services. Sou Yi Lian Mei operates its business primarily through its wholly-owned subsidiary, Jin Du Ya He (Beijing) Network Technology Co., Ltd ("Jin Du Ya He"). The equity transfer agreement contained certain "make good" provisions, under which the noncontrolling interest shareholder of Sou Yi Lian Mei will pledge to the Company the 49% of the equity interest of Sou Yi Lian Mei he owns to secure the make good obligation under the equity transfer agreement. The equity transfer agreement established minimum audited after tax net profit threshold for Sou Yi Lian Mei for fiscal year 2012 ("2012 Performance Threshold"). In the event that the 2012 Performance Threshold is achieved less than 95% by Sou Yi Lian Mei, the noncontrolling shareholder will compensate the Company in cash in the amount equal to the shortfall between the 95% of 2012 Performance Threshold and actual audited after tax net profit for fiscal year 2012 of Sou Yi Lian Mei. In the event that the noncontrolling shareholder is not required to compensate the Company in cash under Shareholders' make good obligation, the Company will then cancel the pledge over the 49% of equity interests of the noncontrolling shareholder. On December 20, 2011, the transaction was approved by, and registered with, the relevant PRC government authorities of Beijing, the PRC. Sou Yi Lian Mei became a majority-owned subsidiary of Business Opportunity Online Hubei accordingly.

As of December 31, 2011, the Company operated its business primarily in China through its PRC subsidiary and PRC operating entities, or VIEs as described above.

2. Variable Interest Entities

To satisfy PRC laws and regulations, the Company conducts certain business in the PRC through its Variable Interest Entities ("VIEs").

As described in Note 1, On October 8, 2008, a series of contractual arrangements (the "VIE Agreements") were entered into between Rise King WFOE and Business Opportunity Online, Beijing CNET Online (collectively the "PRC Operating Entities") and its common individual owners (the "PRC Shareholders" or the "Control Group"). Resulting from these VIE Agreements entered into between Rise King WFOE and the PRC Operating Entities, the Company includes the assets, liabilities, revenues and expenses of these PRC Operating Entities and its subsidiaries in its consolidated financial statements.

The significant terms of the VIE Agreements are summarized below:

Exclusive Business Cooperation Agreements: Pursuant to the Exclusive Business Cooperation Agreements entered into by and between Rise King WFOE and each of the PRC Operating Entities, Rise King WFOE has the exclusive right to provide to the PRC Operating Entities complete technical support, business support and related consulting services during the term of these agreements, which includes but is not limited to technical services, business consultations, equipment or property leasing, marketing consultancy system integration, product research and development, and system maintenance. In exchange for such services, each PRC Operating Entity has agreed to pay a service fee to Rise King WFOE equal to 100% of the net income of each PRC Operating Entity. Adjustments may be made upon approval by Rise King WFOE based on services rendered by Rise King WFOE and operational needs of the PRC Operating Entities. The payment shall be made on a monthly basis, if at year end, after an audit of the financial statements of any PRC Operating Entities, there is determined to be any shortfall in the payment of 100% of the annual net income, such PRC Operating Entity shall pay such shortfall to Rise King WFOE. Each agreement has a ten-year term. The term of these agreements may be extended if confirmed in writing by Rise King WFOE, prior to the expiration of the term. The extended term shall be determined by Rise King WFOE, and the PRC Operating Entities shall accept such extended term unconditionally.

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Exclusive Option Agreements: Under the Exclusive Option Agreements entered into by and among Rise King WFOE, each of the PRC Shareholders irrevocably granted to Rise King WFOE or its designated person an exclusive option to purchase, to the extent permitted by PRC law, a portion or all of their respective equity interest in any PRC Operating Entities for a purchase price of RMB 10, or a purchase price to be adjusted to be in compliance with applicable PRC laws and regulations. Rise King WFOE, or its designated person, has the sole discretion to decide when to exercise the option, whether in part or in full. Each of these agreements has a ten-year term, subject to renewal at the election of Rise King WFOE.

Equity Pledge Agreements: Under the Equity Pledge Agreements entered into by and among Rise King WFOE, the PRC Operating Entities and each of the PRC Shareholders, the PRC Shareholders pledged all of their equity interests in the PRC Operating Entities to guarantee the PRC Operating Entities' performance of its obligations under the Exclusive Business Cooperation Agreements. If the PRC Operating Entities or any of the PRC Shareholders breaches its/his/her respective contractual obligations under these agreements, or upon the occurrence of one of the events regarded as an event of default under each such agreement, Rise King WFOE, as pledgee, will be entitled to certain rights, including the right to dispose of the pledged equity interests. The PRC Shareholders of the PRC Operating Entities agreed not to dispose of the pledged equity interests or take any actions that would prejudice Rise King WFOE's interest, and to notify Rise King WFOE of any events or upon receipt of any notices which may affect Rise King WFOE's interest in the pledge. Each of the equity pledge agreements will be valid until all the payments related to the services provided by Rise King WFOE to the PRC Operating Entities due under the Exclusive Business Cooperation Agreements have been fulfilled. Therefore, the equity pledge agreements shall only be terminated when the payments related to the ten-year Exclusive Business Cooperation Agreement are paid in full and the WFOE does not intend to extend the term of the Exclusive Business Cooperation Agreement.

Irrevocable Powers of Attorney: The PRC Shareholders have each executed an irrevocable power of attorney to appoint Rise King WFOE as their exclusive attorneys-in-fact to vote on their behalf on all PRC Operating Entities matters requiring shareholder approval. The term of each power of attorney is valid so long as such shareholder is a shareholder of the respective PRC Operating Entity.

On December 6, 2010, Rise King WFOE entered into a series of exclusive contractual arrangements, which were similar to the VIE Agreements discussed above, with Rise King (Shanghai) Advertisement Media Co., Ltd. ("Shanghai Jing Yang"), a company incorporated under the PRC laws in December 2009 and primarily engaged in advertisement business, pursuant to which the Company, through its wholly owned subsidiary, Rising King WFOE obtained all of the equity owners' rights and obligations of Shanghai Jing Yang, and the ability to extract the profits from the operation and assume the residual benefits of Shanghai Jing Yang, and hence became the sole interest holder of Shanghai Jing Yang. Therefore, the Company also includes the assets, liabilities, revenues and expenses of Shanghai Jing Yang in its consolidated financial statements.

As a result of these VIE Agreements, the Company through its wholly-owned subsidiary, Rise King WFOE, was granted with unconstrained decision making rights and power over key strategic and operational functions that would significantly impact the PRC Operating Entities or the VIEs' economic performance, which includes, but is not limited to, the development and execution of the overall business strategy; important and material decision making; decision making for merger and acquisition targets and execution of merger and acquisition plans; business partnership strategy development and execution; government liaison; operation management and review; and human resources recruitment and compensation and incentive strategy development and execution. Rise King WFOE also provides comprehensive services to the VIEs for their daily operations, such as operational technical support, OA technical support, accounting support, general administration support and technical support for products and services. As a result of the Exclusive Business Cooperation Agreements, the Equity Pledge Agreements and the Exclusive Option Agreements, the

Company will bear all of the VIEs' operating costs in exchange for 100% of the net income of the VIEs. Under these agreements, the Company has the absolute and exclusive right to enjoy economic benefits similar to equity ownership through the VIE Agreements with our PRC Operating Entities and their shareholders.

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These contractual arrangements may not be as effective in providing the Company with control over the VIEs as direct ownership. Due to its VIE structure, the Company has to rely on contractual rights to effect control and management of the VIEs, which exposes it to the risk of potential breach of contract by the shareholders of the VIEs for a number of reasons. For example, their interests as shareholders of the VIEs and the interests of the Company may conflict and the Company may fail to resolve such conflicts; the shareholders may believe that breaching the contracts will lead to greater economic benefit for them; or the shareholders may otherwise act in bad faith. If any of the foregoing were to happen, the Company may have to rely on legal or arbitral proceedings to enforce its contractual rights, including specific performance or injunctive relief, and claiming damages. Such arbitral and legal proceedings may cost substantial financial and other resources, and result in a disruption of its business, and the Company cannot assure that the outcome will be in its favor. Apart from the above risks, there are no significant judgments or assumptions regarding enforceability of the contracts.

In addition, as all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in the PRC, they would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could further limit the Company’s ability to enforce these contractual arrangements. Furthermore, these contracts may not be enforceable in China if PRC government authorities or courts take a view that such contracts contravene PRC laws and regulations or are otherwise not enforceable for public policy reasons. In the event the Company is unable to enforce these contractual arrangements, it may not be able to exert effective control over the VIEs, and its ability to conduct its business may be materially and adversely affected.

Summarized below is the information related to the consolidated VIEs’ assets and liabilities as of December 31, 2011 and 2010, respectively:

	As of December 31,	
	2011	2010
	US$(’000)	US$(’000)
Assets		
Current assets:		
Cash and cash equivalents	$ 8,322	$ 6,535
Accounts receivable, net	3,705	1,487
Other receivables, net	3,619	7,803
Prepayment and deposit to suppliers	15,360	3,322
Due from related parties	192	156
Deposit for acquisitions	-	1,512
Contingent consideration receivables	159	-
Other current assets	23	2
Total current assets	31,380	20,817
Investment in and advance to equity investment affiliates	1,354	7,162
Property and equipment, net	1,507	1,445
Intangible assets, net	8,111	-
Goodwill	10,999	-
Deferred tax assets-non current	92	-
Total Assets	$ 53,443	$ 29,424

Liabilities		
Current liabilities:		
Accounts payable	$268	$174
Advances from customers	724	783
Accrued payroll and other accruals	251	162
Due to equity investment affiliate	220	-
Due to related parties	161	155
Due to Control Group	11	91
Payable for acquisition	550	-
Taxes payable	4,409	1,753
Other payables	107	10
Total current liabilities	6,701	3,128
Deferred tax Liabilities-non current	1,893	-
Total Liabilities	$8,594	$3,128

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All of the VIEs' assets can be used to settle obligations of its primary beneficiary. Liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company’s general assets

For the year ended December 31, 2011, the financial performance of the VIEs reported in the Company’s consolidated statements of income and comprehensive income includes sales of approximately US$24,109,000, cost of sales of approximately US$11,772,000, operating expenses of approximately US$6,424,000 and net income before allocation to noncontrolling interests of approximately US$5,849,000.

For the year ended December 31, 2010, the financial performance of the VIEs reported in the Company’s consolidated statements of income and comprehensive income includes sales of approximately US$27,709,000, cost of sales of approximately US$18,288,000, operating expenses of approximately US$4,971,000 and net income before allocation to noncontrolling interests of approximately US$4,107,000.

3. Summary of significant accounting policies

a) Basis of presentation

The consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States (“U.S. GAAP”).

b) Principles of consolidation

The consolidated financial statements include the financial statements of all the subsidiaries and VIEs of the Company. All transactions and balances between the Company and its subsidiaries and VIEs have been eliminated upon consolidation. According to the agreements between Beijing CNET Online and Shanghai Borongdingsi, although Beijing CNET Online legally owns 51% of Shanghai Borongdingsi’s interests, Beijing CNET Online only controls the assets and liabilities related to the bank kiosks business, which has been included in the financial statements of Beijing CNET Online, but does not control other assets of Shanghai Borongdingsi, thus, Shanghai Borongdingsi’s financial statements were not consolidated by the Company.

c) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the related disclosure of contingent assets and liabilities at the date of these consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company continually evaluates these estimates and assumptions based on the most recently available information, historical experience and various other assumptions that the Company believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates.

d) Reclassification

Certain prior year amounts have been regrouped or reclassified to conform to the current year presentation, which did not have any impact on the Company’s prior year consolidated financial position, consolidated results of operations and consolidated cash flows.

e) Foreign currency translation and transactions

The functional currency of the Company is United States dollars (“US$”), and the functional currency of China Net HK is Hong Kong dollars (“HK$”). The functional currency of the Company’s PRC operating subsidiary and VIEs is Renminbi (“RMB”), and PRC is the primary economic environment in which the Company operates.

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For financial reporting purposes, the financial statements of the Company's PRC operating subsidiary and VIEs, which are prepared using the RMB, are translated into the Company's reporting currency, the United States Dollar ("U.S. dollar"). Assets and liabilities are translated using the exchange rate at each balance sheet date. Revenue and expenses are translated using average rates prevailing during each reporting period, and stockholders' equity is translated at historical exchange rates. Adjustments resulting from the translation are recorded as a separate component of accumulated other comprehensive income in stockholders' equity.

Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transactions. The resulting exchange differences are included in the determination of net income of the consolidated statements of income and comprehensive income for the respective periods.

The exchange rates used to translate amounts in RMB into US$ for the purposes of preparing the consolidated financial statements are as follows:

	As of December 31,	
	2011	2010
Balance sheet items, except for equity accounts	6.3647	6.6118

	Year ended December 31,	
	2011	2010
Items in the statements of income and comprehensive income, and statements cash flows	6.4735	6.7788

No representation is made that the RMB amounts could have been, or could be converted into US$ at the above rates.

f) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and bank deposits, which are unrestricted as to withdrawal and use. The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

g) Accounts receivable, net

Accounts receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts as needed. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on aging data, historical collection experience, customer specific facts and economic conditions. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company did not have any off-balance-sheet credit exposure relating to its customers, suppliers or others.

h) Investment in equity method affiliates

Investee companies that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting in accordance to ASC Topic 323 "Equity Method and Joint Ventures". Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee companies' board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee companies. Under the equity method of accounting, an investee company's accounts are not reflected within the Company's consolidated balance sheets and statements of income and comprehensive income; however, the Company's share of the earnings or losses of the investee company is reflected in the caption "Share of earnings (losses) in equity investment affiliates" in the consolidated statements of income and comprehensive income. The Company's carrying value (including advance to the investee) in equity method investee companies is reflected in the caption "Investment in and advance to equity investment affiliates" in the Company's consolidated balance sheets.

When the Company's carrying value in an equity method investee company is reduced to zero, no further losses are recorded in the Company's consolidated financial statements unless the Company guaranteed obligations of the investee company or has committed additional funding. When the investee company subsequently reports income, the Company will not record its share of such income until it equals the amount of its share of losses not previously recognized.

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i) Property and equipment, net

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is calculated on the straight-line method after taking into account their respective estimated residual values over the following estimated useful lives:

Vehicles	5 years
Office equipment	3-5 years
Electronic devices	5 years

Depreciation expenses are included in selling expenses, general and administrative expenses and research and development expenses.

When property and equipment are retired or otherwise disposed of, resulting gain or loss is included in net income or loss in the year of disposition for the difference between the net book value and proceeds received thereon. Maintenance and repairs which do not improve or extend the expected useful lives of the assets are charged to expenses as incurred.

j) Intangible assets, net

Purchased software and software platform is initially recorded at cost and amortized on a straight-line basis over the estimated useful economic life.

Intangible assets other than goodwill acquired through various acquisitions are amortized on a straight-line basis over their expected useful economic lives.

If an acquired intangible asset is determined to have an indefinite useful life, it should not be amortized until its useful life is determined to be no longer indefinite. The Company reviews intangible assets' remaining useful lives in each reporting period. If such an asset is later determined to have a finite useful life, the asset will be tested for impairment. That asset will then be amortized prospectively over its estimated remaining useful life and accounted for in the same way as intangible assets subject to amortization.

The Company accounted for website development costs in accordance with ASC Topic 350-50, which requires that certain costs related to the development or purchase of internal-use software and systems as well as the costs incurred in the application development stage related to its website be capitalized and amortized over the estimated useful life of the software or system. ASC Topic 350-50 also require that costs related to the preliminary project stage, data conversion and post implementation/operation stage of an internal-use software development project be expensed as incurred.

Based on the Company analysis of its website development cost which is subject to capitalization in accordance with ASC Topic 350-50 incurred for the development of www.liansuo.com and www.chuangye.com, the Company did not capitalize such cost, as the amount was considered immaterial, which was primarily the labor cost of its staff in the research and development department.

k) Impairment of long-lived assets

Long-lived assets, which include tangible long-lived assets and intangible long-lived assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment loss is recognized for the difference between the carrying amount of the asset and its fair value.

For the years ended December 31, 2011 and 2010, the Company did not record any impairment losses associated with long-lived assets.

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l) Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its consolidated VIEs.

Goodwill is not depreciated or amortized but is tested for impairment at the reporting unit level at least on an annual basis, and between annual tests when an event occurs or circumstances change that could indicate that the asset might be impaired. The test consists of two steps. First, identify potential impairment by comparing the fair value of the reporting unit to its carrying amount, including goodwill. If the fair value of the reporting unit is greater than its carrying amount, goodwill is not considered impaired. Second, if there is impairment identified in the first step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit’s goodwill over the implied fair value of goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with Topic 805 “Business Combinations.”

Application of a goodwill impairment test requires significant management judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. The judgment in estimating the fair value of reporting units includes estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

For the years ended December 31, 2011 and 2010, the Company did not record any impairment losses associated with Goodwill.

m) Deconsolidation

The Company accounts for deconsolidation of subsidiaries in accordance with ASC Topic 810 “Consolidation”.

In accordance with ASC Topic 810-10-40-5, the parent shall account for the deconsolidation of a subsidiary by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of all of the following:

1. The fair value of any consideration received;

2. The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated;

3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.

b. The carrying amount of the former subsidiary’s assets and liabilities.

n) Changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary

The Company accounted for changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary in accordance with ASC Topic 810 “Consolidation”, subtopic 10, which requires the transaction be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent and reallocated the subsidiary's accumulated comprehensive income, if any, among the parent and the noncontrolling interest through an adjustment to the parent's equity.

CHINANET ONLINE HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

o) Fair Value

The Company's financial instruments primarily consist of cash and cash equivalents, accounts receivable, other receivables, prepayment and deposits, accounts payable, advances from customers, accruals and other payables. The carrying values of these financial instruments approximate fair values due to their short maturities.

ASC Topic 820 "Fair Value Measurement and Disclosures," defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This topic also establishes a fair value hierarchy which requires classification based on observable and unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Determining which category an asset or liability falls within the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures each quarter.

p) Revenue recognition

The Company's revenue recognition policies are in compliance with ASC Topic 605 "Revenue Recognition". In accordance with ASC Topic 605, revenues are recognized when the four of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) the service has been rendered, (iii) the fees are fixed or determinable, and (iv) collectability is reasonably assured.

Sales include revenues from reselling of advertising time purchased from TV stations and, internet advertising and providing related value added technical services, reselling of internet advertising spaces and other advertisement related resources. No revenue from advertising-for-advertising barter transactions was recognized because the transactions did not meet the criteria for recognition in ASC Topic 605, subtopic 20. Advertising contracts establish the fixed price and advertising services to be provided. Pursuant to advertising contracts, the Company provides advertisement placements in different formats, including but not limited to banners, links, logos, buttons, rich media and content integration. Revenue is recognized ratably over the period the advertising is provided and, as such, the Company considers the services to have been delivered. The Company treats all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Value added technical services are provided based on two types of contracts: (i) fixed price and (ii) fixed price with minimum performance threshold. For contracts with fixed price terms, revenue is recognized on a pro-rata basis over the engaged service period. For fixed price contracts with minimum performance threshold, revenue is recognized when the specified performance criteria is met. Based upon the Company's credit assessments of its customers prior to entering into contracts, the Company determines if collectability is reasonably assured. In situations where collectability is not deemed to be reasonably assured, the Company recognizes revenue upon receipt of cash from customers, only after services have been provided and all other criteria for revenue recognition have been met.

q) Cost of sales

Cost of sales primarily includes the cost of media advertising time, internet advertisement related resources and other technical services purchased from third parties, labor cost and benefits and PRC business tax.

CHINANET ONLINE HOLDINGS, INC.
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r) Advertising costs

Advertising costs for the Company's own brand building are not includable in cost of sales, they are expensed when incurred or amortized over the estimated beneficial period and are included in "selling expenses" in the statement of income and comprehensive income. For the years ended December 31, 2011 and 2010, advertising expenses for the Company's own brand building were approximately US$1,357,000 and US$2,002,000, respectively.

s) Research and development expenses

The Company accounts for the cost of developing and upgrading technologies and platforms and intellectual property that are used in its daily operations in research and development cost. Research and development costs are charged to expense when incurred. Expenses for research and development for the years ended December 31, 2011 and 2010 were approximately US$2,132,000 and US$907,000, respectively.

t) Income taxes

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

u) Uncertain tax positions

The Company follows the guidance of ASC Topic 740-10-25-5 through 740-10-25-7 and 740-10-25-13, which prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. For the years ended December 31, 2011 and 2010, the Company did not have any interest and penalties associated with tax positions and did not have any significant unrecognized uncertain tax positions.

v) Share-based Compensation

The Company accounted for share-based compensation to employees in accordance with ASC Topic 718 "Compensation-Stock Compensation" which requires that share-based payment transactions be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period, or vesting period.

w) Noncontrolling interest

The Company accounts for noncontrolling interest in accordance with ASC Topic 810-10-45, which requires the Company to present noncontrolling interests (previously referred to as minority interests) as a separate component of total shareholders' equity on the consolidated balance sheet and the consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated income and comprehensive income statement. ASC Topic 810-10-45 also requires that losses attributable to the parent and the noncontrolling interest in a subsidiary be attributed to those interests even if it results in a deficit noncontrolling interest balance.

x) Comprehensive income

The Company accounts for comprehensive income in accordance with ASC Topic 220 “Comprehensive Income”, which establishes standards for reporting and displaying comprehensive income and its components in the consolidated financial statements. Comprehensive income is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. Accumulated other comprehensive income, as presented in the Company’s consolidated balance sheets are the cumulative foreign currency translation adjustments.

CHINANET ONLINE HOLDINGS, INC.
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y) Earnings per share

Earnings per share are calculated in accordance with ASC Topic 260, "Earnings Per Share". Basic earnings per share is computed by dividing income attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Common shares issuable upon the conversion of the convertible preferred shares are included in the computation of diluted earnings per share on an "if-converted" basis when the impact is dilutive. The dilutive effect of outstanding common stock warrants and options are reflected in the diluted earnings per share by application of the treasury stock method when the impact is dilutive.

z) Commitments and contingencies

The Company has adopted ASC 450 "Contingencies" subtopic 20, in determining its accruals and disclosures with respect to loss contingencies. Accordingly, estimated losses from loss contingencies are accrued by a charge to income when information available prior to issuance of the financial statements indicates that it is probable that a liability have been incurred and the amount of the loss can be reasonably estimated. Legal expenses associated with the contingency are expensed as incurred. If a loss contingency is not probable or reasonably estimable, disclosure of the loss contingency is made in the financial statements when it is at least reasonably possible that a material loss could be incurred.

aa) Recent accounting pronouncements

In September 2011, the FASB issued ASU No. 2011-08 — "Intangibles — Goodwill and Other". The amendments in this update will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of the provisions in ASU 2011-08 will have no material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12 — "Comprehensive Income". The amendments in this update supersede certain pending paragraphs in ASU No. 2011-05, to effectively defer only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the Board time to re-deliberate the presentation requirements for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities. The amendments in this update are effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The adoption of the provisions in ASU 2011-12 will have no material impact on the Company's consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's consolidated financial statements upon adoption.

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4. Acquisitions

In order to further diversify the channels of the Company's adverting and marketing campaign services, achieve an entry into Fujian province, a base of fast growing small to medium enterprises, and expand the Company's market opportunities from these enterprises, which are looking to domestically expand their businesses through franchises, dealerships and merchants in China, the Company acquired a 100% equity interest and a 51% equity interest in Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He, respectively. In order to establish the distinct brands in each of the Company's targeted customer segment and achieved more diversified operational synergies of the Company's internet advertising and marketing business, the Company acquired a 51% equity interest in Sou Yi Lian Mei, an established internet advertising and marketing services provider for merchant and franchise enterprises and organizations primarily involved in small office/home office ("SOHO") and emerging business, through its web portal, www.sooe.cn. As described in Note 1, the acquisition of a 100% equity interest in Quanzhou Zhi Yuan, the acquisition of a 51% equity interest in Quanzhou Tian Xi Shun He and the acquisition of a 51% equity interest in Sou Yi Lian Mei, was consummated on January 4, 2011, February 23, 2011and December 20, 2011, respectively.

Each acquisition was accounted for using the acquisition method of accounting in accordance with ASC Topic 805 "Business Combinations", and accordingly the acquired assets and liabilities were recorded at their fair values on the dates of acquisitions and the results of their operations have been included in the Company's results of operations since the dates of their acquisitions.

The income approach is applied for identifiable intangible assets (except software technologies) and noncontrolling interests' valuation, based on a five-year financial projection and using the discounted cash flow method to calculate the present value of the future economic benefits. Key inputs used for such valuation include: weighted average cost of capital ("WPCC"), discount rate, and terminal growth rate. The income approach explicitly recognizes that the current value of an asset is premised upon the expected receipt of future economic benefits focusing on the income producing capability of a business or an asset.   It measures the current value of a business or asset by calculating the present value of its future economic benefits such as earnings, cost savings, tax deduction, and proceeds from disposition. Indications of value are developed by discounting these benefits to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation, and risk associated with the particular investment which reflects both current return requirements of the market and specific investment. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as of each assessment date. The Cost approach is applied for software technologies valuation based on the estimated replacement cost of the software technologies. The Monte Carlo simulation is applied for the valuation of contingent consideration receivables. Contingent consideration receivables arose from certain "make good" provisions stipulated in the acquisition agreements with the sellers, which were that if audited pretax profit or after tax profit for the required further years increases by less than certain amount or percentage while compared to audited pretax profit or after tax profit of the prior year, the sellers need to compensate the Company in cash for the difference between target pretax profit or after tax profit and actual result achieved then.

Goodwill recognized from these transactions mainly represented the expected operational synergies upon acquisition of these subsidiaries and intangibles not qualifying for separate recognition. Goodwill is nondeductible for income tax purpose in the tax jurisdiction of these acquisition transactions incurred.

Acquisition of Quanzhou Zhi Yuan

The following table summarizes the assignment of fair value to identifiable assets and liabilities assumed as of January 4, 2011 (the acquisition date of Quanzhou Zhi Yuan):

	Fair Value US$('000)	Amortization Period (Years)
Cash and cash equivalents	$ 11	
Accounts receivables	17	
Property and equipment, net	57	
Other current liabilities	(13)	
Deferred tax liabilities	(196)	
Acquired intangible assets:		
Trade Name	113	Indefinite
Contract Backlog	18	0.7
Customer Relationship	547	8
Non-Compete Agreement	106	5
Goodwill:		
Assembled Workforce	20	
Other unidentifiable intangibles	708	
	728	
Total Value	$ 1,388	
Purchase price	$ 1,440	
Contingent consideration receivable	(52)	
Total amount to be allocated	$ 1,388	

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Acquisition of Quanzhou Tian Xi Shun He

The following table summarized the assignment of fair value to identifiable assets and liabilities assumed as of February 23, 2011 (the acquisition date of Quanzhou Tian Xi Shun He):

	Fair Value US$('000)	Amortization Period (Years)
Cash and cash equivalents	$ 12	
Accounts receivables and other receivables	55	
Property and equipment, net	41	
Other current liabilities	(34)	
Deferred tax liabilities	(289)	
Acquired intangible assets:		
Trade Name	182	Indefinite
Contract Backlog	170	0.6
Customer Relationship	722	9
Non-Compete Agreement	83	5
Goodwill:		
Assembled Workforce	23	
Other unidentifiable intangibles	1,143	
	1,166	
Total Value	2,108	
Purchase price	1,138	
Fair value of non-controlling interest	1,034	
Contingent consideration receivable	(64)	
Total amount to be allocated	2,108	

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Acquisition of Sou Yi Lian Mei

The following table summarized the assignment of fair value to identifiable assets and liabilities assumed as of December 20, 2011 (the acquisition date of Sou Yi Lian Mei):

	Fair Value US$('000)	Amortization Period (Years)
Cash and cash equivalents	$ 310	
Receivables and prepayments	1,957	
Other current assets	23	
Property and equipment, net	33	
Other current liabilities	(2,140)	
Deferred tax liabilities	(1,266)	
Acquired intangible assets:		
Domain Name	1,512	Indefinite
Customer Relationship	2,085	5
Non-Compete Agreement	1,148	6
Software technologies	321	5
Goodwill:		
Assembled Workforce	42	
Other unidentifiable intangibles	8,963	
	9,005	
Total Value	12,988	
Purchase price	8,078	
Fair value of non-controlling interest	5,021	
Contingent consideration receivable	(111)	
Total amount to be allocated	12,988	

The operating results of these acquirees are only included from the date of their respective acquisition dates. For the year ended December 31, 2011, the financial performance of the acquirees reported in the Company's consolidated statements of income and comprehensive income includes sales of approximately US$1,474,000 and net income before allocation to noncontrolling interests of approximately US$441,000.

The following unaudited pro-forma financial results for the year ended December 31, 2011 and 2010, combines the historical operating results of the Company with those of Quanzhou Zhi Yuan, Quanzhou Tian Xi Shun He and Sou Yi Lian Mei in the aggregate, as if these acquisitions had been completed as of the beginning of the reporting periods, and also includes the adjustments for the business combination effect of the amortization charges from acquired intangible assets and the related tax effects. (Amounts in thousands, except for per share data):

	Year ended December 31, 2011	2010
Revenue	$ 35,659	$ 47,717

Net income before allocation to the noncontrolling interests	$ 4,508	$ 17,556
Earnings per share-Basic	$ 0.19	$ 0.99
Earnings per share-Diluted	$ 0.19	$ 0.84

The pro forma information does not necessarily reflect the actual results that would have occurred nor is it necessarily indicative of future results of operations.

5. Cash and cash equivalent

	As of December 31,	
	2011	2010
	US$('000)	US$('000)
Cash	181	39
Bank deposit	10,514	15,551
	10,695	15,590

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6. Accounts receivable, net

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Accounts receivable	6,546	4,319
Allowance for doubtful debts	(2,102)	-
Accounts receivable, net	4,444	4,319

All of the accounts receivable are non-interest bearing. Based on the assessment of the collectability of the accounts receivable as of December 31, 2011, the Company provided approximately US$2,102,000 allowance for doubtful debts for the year ended December 31, 2011, which was related to the accounts receivable of the Company's internet advertising business segment with an aging over six months.

7. Other receivables, net

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Short-term loan for marketing campaign	2,985	3,781
Short-term loans to third parties	-	3,781
Staff advances for normal business purpose	279	249
Overdue contract execution deposits	891	-
Allowance for doubtful debts	(524)	-
Other receivables, net	3,631	7,811

Short-term loan for marketing campaign: for one of the major marketing campaigns, the Company made a marketing-related loan of RMB25,000,000 (approximately US$3,781,000) to a TV series of 36 episodes, called "Xiao Zhang Feng Yun". This TV series was produced for the commemoration of "The Republican Revolution of 1911" (the Chinese bourgeois democratic revolution led by Dr. Sun Yat-sen which overthrew the Qing Dynasty). By participating in this TV series, the Company will be shown during the credit at the closing of each episode with its logo presented and also shown as a separate card during the closing before the credit screen. This TV series has been broadcasted on CCTV 8 and www.sina.com.cn from September 2011 and is continually selling its broadcasting rights to other provincial TV channels for additional exposure. In November and December, 2011, the Company collected its first two repayments of RMB6,000,000 (approximately US$942,700) in the aggregate from the borrower. In accordance with the communication between the Company and the debtor, the Company has extended the term of this loan from December 31, 2011 to December 31, 2012, as this TV series had only completed its first round selling broadcasting rights. The Company will continue to assess the collectability of this loan and if an event occurs or circumstances change that could indicate that the collectability of this loan is remote, a full allowance of bad debts provision will be provided for the remaining outstanding balance of this loan.

The Company lends third parties on a subjective condition of search and/or obtaining other potential value added communication channel resources with lower cost from time to time. Any of the third parties is required to pay back the capital within three months or on demand if they have not contributed any searches. The acquired resources are mainly used to self-advertising and marketing or advertising for clients in internet bundle packages in second and third tier cities or regions. The outstanding third party loans as of December 31, 2010 were paid in full in March 2011. As of December 31, 2011, there was no third party loan outstanding under these arrangements.

For all advertising resources purchase contracts signed by the Company with its resources providers, the Company is required to deposit contract execution guarantees, the contract execution guarantees will be used to offset the contact amount need to be paid for the resources provided in the last month of each contract period or refunded to the company upon expiration of the purchase contract. Overdue contract execution deposits as of December 31, 2011 represented the portion of the contract execution deposits, which related advertising resources purchase contracts had been completed as of December 31, 2011. Based on the assessment of the collectability of these overdue contract execution deposits as of December 31, 2011, the Company provided approximately US$524,000 allowance for doubtful debts for the year ended December 31, 2011, which was related to the contract execution deposits of its TV advertising business segment.

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8. Prepayments and deposit to suppliers

	As of December 31, 2011 US$('000)	2010 US$('000)
Contract execution guarantees to TV advertisement and internet resources providers	10,050	2,778
Prepayments to TV advertisement and internet resources providers	5,285	413
Prepayment to online game operating service provider	-	91
Other deposits and prepayments	25	43
	15,360	3,325

Contract execution guarantees to TV advertisement and internet resource providers are paid as contractual deposits to the Company's resources and services providers. These amounts will be used to offset the contact amount and service fee need to be paid for the resources and services provided in the last month of each contract period or refunded to the Company upon expiration of the purchase contracts.

According to the contracts signed between the Company and its suppliers, the Company is normally required to pay the contract amount in advance. These prepayments will be transferred to cost of sales when the related services are provided.

9. Due from related parties

	As of December 31, 2011 US$('000)	2010 US$('000)
Beijing Fengshangyinli Technology Co., Ltd.	113	-
Beijing Saimeiwei Food Equipment Technology Co., Ltd.	74	-
Beijing Telijie Century Environmental Technology Co., Ltd.	137	39
Sou Yi Lian Mei Advertising Co., Ltd.	-	146
	324	185

These related parties are directly or indirectly owned by the Control Group or the management of the Company. Control Group refers to Mr. Handong Cheng, Mr. Xuanfu Liu and Ms. Li Sun (acting as nominee for Mr. Zhang Zhige), the owners of the Company's PRC VIEs, Business Opportunities Online and Beijing CNET Online before the Offshore Restructuring. The Company provided advertising services to these related parties or purchased advertising resources on behalf of these related parties during the years ended December 31, 2011 and 2010. Due from related parties as of December 31, 2011 and 2010 represented the outstanding receivables from these related parties for the services the Company provided to them.

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10. Deposit for acquisitions

	As of December 31, 2011 US$('000)	2010 US$('000)
Quanzhou Zhi Yuan	-	983
Quanzhou Tian Xi Shun He	-	529
	-	1,512

In accordance with the acquisition agreement the Company entered into with the shareholders of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He on December 18, 2010 and December 22, 2010, respectively, the Company prepaid RMB6,500,000 (approximately US$983,000) and RMB3,500,000 (approximately US$529,000) of the cash consideration for the acquisition of a 100% equity interest in Quanzhou Zhi Yuan and a 51% equity interest in Quanzhou Tian Xi Shun He, respectively, as deposits to an independent agent who was entrusted by both of the counter-parties upon signing the agreement. The shareholders of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He would then fulfill the related obligations and process the relevant legal procedures and formalities as required in the acquisition agreements to complete the transaction. As agreed by all parties, the completion dates of these acquisition transactions and the transfer of the control of the acquirees were the dates that the equity interest transfers were approved by, and registered with, the relevant PRC government authorities and the prepaid cash consideration would be released to the shareholders of the acquirees on their respective transaction completion date. Therefore, as of December 31, 2010, the cash considerations prepaid were recorded as deposit for acquisitions.

On January 4, 2011 and February 23, 2011, the acquisition of a 100% equity interest in Quanzhou Zhi Yuan and the acquisition of a 51% equity interest in Quanzhou Tian Xi Shun He were approved by, and registered with, the relevant PRC government authorities of Quanzhou City, Fujian Province, respectively, and the prepaid cash considerations deposits were released to the shareholders of the acquirees in accordance. The Company determined the acquisition dates of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He as of January 4, 2011 and February 23, 2011, respectively, and the prepaid cash deposits were accounted for as part of the purchase price allocation (see Note 4).

11. Contingent consideration receivables

	Amount US$('000)
Balance as of January 1, 2011	-
Recognized from acquisition of VIEs: (Note 4)	
--Quanzhou Zhi Yuan	52
--Quanzhou Tian Xi Shun He	64
--Sou Yi Lian Mei	111
Changes in fair value of contingent consideration receivables	(72)
Exchange translation adjustment	4
Balance as of December 31, 2011	159

According to the acquisition agreements the Company entered into with Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He, if audited pretax profit for 2011 and 2012 increases by less than 30% while compared to that of the prior year, the sellers shall compensate the Company for the difference between the target pretax profit and actual results achieved in cash. Fair value of the contingently consideration receivable as of the respective acquisition date of

Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He was approximately US$52,000 and US$64,000, respectively (See Note 4). As Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He have both achieved its respective target pre-tax profit for the year ended December 31, 2011, they will not compensate the Company any cash in accordance with the acquisition agreement. The Company reassessed the fair value of these contingent consideration receivables as of December 31, 2011 for the respective make good arrangement for the year ended December 31, 2012, based on their respectively historical performance and other relevant assumptions. The changes in the fair value of the contingent consideration receivables for the year ended December 31, 2011 was included in the Company's statement of income and comprehensive income.

According to the acquisition agreement the Company entered into with Sou Yi Lian Mei, if Sou Yi Lian Mei achieved less than 95% of its 2012 Performance Threshold, which is RMB15,800,000 (approximately US$2.4 million) of audited after tax net profit for the year ended December 31, 2012, the noncontrolling shareholder of Sou Yi Lian Mei shall compensation the Company the shortfall between the 95% of 2012 Performance Threshold and actual audited after tax net profit for fiscal year 2012. Fair value of the contingently consideration receivable as of the acquisition date of Sou Yi Lian Mei was approximately US$111,000 (See Note 4).

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12. Investment in and advance to equity investment affiliates

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Investment in equity investment affiliates	1,354	1,112
Advance to equity investment affiliates	42	6,050
	1,396	7,162

The following table summarizes the movement of the investment in and advance to equity investment affiliates for the year ended December 31, 2011:

	Beijing Yang Guang US$('000)	Shenzhen Mingshan US$('000)	Zhao Shang Ke Hubei US$('000)	Total US$('000)
Balance as of December 31, 2010	7,162	-	-	7,162
Deconsolidation of Shenzhen Mingshan	-	395	-	395
Gain on deconsolidation of Shenzhen Mingshan	-	237	-	237
Advance to Shenzhen Mingshan	-	42	-	42
Loan to Beijing Yang Guang	1,571	-	-	1,571
Loan repayment from Beijing Yang Guang	(7,856)	-	-	(7,856)
Additional investment to Shenzhen Mingshan	-	170	-	170
Share of earnings (losses) in equity investment affiliates	26	(249)	-	(223)
Disposal of investment in Beijing Yang Guang	(1,181)	-	-	(1,181)
Deconsolidation of Zhao Shang Ke Hubei	-	-	97	97
Gain on deconsolidation of Zhao Shang Ke Hubei	-	-	704	704
Exchange translation adjustment	278	-	-	278
Balances as of December 31, 2011	-	595	801	1,396

Beijing Yang Guang:

Beijing Yang Guang was incorporated on October 25, 2010. On December 8, 2010, one of the Company's VIEs, Shanghai Jing Yang acquired a 49% interest in Beijing Yang Guang for cash consideration of RMB7,350,000 (approximately US$1,112,000) and became the noncontrolling interest holder of Beijing Yang Guang. The investment in Beijing Yang Guang was accounted for under the equity method until the Company withdrew its investment and ceased to have any noncontolling interest in Beijing Yang Guang in August 2011.

The Company did not recognize its pro-rata share of losses in Beijing Yang Guang for the year ended December 31, 2010 as the amount is immaterial. For the year ended December 31, 2011, before the Company disposed its investment in Beijing Yang Guang, the Company recognized its pro-rata share of earnings in Beijing Yang Guang of approximately US$26,000, which was reflected in the caption of "Share of earnings (losses) in equity investment affiliates" in the Company's consolidated statements of income and comprehensive income with a corresponding increase to the carrying value of the investment in Beijing Yang Guang in the Company's consolidated balance sheet.

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In August 2011, the Company withdrew its investment in Beijing Yang Guang and sold back its 49% equity interest to the majority shareholder of Beijing Yang Guang for cash consideration equal to the amount the Company paid for the acquisition of the 49% equity interest in December 2010, which amount has been fully collected as of December 31, 2011. In November 2011, Beijing Yang Guang also distributed to the Company its pro-rata share of net income of approximately US$26,000, generated by Beijing Yang Guang during the period when the Company held 49% of the equity interest of Beijing Yang Guang.

As of December 31, 2011, the Company collected the aggregate of RMB50,000,000 (approximately US$7,856,000) working capital loan borrowed by Beijing Yang Guang in 2010 and 2011, which was the total amount due under the loan.

Shenzhen Mingshan:

Shenzhen Mingshan was incorporated on June 24, 2010 by one of the Company's VIEs, Business Opportunities Online and three other individuals who were not affiliated with the Company. Shenzhen Mingshan was 51% owned by the Company and was a consolidated subsidiary of the Company from the date of incorporation through January 6, 2011. On January 6, 2011, an independent third party investor invested RMB15,000,000 (approximately US$2,357,000) cash into Shenzhen Mingshan in exchange for a 60% equity interest in Shenzhen Mingshan. The Company's share of equity interest decreased from 51% to 20.4% accordingly. The carrying value of the investment to Shenzhen Mingshan upon the deconsolidation of approximately US$395,000 was included in the balance sheet as "Investment in equity investment affiliates".

The deconsolidation of Shenzhen Mingshan was accounted for in accordance with ASC Topic 810 "Consolidation". The Company recognized a gain of approximately US$237,000 upon deconsolidation of Shenzhen Mingshan, which has been recorded as a gain on deconsolidation of subsidiaries in the Company's consolidated statements of income and comprehensive income with a corresponding increase in the carrying value of the investment in Shenzhen Mingshan in the Company's consolidated balance sheet. This gain represents the excess of the fair value of the Company's retained equity interest over its carrying value as of the date of deconsolidation.

The Company determined the estimated fair value of its retained equity interest in Shenzhen Mingshan based on the valuation of Shenzhen Mingshan used when an independent third party investor purchased an equity interest in Shenzhen Mingshan, which purchase price was negotiated on an arm's length basis. Under these circumstances, the Company estimated the fair value of its retained equity interest based on the fair value of the equity interest purchased by the independent third party investor.

In March 2011, the Company, through its wholly-owned subsidiary Rise King WFOE, sold some spared computer servers to Shenzhen Mingshan for approximately US$42,000. The Company does not intend to collect this amount within one year, as the amount is immaterial. Therefore, this balance was recorded as part of the long-term investment to Shenzhen Mingshan.

In August 2011, the Company made an additional capital injection of RMB1,080,000 (approximately US$170,000) in cash to Shenzhen Mingshan for its portion of the unpaid registered capital, which was required to be fully contributed within two years from the incorporation of Shenzhen Mingshan. This amount was recorded as an increase in investment in equity investment affiliates in the Company's consolidated balance sheet.

The Company applied the equity method of accounting prospectively from the date immediately after the deconsolidation. For the year ended December 31, 2011, the Company recognized its pro-rata share of losses in

Shenzhen Mingshan of approximately US$249,000, which was reflected in the caption of "Share of earnings (losses) in equity investment affiliates" in the Company's consolidated statements of income and comprehensive income with a corresponding decrease to the carrying value of the investment in Shenzhen Mingshan in the Company's consolidated balance sheet.

Zhao Shang Ke Hubei:

Zhao Shang Ke Hubei was incorporated on April 18, 2011 by one of the Company's VIEs, Business Opportunities Online Hubei and a co-founding individual who was not affiliated with the Company. Zhao Shang Ke Hubei was 51% owned by the Company and was a consolidated subsidiary of the Company from the date of incorporation through December 29, 2011. On December 29, 2011, two independent third party investors invested RMB10,000,000 (approximately US$1,571,000) cash into Zhao Shang Ke Hubei in exchange for an aggregate 50% equity interest in Zhao Shang Ke Hubei. The Company's share of equity interest decreased from 51% to 25.5% accordingly. The carrying value of the investment to Zhao Shang Ke Hubei upon deconsolidation of approximately US$97,000 was included in the balance sheet as "Investment in equity investment affiliates".

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The deconsolidation of Zhao Shang Ke Hubei was accounted for in accordance with ASC Topic 810 “Consolidation”. The Company recognized a gain of approximately US$704,000 upon deconsolidation of Zhao Shang Ke Hubei, which has been recorded as a gain on deconsolidation of subsidiaries in the Company’s consolidated statements of income and comprehensive income with a corresponding increase in the carrying value of the investment in Zhao Shang Ke Hubei in the Company’s consolidated balance sheet. This gain represents the excess of the fair value of the Company’s retained equity interest over its carrying value as of the date of deconsolidation.

The Company determined the estimated fair value of its retained equity interest in Zhao Shang Ke Hubei based on the valuation of Zhao Shang Ke Hubei used when the two independent third party investors purchased equity interest in Zhao Shang Ke Hubei, which purchase price was negotiated on an arm’s length basis. Under these circumstances, the Company estimated the fair value of its retained equity interest based on the fair value of equity interest purchased by the independent third party investors.

The Company applied the equity method of accounting prospectively from the date immediately after the deconsolidation. For the year ended December 31, 2011, the Company did not recognize its pro-rata share of losses in Zhao Shang Ke Hubei as the amount is immaterial.

13. Property and equipment, net

	As of December 31,	
	2011	2010
	US$(’000)	US$(’000)
Vehicles	683	584
Office equipment	1,399	1,183
Electronic devices	1,196	969
Property and equipment, cost	3,278	2,736
Less: accumulated depreciation	(1,376)	(726)
Property and equipment, net	1,902	2,010

Depreciation expenses in aggregate for the years ended December 31, 2011 and 2010 were approximately US$551,000 and $383,000, respectively.

14. Intangible assets, net

	As of December 31,	
	2011	2010
	US$(’000)	US$(’000)
Intangible assets not subject to amortization:		
Trade name	306	-
Domain name	1,518	-
Intangible assets subject to amortization:		-
Contract backlog	195	-
Customer relationship	3,408	-
Non-compete agreements	1,348	-
Software technologies	322	-
Cloud-computing based software platforms	1,458	-
Other computer software	75	61

Intangible assets, cost	8,630	61
Less: accumulated amortization	(479)	(10)
Intangible assets, net	8,151	51

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Trade name, Domain name, Contract backlog, Customer relationship, Non-compete agreements and Software technologies were acquired through the acquisition transactions described in Note 4.

On July 1, 2011, one of the Company's VIEs, Business Opportunity Online Hubei, and an individual who was not affiliated with the Company formed a new company, Sheng Tian Network Technology (Hubei) Co., Ltd ("Sheng Tian Hubei"), which was 51% owned by Business Opportunity Online Hubei and 49% owned by this individual. In addition, Business Opportunity Online Hubei, entered into a software platform and technology purchase agreement with this individual. The agreement provides that the purchase price shall be based on a valuation of RMB18,200,000 (approximately US$2,860,000), and Business Opportunity Online shall pay RMB9,282,000 (approximately US$1,458,000) and own 51% of these software platforms and the related technology accordingly. The agreement stipulates that the seller shall transfer all software platforms and the related documentations to Sheng Tian Hubei and provide assistance for the registration of the software platforms and the related technology in the name of Sheng Tian Hubei. The agreement also provides that the seller shall dismiss all human resources for the business activities related to the software platforms from the date of this agreement and provide assistance for Sheng Tian Hubei to re-employ the necessary technology staff from the seller upon establishment of Sheng Tian Hubei to ensure a smooth transitioning of the activities related to the software platforms. These software platforms are all based on the cloud-computing technology and will be further consolidated and integrated into the Company's advertising and marketing platform and mainly, management tools platform and packed into different value-added services to be provided to its clients. These cloud-computing technology based software platforms were recorded at cost and amortized on a straight line basis for an estimated economic life of ten years.

Amortization expenses in aggregate for the year ended December 31, 2011 and 2010 were approximately US$461,000 and US$10,000, respectively.

Based on the carrying value of the finite-lived intangible assets recorded as of December 31, 2011, and assuming no subsequent impairment of the underlying intangible assets, the estimated future amortization expenses is approximately US$1,014,000 per year through December 31, 2015 and approximately US$975,000 for the year ended December 31, 2016.

15. Goodwill

	Amount US$('000)
Balance as of January 1, 2011	-
Acquisitions: (Note 4)	
--Quanzhou Zhi Yuan	728
--Quanzhou Tian Xi Shun He	1,166
--Sou Yi Lian Mei	9,005
Exchange translation adjustment	100
Balance as of December 31, 2011	10,999

16. Accrued payroll and other accruals

	As of December 31,	
	2011	2010
	US$('000)	US$('000)

Accrued payroll and staff welfare	344	258
Accrued operating expenses	272	212
	616	470

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17. Due to equity investment affiliate

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Zhao Shang Ke Hubei	220	-

Zhao Shang Ke Hubei became an equity investment affiliate of the Company immediately after the deconsolidation (See Note 12). Amounts due to Zhao Shang Ke Hubei as of December 31, 2011 was a temporary non-interest bearing working capital loan borrow by one of the Company's VIE from Zhao Shang Ke Hubei.

18. Due to related parties

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Shiji Huigu Technology Investment Co., Ltd	-	91
Beijing Saimeiwei Food Equipments Technology Co., Ltd	4	3
Beijing Telijie Century Environmental Technology Co., Ltd.	-	45
Due to legal (nominal) shareholders of Shanghai Jing Yang	157	152
	161	291

The related parties listed above are directly or indirectly owned by the Control Group (See Note 9), the Company provided advertising services to them. The advance payments listed above are received from these parties for advertising services will be provided in the future periods.

Shanghai Jing Yang was incorporated in December 2009 by the Company's senior management, prior to entering into the Contractual Agreements with the Company (see Note 1), the legal shareholders contributed RMB1,000,000 (approximately US$157,000) as the original paid-in capital of Shanghai Jing Yang upon incorporation. This amount will be returned to the legal (nominal) shareholders of Shanghai Jing Yang in the first half of 2012.

19. Due to Control Group

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Due to Control Group	-	81

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Due to Control Group represents the outstanding balance due to the Control Group for the costs and operating expenses paid by them on behalf of the Company. As of December 31, 2011, the Company had settled the balance to the Control Group.

20. Due to director

	As of December 31,	
	2011	2010
	US$('000)	US$('000)
Due to director	-	559

Due to director represents the operating expenses paid by director on behalf of the Company. As of December 31, 2011, the Company has settled the balance to the director.

21. Payable for acquisition

	As of December 31,	
	2011	2010
	US$('000)	US$('000)
Sou Yi Lian Mei	550	-

Payable for acquisition represented the outstanding payment of RMB3,500,000 (approximately US$550,000) for the acquisition transaction of Sou Yi Lian Mei as of December 31, 2011.

22. Taxation

1) Income tax

The entities within the Company file separate tax returns in the respective tax jurisdictions in which they operate.

i). The Company is incorporated in the state of Nevada. Under the current law of Nevada, the company is not subject to state corporate income tax. Following the Share Exchange, the Company became a holding company and does not conduct any substantial operations of its own. No provision for federal corporate income tax has been made in the financial statements as the Company has no assessable profits for the year ended December 31, 2011 and 2010, or any prior periods. The Company does not provide for U.S. taxes or foreign withholding taxes on undistributed earnings from its non-U.S. subsidiaries because such earnings are intended to be reinvested indefinitely. If undistributed earnings were distributed, foreign tax credits could become available under current law to reduce the resulting U.S. income tax liability.

ii). China Net BVI was incorporated in the British Virgin Islands ("BVI"). Under the current law of the BVI, China Net BVI is not subject to tax on income or capital gains. Additionally, upon payments of dividends by China Net BVI to its shareholders, no BVI withholding tax will be imposed.

iii). China Net HK was incorporated in Hong Kong and does not conduct any substantial operations of its own. No provision for Hong Kong profits tax has been made in the financial statements as China Net HK has no assessable profits for the year ended December 31, 2011 and 2010 or any prior periods. Additionally, upon payments of dividends by China Net HK to its shareholders, no Hong Kong withholding tax will be imposed.

iv). The Company's PRC operating subsidiary and VIEs, being incorporated in the PRC, are governed by the income tax law of the PRC and is subject to PRC enterprise income tax ("EIT"). Effective from January 1, 2008, the EIT rate of PRC was changed from 33% to 25%, and applies to both domestic and foreign invested enterprises.

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- Rise King WFOE is a software company qualified by the related PRC governmental authorities and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a two-year EIT exemption from its first profitable year and a 50% reduction of its applicable EIT rate, which is 25% to 12.5% of its taxable income for the succeeding three years. Rise King WFOE had a net loss for the year ended December 31, 2008 and its first profitable year was fiscal year 2009 which has been verified by the local tax bureau by accepting the application filed by the Company. Therefore, it was approved to be entitled to a two-year EIT exemption for fiscal year 2009 through fiscal year 2010 and a 50% reduction of its applicable EIT rate which is 25% to 12.5% for fiscal year 2011 through fiscal year 2013. Therefore, for the year ended December 31, 2011 and 2010, the applicable income tax rate for Rise King WFOE was 12.5% and nil%, respectively. After fiscal year 2013, the applicable income tax rate for Rise King WFOE will be 25% under the current EIT law of PRC.

- Business Opportunity Online was qualified as a High and New Technology Enterprise in Beijing High-Tech Zone in 2005 and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a three-year EIT exemption for fiscal year 2005 through fiscal year 2007 and a 50% reduction of its applicable EIT rate, which is 15% to 7.5% for the following three years for fiscal year 2008 through fiscal year 2010. However, in March 2007, a new enterprise income tax law (the "New EIT") in the PRC was enacted which was effective on January 1, 2008. Subsequently, on April 14, 2008, relevant governmental regulatory authorities released new qualification criteria, application procedures and assessment processes for "High and New Technology Enterprise" status under the New EIT which would entitle the re-qualified and approved entities to a favorable statutory tax rate of 15%. Business Opportunity Online re-applied its qualification for a High and New Technology Enterprise in 2008 to the related PRC regulatory authorities. With an effective date of September 4, 2009, Business Opportunity Online obtained the approval of its reassessment of the qualification as a "High and New Technology Enterprise" under the New EIT law and was approved again by the local tax authorities to be entitled to a favorable statutory tax rate of 15%. Under the previous EIT laws and regulations, High and New Technology Enterprises enjoyed a favorable tax rate of 15% and were exempted from income tax for three years beginning with their first year of operations, and were entitled to a 50% tax reduction to 7.5% for the subsequent three years and 15% thereafter. The current EIT Law provides grandfathering treatment for enterprises that were (1) qualified as High and New Technology Enterprises under the previous EIT laws, and (2) established before March 16, 2007, if they continue to meet the criteria for High and New Technology Enterprises under the current EIT Law. The grandfathering provision allows Business Opportunity Online to continue enjoying their unexpired tax holidays provided by the previous EIT laws and regulations, as it was established in December 2004 and qualified as a High and New Technology Enterprises under the previous EIT laws in 2005. After the expiration of the current tax holiday as of December 31, 2010, the applicable income tax rate of Business Opportunity Online increased to 15%, the standard preferential income tax rate for a High and New Technology Enterprise. Therefore, for the year ended December 31, 2011 and 2010, the applicable income tax rate for Business Opportunity Online was 15% and 7.5%, respectively. Business Opportunity Online's High and New Technology Enterprise certificate will expire on September 4, 2012 and subject to an administrative review by the relevant PRC governmental regulatory authorities for obtaining the renewed certificate. As confirmed with the local tax authorities, if Business Opportunity Online fails to pass the administrative review, the enacted tax rate will be increased to 25% starting from January 1, 2012. Business Opportunity Online assessed the situation and concluded that more likely than not it will be able to pass this administrative review and continue to enjoy the 15% preferential income tax rate as a High and New Technology Enterprise.

- Business Opportunity Online Hubei, Hubei CNET and Zhao Shang Ke Hubei were all incorporated in Xiaotian Industrial Park of Xiaogan Economic Development Zone in Xiaogan City, Hubei province of the PRC in 2011. These operating entities have been approved by the related local government authorities to apply the deemed income tax method for its computation of income tax expense for the year ended December 31, 2011. Under the deemed income tax method, the deemed profit is calculated based on 10% of the total revenue and the applicable income tax rate is 25%. Therefore, the income tax expenses under the deemed income tax method is calculated as 2.5% of the total revenue recognized for the year ended December 31, 2011 for each of these operating entities. In December 2011, the local tax authorities of these operating entities informed the Company, that they will cancel the current applicable deemed income tax method for computation of income tax expenses starting from January 1, 2012 for these entities, but may refund certain amount of the income tax paid by these operating entities as an local subsidy to these entities. Therefore, the applicable income tax rate for these operating entities will be 25% starting from January 1, 2012.

l The applicable income tax rate for other PRC operating entities of the Company is 25% for the years ended December 31, 2011 and 2010.

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1 The New EIT also imposed a 10% withholding income tax for dividends distributed by a foreign invested enterprise to its immediate holding company outside China, which were exempted under the previous enterprise income tax law and rules. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% rate. Rise King WFOE is invested by immediate holding company in Hong Kong and will be entitled to the 5% preferential withholding tax rate upon distribution of the dividends to its immediate holding company.

All of the preferential income tax treatments enjoyed by the Company's PRC subsidiary and VIEs were based on the current applicable laws and regulations of the PRC and approved by the related government regulatory authorities and local tax authorities where the Company's respective PRC subsidiary and VIEs operate. Rise King WFOE, Business Opportunity Online, Business Opportunity Online Hubei, Hubei CNET and Zhao Shang Ke Hubei were most affected by these preferential income tax treatments within the structure of the Company for the year ended December 31, 2011 and 2010. The preferential income tax treatments are subject to change in accordance with the PRC government economic development policies and regulations. These preferential income tax treatments are mainly determined by the regulation and policies of the PRC government in the context of the overall economic policy and strategy. As a result, the uncertainty of theses preferential income tax treatments are subject to, but not limited to, the PRC government policy on supporting any specific industry's development under the outlook and strategy of overall macroeconomic development.

2) Business tax and relevant surcharges

Revenue of advertisement services is subject to 5.5% business tax and 3% cultural industry development surcharge of the net service income after deducting amount paid to ending media promulgators. Revenue of internet technical support services is subjected to 5.5% business tax. Business tax charged was included in cost of sales.

3) Value added tax

As a general value-added tax payer, revenue from sales of software of Rise King WFOE is subjected to 17% value added tax.

As of December 31, 2011 and 2010, taxes payable consists of:

	As of December 31,	
	2011	2010
	US$('000)	US$('000)
Business tax payable	2,210	1,147
Culture industry development surcharge payable	2	5
Value added tax payable	-	216
Enterprise income tax payable	2,770	759
Individual income tax payable	58	66
	5,040	2,193

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A reconciliation of the provision for income taxes determined at the US federal corporate income tax rate to the Company’s effective income tax rate is as follows:

	Year ended December 31, 2011 US$(’000)	2010 US$(’000)
Pre-tax income	4,035	16,727
US federal rate	35 %	35 %
Income tax expense computed at U.S. federal rate	1,412	5,854
Reconciling items:		
Rate differential for domestic earnings	(770)	(1,601)
Preferential tax treatments and tax holiday effects	(1,552)	(3,785)
Valuation allowance on deferred tax assets	1,921	401
Loss not recognized as deferred tax assets	-	109
Non-deductible expenses and non-taxable income	24	(626)
Effective income tax expense	1,035	352

For the year ended December 31, 2011 and 2010, the Company’s income tax expense consisted of:

	Year ended December 31, 2011 US$(’000)	2010 US$(’000)
Current-PRC	1,008	352
Deferred-PRC	27	-
	1,035	352

The Company’s deferred tax liabilities at December 31, 2011 and 2010 were as follows:

	Amount US$(’000)
Balance as of January 1, 2011	-
Tax effect of recognition of identifiable intangible assets acquired	1,751
Tax effect of gain on deconsolidation of subsidiaries	212
Reversal during the period	(93)
Exchange translation adjustment	23
Balance as of December 31, 2011	1,893

Deferred tax liabilities arose on the recognition of the identifiable intangible assets acquired from acquisition transactions described on Note 4.

Deferred tax liabilities arose on the gain on deconsolidation of subsidiaries upon deconsolidation of Shenzhen Mingshan and Zhao Shang Ke Hubei on January 6, 2011 and December 29, 2011, respectively, which was calculated based on the respective deconsolidation gain recognized and the respective corresponding enacted tax rate that will be in effect in the period in which the differences are expected to reverse.

Reversal during the year ended December 31, 2011 of approximately US$93,000, was due to the amortization of these acquired intangible assets.

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The Company's deferred tax assets at December 31, 2011 and 2010 were as follows:

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Tax effect of net operating losses carried forward	1,975	602
Bad debts provision	651	-
Valuation allowance	(2,534)	(602)
	92	-

The net operating losses carried forward incurred by the Company (excluding its PRC subsidiary and VIEs) were approximately US$5,381,000 and US$1,719,000 at December 31, 2011 and 2010, respectively, which will expire in years through 2031. A full valuation allowance has been recorded because it is considered more likely than not that the deferred tax assets will not be realized through sufficient future earnings of the entity to which the operating losses relate.

The net operating losses carried forward incurred by the Company's PRC subsidiary and VIEs were approximately US$361,000 and US$nil at December 31, 2011 and 2010, respectively, which will expire in years through 2016. The related deferred tax assets was calculated based on the respective net operating losses incurred by each of the PRC subsidiary and VIEs and the respective corresponding enacted tax rate that will be in effect in the period in which the differences are expected to reverse. No valuation allowance has been recorded because it is considered more likely than not that the deferred tax assets will be realized through sufficient future earnings of the entities to which the operating losses relate.

The bed debts provision recorded by the Company's PRC subsidiary and VIEs were approximately US$2,583,000. A full valuation allowance has been recorded because it is considered more likely than not that the deferred tax assets will not be realized through bad debts verification by the local tax authorities where the PRC subsidiary and VIEs operate.

23. Dividend payable

	As of December 31, 2011 US$('000)	As of December 31, 2010 US$('000)
Dividend payable to Series A convertible stock holders	5	255

Dividend to Series A convertible preferred stockholders was accrued at the per annum rate of 10% and calculated based on US$2.5 per share liquidation preference and the actual number of days of each share of the Series A convertible preferred stock outstanding for the year ended December 31, 2011 and 2010, respectively. For the years ended December 31, 2011 and 2010, the Company paid approximately US$657,000 and US$912,000 dividends to its Series A convertible preferred stockholders, respectively. The outstanding dividend payable of approximately US$5,000 as of December 31, 2011 was paid by the Company in February 2012.

24. Long-term borrowing from director

	As of December 31, 2011	As of December 31, 2010

	US$('000)	US$('000)
Long-term borrowing from director	137	132

Long-term borrowing from director was a non-interest bearing loan from a director of the Company relating to the original paid-in capital contribution in the Company's wholly-owned subsidiary Rise King WFOE.

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25. Series A convertible preferred shares and Warrants

On August 21, 2009, the Company entered into a securities purchase agreement (the “Purchase Agreement”), with several investors, including institutional, accredited and non-US persons and entities (the “Investors”), pursuant to which the Company sold units, comprised of 10% Series A Convertible Preferred Stock, par value US$0.001 per share (the “Series A preferred stock”), and two series of warrants, for a purchase price of US$2.50 per unit (the “August 2009 Financing”). The Company sold 4,121,600 units in the aggregate, which included (i) 4,121,600 shares of Series A preferred stock, (ii) Series A-1 Warrant to purchase 2,060,800 shares of common stock at an exercise price of US$3.00 per share with a three-year term, and (iii) Series A-2 Warrants to purchase 2,060,800 shares of common stock at an exercise price of US$3.75 with a five-year term. Net proceeds were approximately US$9,162,000, net of issuance costs of approximately US$1,142,000. TriPoint Global Equities, LLC acted as placement agent and received (i) a placement fee in the amount equal to 8% of the gross proceeds and (ii) warrants to purchase up to 329,728 shares of common stock at an exercise price of US$2.50, 164,864 shares at an exercise price of US$3.00 and 164,864 shares at an exercise price of US$3.75 respectively, with a five-year term (“Placement agent warrants” and together with the Series A-1 Warrant and Series A-2 Warrant, the “Warrants”).

Key terms of the Series A preferred stock sold by the Company in the August 2009 Financing are summarized as follows:

Dividends

Dividends on the Series A preferred stock shall accrue and be cumulative from and after the issuance date. For each outstanding share of Series A preferred stock, dividends are payable at the per annum rate of 10% of the Liquidation Preference Amount of the Series A preferred stock. Dividends are payable quarterly within thirty (30) days following the last Business Day of each August, November, February and May of each year (each, a “Dividend Payment Date”), and continuing until such stock is fully converted. The Company shall have the right, at its sole and exclusive option, to pay all or any portion of each and every quarterly dividend that is payable on each Dividend Payment Date, either (i) in cash, or (ii) by issuing to the holder of Series A preferred stock such number of additional Conversion Shares which, when multiplied by US$2.5 would equal the amount of such quarterly dividend not paid in cash.

Liquidation Preference

In the event of the liquidation, dissolution or winding up of the affairs of the Company, whether voluntary or involuntary (each, a “Liquidation”), the holders of the Series A preferred stock then outstanding shall be entitled to receive, out of the assets of the Company available for distribution to its stockholders, an amount equal to US$2.5 per share of the Series A preferred stock, plus any accrued but unpaid dividends thereon, whether or not declared, together with any other dividends declared but unpaid thereon, as of the date of Liquidation (collectively, the “Series A Liquidation Preference Amount”) before any payment shall be made or any assets distributed to the holders of the common stock or any other junior stock. If upon the occurrence of Liquidation, the assets thus distributed among the holders of the Series A shares shall be insufficient to permit the payment to such holders of the full Series A Preference Amount, then the entire assets of the Company legally available for distribution shall be distributed ratably among the holders of the Series A preferred stock.

Conversion Rights

Voluntary Conversion:

At any time on or after the date of the initial issuance of the Series A preferred stock, the holder of any such shares of Series A preferred stock may, at such holder's option, subject to the limitations described below in "Conversion Restriction", elect to convert all or portion of the shares of Series A preferred stock held by such person into a number of fully paid and non-assessable shares of common stock equal to the quotient of Liquidation preference amount of the Series A preferred stock divided by the initial conversion price of US$2.5. The initial conversion price may be adjusted for stock splits and combinations, dividend and distributions, reclassification, exchange or substitution, reorganization, merger, consolidation or sales of assets, issuance of additional shares of common stock or equivalents with lower price or without considerations etc, as stimulated in the Certification of Designation.

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Mandatory Conversion:

All outstanding shares of the Series A preferred stock shall automatically convert into shares of Common Stock, subject to the limitations described below in "Conversion Restriction", at the earlier to occur of (i) twenty-four month anniversary of the Closing Date, and (ii) at such time that the Volume Weighted Average Price of the Company's common stock is no less than US$5.00 for a period of ten (10) consecutive trading days with the daily volume of the common stock of at least 50,000 shares per day.

On August 21, 2011, 2,367,792 shares of the Company's outstanding Series A preferred stock, which has not been voluntarily converted into the Company's common shares, were fully converted to the Company's common shares under the Mandatory Conversion clause described above.

Registration Rights Agreement

In connection with the Financing, the Company entered into a registration rights agreement (the "RRA") with the Investors in which the Company agreed to file a registration statement (the "Registration Statement") with the Securities and Exchange Commission to register the shares of common stock underlying the Series A preferred stock (the "Conversion Shares") and the Warrants (the "Warrant Shares"), thirty (30) days after the closing of the Financing. The Company agreed to use its best efforts to have the Registration Statement declared effective within 150 calendar days after filing, or 180 calendar days after filing in the event the Registration Statement is subject to a "full review" by the SEC.

The Company is required to keep the Registration Statement continuously effective under the Securities Act until such date as is the earlier of the date when all of the securities covered by that registration statement have been sold or the date on which such securities may be sold without any restriction pursuant to Rule 144 (the "Financing Effectiveness Period"). The Company will pay liquidated damages of 2% of each holder's initial investment in the Units sold in the Financing per month, payable in cash, up to a maximum of 10%, if the Registration Statement is not filed or declared effective within the foregoing time periods or ceases to be effective prior to the expiration of the Financing Effectiveness Period. However, no liquidated damages shall be paid with respect to any securities being registered that the Company are not permitted to include in the Financing Registration Statement due to the SEC's application of Rule 415.

The Company evaluated the contingent obligation related to the RRA liquidated damages in accordance with "ASC Topic 825 "Financial Instruments" subtopic 20, which required the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement be separately recognized and measured in accordance with "ASC Topic 450" "Contingencies". The shares of common stock underlying the Series A preferred stock (the "Conversion Shares") and the Warrants (the "Warrant Shares") have been successfully registered by the Company as of December 31, 2009 and remained effective as of December 31, 2011. Therefore, the Company concluded that such obligation was not probable to incur and no contingent obligation related to the RRA liquidated damages needs to be recognized for the years ended December 31, 2011 and 2010.

Security Escrow Agreement

The Company entered into a securities escrow agreement with the Investors (the "Escrow Agreement"), pursuant to which Rise King Investment Limited, a British Virgin Islands company (the "Principal Stockholder"), initially placed 2,558,160 shares of Common Stock (the "Escrow Shares") into an escrow account. Of the Escrow Shares, 1,279,080 shares (equivalent to 50% of the Escrow Shares) were being held as security for the achievement of audited net income equal to or greater than $7.7 million for the fiscal year 2009 (the “2009 Performance Threshold”) and the remaining 1,279,080 of the Escrow Shares are being held as security for the achievement of audited net income equal to or greater than $14 million for the fiscal year 2010 (the “2010 Performance Threshold”).

If the Company achieves at least 95% of the applicable Performance Threshold, all of the Escrow Shares for the corresponding fiscal year shall be returned to the Principal Stockholder. If the Company achieves less than 95% of the applicable Performance Threshold, the Investors shall receive in the aggregate, on a pro rata basis (based upon the number of shares of Series A preferred stock or conversion shares owned by each such Investor as of the date of distribution of the Escrow Shares), 63,954 shares of the Escrow Shares for each percentage by which the applicable Performance Threshold was not achieved up to the total number of Escrow Shares for the applicable fiscal year. Any Escrow Shares not delivered to any investor because such investor no longer holds shares of Series A preferred stock or conversion shares shall be returned to the Principal Stockholder.

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For the purposes of the Escrow Agreement, net income is defined in accordance with US GAAP and reported by the Company in its audited financial statements for each of the fiscal years ended 2009 and 2010; provided, however, that net income for each of fiscal years ended 2009 and 2010 shall be increased by any non-cash charges incurred (i) as a result of the Financing , including without limitation, as a result of the issuance and/or conversion of the Series A Preferred Stock, and the issuance and/or exercise of the Warrants, (ii) as a result of the release of the Escrow Shares to the Principal Stockholder and/or the investors, as applicable, pursuant to the terms of the Escrow Agreement, (iii) as a result of the issuance of ordinary shares of the Principal Stockholder to Messrs. Handong Cheng and Xuanfu Liu and Ms. Li Sun (the "PRC Shareholders"), upon the exercise of options granted to the PRC Shareholders by the Principal Stockholder, (iv) as a result of the issuance of warrants to any placement agent and its designees in connection with the Financing, (v) the exercise of any warrants to purchase common stock outstanding and (vi) the issuance under any performance based equity incentive plan that the Company adopts.

Because both the 2009 and 2010 performance threshold had been met, the Escrow Shares were released to the Principal Stockholder in the middle of 2010 and 2011, respectively.

In accordance with ASC Topic 718 and ASU No. 2010-05—Compensation—Stock Compensation: Escrowed Share Arrangements and the Presumption of Compensation. The Company evaluated the substance of this arrangement and whether the presumption of compensation has been overcome. According to the Security Escrow Agreement signed between the Company and its investors, the release of these escrow shares to the Principal Stockholder was not contingent on continue employment, and this arrangement is in substance an inducement made to facilitate the financing transaction on behalf of the Company, rather than as compensatory. Therefore, the Company has accounted for the escrowed share arrangement according to its nature, and therefore did not recognize any non-cash compensation charge as a result of the Company satisfying both the 2009 and 2010 performance thresholds.

On December 1, 2011, the Company initiated an exchange offer (the "Offer") pursuant to which holders of certain of the Company's outstanding warrants (the "Warrants") to purchase an aggregate of 4,121,600 shares of the Company's common stock had the opportunity to acquire shares of the Company's common stock (the "Shares") through a warrant for share exchange. The Company issued the Shares in exchange for the Warrants in accordance with the following exchange ratios: (A) with respect to any Series A-1 Warrant, one (1) Share in exchange for every twenty (20) Shares for which such Series A-1 Warrant was exercisable, and (B) with respect to any Series A-2 Warrant, one (1) Share in exchange for every ten (10) Shares for which such Series A-2 Warrant was exercisable; provided that each holder must have exchanged all its Series A-1 Warrants and/or all its Series A-2 Warrants pursuant to the terms and conditions thereof. The Offer continued for a period of twenty (20) business days from December 1, 2011 and expired on December 30, 2011, at 5:00 p.m., Eastern Time. Based on information provided by Empire Stock Transfer Inc., the Company's stock transfer agent, and pursuant to the terms of the Offer, 1,418,800 Series A-1 Warrants were tendered in exchange for approximately 70,940 Shares and 356,800 Series A-2 Warrants were tendered in exchange for approximately 35,680 Shares, for a total of 1,775,600 Warrants exchanged for approximately 106,620 Shares. The Company had accepted for exchange all of the Warrants validly tendered and not withdrawn.

Warrants issued and outstanding at December 31, 2011 and changes during the year then ended are as follows:

	Warrants Outstanding			Warrants Exercisable		
	Number of underlying shares	Weighted Average Exercise Price	Average Remaining Contractual Life (years)	Number of underlying shares	Weighted Average Exercise Price	Average Remaining Contractual Life (years)

Balance, January 1, 2011	4,781,056	$3.31	2.77	4,781,056	$3.31	2.77
Granted / Vested	-			-		
Forfeited	-			-		
Exercised	-			-		
Exchanged in the Offer	(1,775,600)			(1,775,600)		
Balance, December 31, 2011	3,005,456	$3.41	2.21	3,005,456	$3.41	2.21

As the Offer related solely to warrants that were sold by the Company to investors in its August 2009 Financing and was accounted for as equity instrument since March 29, 2010 upon removal of the “Down-round protection” as described in Note 26. Therefore, this Offer for warrants exchange for common shares was accounted for as an equity transaction with no changes in fair value of instruments resulted from the exchange recognized in the statement of income and comprehensive income. The capital stock account has been adjusted to reflect the new issuance of the common shares with a corresponding decrease of additional paid-in capital account.

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26. Changes in fair value of Warrant

The Company analyzed the Warrants issued in the August 2009 Financing in accordance to ASC Topic 815 "Derivatives and Hedging" to determine whether the Warrants meet the definition of a derivative under ASC Topic 815 and if so, whether the Warrants meet the scope exception of ASC Topic 815, which is that contracts issued or held by the reporting entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity shall not be considered to be derivative instruments for purposes of ASC Topic 815. The Company adopted the provisions of ASC Topic 815 subtopic 40, which applies to any freestanding financial instruments or embedded features that have the characteristics of a derivative, as defined by ASC Topic 815 and to any freestanding financial instruments that are potentially settled in an entity's own common stock. As a result of adopting ASC Topic 815 subtopic 40, the Company originally concluded that the Warrants issued in the August 2009 financing should be treated as a derivative liability, because the Warrants were entitled to a price adjustment provision to allow the exercise price to be reduced, in the event the Company would issue or sell any additional shares of common stock at a price per share less than the then-applicable exercise price or without consideration, which is typically referred to as a "Down-round protection" or "anti-dilution" provision. According to ASC Topic 815 subtopic 40, the "Down-round protection" provision is not considered to be an input to the fair value of a fixed-for-fixed option on equity shares which leads the Warrants fail to be qualified as indexed to the Company's own stock and then to fail to meet the scope exceptions of ASC Topic 815. Therefore, the Company originally accounted for the Warrants as derivative liabilities under ASC Topic 815. Pursuant to ASC Topic 815, derivatives should be measured at fair value and re-measured at fair value with changes in fair value recorded in earnings at each reporting period.

On March 29, 2010, the Company and the holders of the Warrants entered into agreements to amend certain provisions of the Warrants. The amendment to the investor and placement agent warrants removes the "Down-round protection" rights that were applicable if the Company were to issue new shares of common stock or common stock equivalents at a price per share less than the exercise price of the Warrants. In addition, the amendment to the warrants added a provision to grant the holders of a majority of the warrants an approval right until December 31, 2010, over any new issuance of shares of common stock or common stock equivalents at a price per share less than the exercise price of the warrants.

As a result of this amendment, the Warrants issued in the August 2009 Financing were qualified as indexed to the Company's own stock and then met the scope exceptions of ASC Topic 815, and were eligible to be reclassified as equity. In accordance to ASC Topic 815, the classification of a contract should be reassessed at each balance sheet date. If the classification required under this ASC changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification. If a contract is reclassified from an asset or a liability to equity, gains or losses recorded to account for the contract at fair value during the period that the contract was classified as an asset or a liability should not be reversed. Therefore, the Company re-measured the fair value of the Warrants as of March 29, 2010, the date of the event that caused the classification, which was approximately US$7,703,000 and reclassified the amount to equity as additional paid-in capital. The gain of the changes in fair value during the period that the Warrants were classified as a derivative liability, which was approximately US$1,861,000 was recorded in earnings for the year ended December 31, 2010. As the Warrants have been reclassified to equity on March 29, 2010, no gain or loss of changes in fair value of the Warrants would be recorded thereafter.

The following table summarized the above transactions:

	As of March 29, 2010	As of December 31,	Changes in Fair Value (Gain)/Loss

		2009	
	US$'000	US$'000	US$'000
Fair value of the Warrants:			
Series A-1 warrant	3,606	4,513	(907)
Series A-2 warrant	3,256	4,019	(763)
Placement agent warrants	841	1,032	(191)
	7,703	9,564	(1,861)

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27. Restricted Net Assets

As most of the Company's operations are conducted through its PRC subsidiary and VIEs, the Company's ability to pay dividends is primarily dependent on receiving distributions of funds from its PRC subsidiary and VIEs. Relevant PRC statutory laws and regulations permit payments of dividends by its PRC subsidiary and VIEs only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations and after it has met the PRC requirements for appropriation to statutory reserves. Paid in capital of the PRC subsidiary and VIEs included in the Company's consolidated net assets are also non-distributable for dividend purposes.

In accordance with the PRC regulations on Enterprises with Foreign Investment, a WFOE established in the PRC is required to provide certain statutory reserves, namely general reserve fund, the enterprise expansion fund and staff welfare and bonus fund which are appropriated from net profit as reported in the enterprise's PRC statutory accounts. A WFOE is required to allocate at least 10% of its annual after-tax profit to the general reserve until such reserve has reached 50% of its registered capital based on the enterprise's PRC statutory accounts. Appropriations to the enterprise expansion fund and staff welfare and bonus fund are at the discretion of the board of directors. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. Rise King WFOE is subject to the above mandated restrictions on distributable profits. Additionally, in accordance with the Company Law of the PRC, a domestic enterprise is required to provide a statutory common reserve of at least 10% of its annual after-tax profit until such reserve has reached 50% of its registered capital based on the enterprise's PRC statutory accounts. A domestic enterprise is also required to provide for a discretionary surplus reserve, at the discretion of the board of directors. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends. All of the Company's PRC VIEs are subject to the above mandated restrictions on distributable profits.

As a result of these PRC laws and regulations, the Company's PRC subsidiary and VIEs are restricted in their ability to transfer a portion of their net assets to the Company. As of December 31, 2011 and 2010, net assets restricted in the aggregate, which includes paid-in capital and statutory reserve funds of the Company's PRC subsidiary and VIEs that are included in the Company's consolidated net assets, was approximately US$4.7 million and US$3.4 million, respectively.

The New PRC Enterprise Income Tax ("EIT") Law, which was effected on January 1, 2008, also imposed a 10% withholding income tax for dividends distributed by a foreign invested enterprise to its immediate holding company outside China, which were exempted under the previous EIT law. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% rate. Rise King WFOE is invested by its immediate holding company in Hong Kong and will be entitled to the 5% preferential withholding tax rate upon distribution of the dividends to its immediate holding company.

The ability of the Company's PRC subsidiary and VIEs to make dividends and other payments to the Company may also be restricted by changes in applicable foreign exchange and other laws and regulations.

Foreign currency exchange regulation in China is primarily governed by the following rules:

- Foreign Exchange Administration Rules (1996), as amended in August 2008, or the Exchange Rules;
- Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules.

Currently, under the Administration Rules, Renminbi is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the State Administration of Foerign Exchange (the “SAFE”) is obtained and prior registration with the SAFE is made. Foreign-invested enterprises like Rise King WFOE that need foreign exchange for the distribution of profits to its shareholders may effect payment from their foreign exchange accounts or purchase and pay foreign exchange rates at the designated foreign exchange banks to their foreign shareholders by producing board resolutions for such profit distribution. Based on their needs, foreign-invested enterprises are permitted to open foreign exchange settlement accounts for current account receipts and payments of foreign exchange along with specialized accounts for capital account receipts and payments of foreign exchange at certain designated foreign exchange banks.

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Although the current Exchange Rules allow the convertibility of Chinese Renminbi into foreign currency for current account items, conversion of Chinese Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of SAFE, which is under the authority of the People's Bank of China. These approvals, however, do not guarantee the availability of foreign currency conversion. The Company cannot be sure that it will be able to obtain all required conversion approvals for its operations or the Chinese regulatory authorities will not impose greater restrictions on the convertibility of Chinese Renminbi in the future. Currently, most of the Company's retained earnings are generated in Renminbi. Any future restrictions on currency exchanges may limit the Company's ability to use its retained earnings generated in Renminbi to make dividends or other payments in U.S. dollars or fund possible business activities outside China.

As of December 31, 2011 and 2010, there was approximately US$34.0 million and US$26.8 million retained earnings in the aggregate, respectively, which was generated by the Company's PRC subsidiary and VIEs in Renminbi included in the Company's consolidated net assets, aside from US$2.2 million and US$1.6 million statutory reserve funds as of December 31, 2011 and 2010, respectively, that may be affected by increased restrictions on currency exchanges in the future and accordingly may further limit the Company's PRC subsidiary' and VIEs' ability to make dividends or other payments in U.S. dollars to the Company, in addition to the approximately US$4.7 million and US$3.4 million restricted net assets as of December 31, 2011 and 2010, respectively, as discussed above.

28. Related party transactions

Revenue from related parties:

	Year ended December 31,	
	2011	2010
	US$('000)	US$('000)
-Beijing Saimeiwei Food Equipment Technology Co., Ltd,	85	278
-Beijing Fengshangyinli Technology Co., Ltd.	307	478
-Beijing Xiyue Technology Co., Ltd	-	51
-Beijing Telijie Century Environmental Technology Co., Ltd.	234	357
	626	1,164

Sales of fixed assets to an equity investment affiliate:

For the year ended December 31, 2011, Rise King WFOE sold some spared computer servers to Shenzhen Mingshan, the Company's equity investment affiliates for approximately US$36,000, the profit from this transaction which was included in the Company's consolidated earnings was approximately US$3,000.

29. Employee defined contribution plan

Full time employees of the Company in the PRC participate in a government mandated defined contribution plan, pursuant to which certain pension benefits, medical care, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require that the PRC subsidiaries of the Company make contributions to the government for these benefits based on certain percentages of the employees' salaries. The Company has no legal obligation for the benefits beyond the contributions made. The total amounts for such employee benefits, which were expensed as incurred, were approximately US$381,000 and US$245,000 for the years ended December 31, 2011 and 2010, respectively.

30. Concentration of risk

Credit risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, accounts receivable, other receivables and prepayments and deposits to suppliers. As of December 31, 2011 and 2010, substantially all of the Company's cash and cash equivalents were held by major financial institutions located in the PRC and Hong Kong, which management believes are of high credit quality.

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Risk arising from operations in foreign countries

All of the Company’s operations are conducted within the PRC. The Company’s operations in the PRC are subject to various political, economic, and other risks and uncertainties inherent in the PRC. Among other risks, the Company’s operations in the PRC are subject to the risks of restrictions on transfer of funds, changing taxation policies, foreign exchange restrictions; and political conditions and governmental regulations.

Currency convertibility risk

Significant part of the Company’s businesses is transacted in RMB, which is not freely convertible into foreign currencies. All foreign exchange transactions take place either through the People’s Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rates quoted by the People’s Bank of China. Approval of foreign currency payments by the People’s Bank of China or other regulatory institutions requires submitting a payment application form together with suppliers’ invoices and signed contracts. These exchange control measures imposed by the PRC government authorities may restrict the ability of the Company’s PRC subsidiary and VIEs to transfer its net assets, which to the Company through loans, advances or cash dividends.

Concentration of Supplier

For the year ended December 31, 2011, two suppliers individually accounted for 36% and 24% of the Company’s cost of sales, respectively. For the year ended December 31, 2010, three suppliers individually accounted for 20%, 20% and 11% of the Company’s cost of sales, respectively. Except for the afore-mentioned, there was no other single supplier who accounted for more than 10% of the Company’s cost of sales for the years ended December 31, 2011 and 2010, respectively.

31. Commitments

The following table sets forth the Company’s contractual obligations as of December 31, 2011:

	Server hosting and board-band lease US$(’000)	Purchase of TV advertisement time US$(’000)	Total US$(’000)
Year ended December 31,			
-2012	110	32,941	33,051
-Thereafter	-	-	-
Total	110	32,941	33,051

32. Segment reporting

The Company follows FASB ASC Topic 280, Segment Reporting, which requires that companies disclose segment data based on how management makes decisions about allocating resources to segments and evaluating their performance. Reportable operating segments include components of an entity about which separate financial information is available and which operating results are regularly reviewed by the chief operating decision maker (“CODM”) to make decisions about resources to be allocated to the segment and assess each operating segment’s performance.

Beginning on January 1, 2011, the Company combined the Internet Advertisement Resources Reselling segment and the Internet Information Management ("IIM") segment with the Internet Advertisement segment, due to the fact that the relative percentages of these two combined segments' financial performances were immaterial and will be immaterial to the Company's consolidated financial results for each of the reporting period. Certain prior period amounts have been regrouped to conform to the current period presentation. As a result of the acquisition of Quanzhou Zhi Yuan, Quanzhou Tianxi Shun He and the launch of Zhao Shang Ke Hubei, the Company also now operates in one more reportable business segment, Brand Management and Sales Channel Building.

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Year Ended December 31, 2011

	Internet Ad. US$ ('000)	TV Ad. US$ ('000)	Bank kiosk US$ ('000)	Brand management and sales channel building US$ ('000)	Others US$ ('000)	Inter-segment and reconciling item US$ ('000)	Total US$ ('000)
Revenue	19,981	6,448	487	1,829	-	(14)	28,731
Cost of sales	6,287	5,247	42	465		(14)	12,027
Total operating expenses	6,834	1,002	226	889	4,591 *	-	13,542
Including: Depreciation and amortization expense	263	76	191	387	95	-	1,012
Operating income(loss)	6,860	199	219	475	(4,591)	-	3,162
Changes in fair value of contingent consideration receivables	-	-	-	(70)	-	-	(70)
Gain on deconsolidation of subsidiaries	-	-	-	693	232	-	925
Share of earnings (losses) in equity investment affiliates	-	26	-	-	(245)	-	(219)
Expenditure for long-term assets	1,564	4	186	417	15	-	2,186
Net income (loss)	6,247	179	219	769	(4,633)	-	2,781
Total assets	61,741	15,954	800	6,369	16,305	(43,887)	57,282

*Including approximate US$2,900,000 share-based compensation expenses.

Year ended December 31, 2010

	Internet Ad. US$ ('000)	TV Ad. US$ ('000)	Bank kiosk US$ ('000)	Brand management and sales channel building US$ ('000)	Others US$ ('000)	Inter-segment and reconciling item US$ ('000)	Total US$ ('000)
Revenue	28,563	12,493	531	-	596	(596)	41,587
Cost of sales	6,879	11,974	45	-	72	-	18,970
Total operating expenses	4,980	459	232	-	2,695 *	(596)	7,770
Including: Depreciation and amortization expense	169	121	111	-	64	-	465
Operating income(loss)	16,704	60	254	-	(2,171)	-	14,847

Changes in fair value of warrants	-	-	-	-	1,861	-	1,861
Expenditure for long-term assets	287	5	503	-	266	-	1,061
Net income (loss)	16,363	58	254	-	(300)	-	16,375
Total assets	32,103	5,864	774	-	19,231	(15,976)	41,996

*Including approximate US$337,000 share-based compensation expenses.

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33. Earnings per share

Basic and diluted earnings per share for each of the periods presented are calculated as follows:

	Year ended December 31, 2011 US$('000)		Year ended December 31, 2010 US$('000)
	(Amount in thousands except for the number of shares and per share data)		
Net income attributable to ChinaNet Online Holdings, Inc.	$ 2,995		$ 16,589
Dividend for Series A convertible preferred stock	(407)		(794)
Net income attributable to common shareholders of ChinaNet Online Holdings, Inc. (numerator for basic earnings per share)	2,588		15,795
Dividend for Series A convertible preferred stock	-	(1)	794
Net income attributable to common shareholders of ChinaNet Online Holdings, Inc. (numerator for diluted earnings per share)	2,588		16,589
Weighted average number of common shares outstanding - Basic	18,545,609		16,778,176
Effect of diluted securities:			
Series A Convertible preferred stock	-	(1)	3,178,402
Warrants	213,631		939,483
Weighted average number of common shares outstanding -Diluted	18,759,240		20,896,061
Earnings per share-Basic	$ 0.14		$ 0.94
Earnings per share-Diluted	$ 0.14		$ 0.79

(1) The diluted earnings per share calculation for the year ended December 31, 2011 did not include the effect of the 1,625,526 incremental shares resulted from assumed conversion of the convertible preferred stock, because their effect were anti-dilutive.

34. Share-based compensation expenses

On June 17, 2009, the Company entered into a one-year agreement to engage J and M Group, LLC ("J&M") to provide investor relations services. As additional compensation, the Company issued J&M 120,000 shares of the Company's common stock. The shares were issued in accordance with the exemption from the registration provisions of the Securities Act of 1933, as amended, provided by Section 4(2) of such Act for issuances not involving any public offering. These shares were valued at $0.15 per share, the closing bid price of the Company's common stock on the date of grant and the related compensation expenses were amortized over the requisite service period. Total compensation expenses recognized for the year ended December 31, 2011 and 2010 was US$nil and US$9,000, respectively.

On July 1, 2009, the Company entered into a one-year agreement to engage Hayden Communications International, Inc. ("HCI") to provide investor relations services. As additional compensation, the Company issued HCI 80,000 shares of the Company's common stock. The shares were issued in accordance with the exemption from the registration provisions of the Securities Act of 1933, as amended, provided by Section 4(2) of such Act for issuances not involving any public offering. These shares were valued at $1.75 per share, the closing bid price of the Company's common stock on the date of grant and the related compensation expenses were amortized over the requisite service period. Total compensation expenses recognized for the year ended December 31, 2011 and 2010 was US$nil and US$70,000, respectively.

On July 1, 2010, the Company entered into a six-month agreement to engage Chesapeake Group Inc. ("Chesapeake") to provide investor relations services. As compensation, the Company issued Chesapeake 30,000 restricted shares of the Company's common stock. The shares were issued in accordance with the exemption from the registration provisions of the Securities Act of 1933, as amended, provided by Section 4(2) of such Act for issuances not involving any public offering. These shares were valued at $3.70 per share, the closing bid price of the Company's common stock on the date of grant and the related compensation expenses were amortized over the requisite service period. Total compensation expenses recognized for the year ended December 31, 2011 and 2010 was US$nil and US$111,000, respectively.

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On July 12, 2010, the Company renewed the investor relations service contract with Hayden Communications International, Inc. (“HCI”) for an18-month service contract commencing July 12, 2010. As additional compensation, the Company issued HCI 60,000 restricted shares of the Company’s common stock. The shares were issued in accordance with the exemption from the registration provisions of the Securities Act of 1933, as amended, provided by Section 4(2) of such Act for issuances not involving any public offering. These shares were valued at $3.80 per share, the closing bid price of the Company’s common stock on the date of grant and the related compensation expense were amortized over the requisite service period. Total compensation expenses recognized for the year ended December 31, 2011 and 2010 was US$152,000 and US$70,000, respectively.

On November 30, 2009, the Company granted one 5-year options to each of its three independent directors, Mr. Douglas MacLellan, Mr. Mototaka Watanabe and Mr. Zhiqing Chen, to purchase in the aggregate 54,000 shares of the Company’s common stock at an exercise price of US$5.00 per share, in consideration of their services to the Company. These options vest quarterly at the end of each 3-month period, in equal installments over the 24-month period from the date of grant. However, upon a change of control, the option shall automatically become fully vested and exercisable as of the date of such changes of control. The company utilized Black-Scholes option pricing model to gauge the grant date fair value of these options. The related compensation expenses were amortized over its vesting period. Total compensation expenses recognized for these options for the year ended December 31, 2011 and 2010 was US$141,480 and US$77,220, respectively.

The Company estimated the fair value of these common stock options granted on November 30, 2009 using the Black-Scholes option pricing model based on the following assumptions:

Underlying stock price	$5.00
Expected term (years)	3.00
Risk-free interest rate	1.10%
Dividend yield	-
Expected Volatility	150%
Exercise price of the option	$5.00
Value per option	$4.05

Underlying stock price is the closing bid price of the Company’s common stock on the date of grant. As the three individuals receiving options are non-employee executive directors, the Company believes that forfeitures are highly unlikely, and termination is not applicable. As such, the Company developed a weighted-average expected term at 3 years based on analysis of the vesting schedule and exercise assumptions. The risk-free interest rate is based on the 3 year U.S. Treasury rate. The dividend yield is calculated based on management’s estimate of dividends to be paid on the underlying stock. The expected volatility is calculated using historical data obtained from an appropriate index due to lack of liquidity of the Company’s underlying stock. Exercise price of the option is the contractual exercise price of the option.

On November 30, 2011, under the Company’s 2011 Omnibus Securities and Incentive Plan, adopted by the stockholders of the Company at its annual meeting held on June 15, 2011, the Company issued its management, employees and directors in the aggregate of 2,000,000 restricted shares of the Company’s common stock for the services they provided to the Company. The restricted stock is subject to a strict lock-up for an initial six-month period. Following the initial six-month period, the restricted stock will continue to be locked up until the earlier of (i) the date upon which the closing price of the Company's common stock equals or exceeds $2.50 for five consecutive trading days, and (ii) November 30, 2013. In addition, the restricted stock is subject to forfeiture upon an employee's cessation of employment at the discretion of the Company. The restricted stock was fully vested upon issuance and was valued at $1.14 per share, the closing bid price of the Company's common stock on the date of grant. Total compensation cost recognized for the year ended December 31, 2011 was US$2,280,000.

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On November 30, 2011, under the Company's 2011 Omnibus Securities and Incentive Plan, the Company also issued its management, employees and directors in the aggregate of 885,440 options to purchase up the same number of the company's common stock at an exercise price of US$1.20 per share. These options were fully vested and exercisable upon issuance and subject to forfeiture upon an employee's cessation of employment at the discretion of the Company. Total compensation expenses recognized for these options for the year ended December 31, 2011 was US$328,000.

The Company estimated the fair value of these options granted on November 30, 2011 using the Black-Scholes option pricing model based on the following assumptions:

Adjusted underlying stock price	$1.037
Expected term (years)	5.00
Risk-free interest rate	0.95%
Dividend yield	-
Expected Volatility	46.73%
Exercise price of the option	$1.20
Value per option	$0.37

Adjusted underlying stock price is based on the closing bid price of the Company common stock on the grant date, after adjustment for the 2,000,000 restricted shares award issued on November 30, 2011. Expected tenor are used when estimates of the expected lives of the options, based on vesting schedule and exercise assumptions, which has taken into account of early exercise behavior of the option holders. Yield-to-maturities in continuous compounding of the United States Government Bonds with the time-to-maturities same as the expected tenor of the options of 5 year are adopted as the risk-free rate. Average/median of industry annualized historical stock price volatility from an appropriate index as at the grant date is deemed to be appropriate to serve as the expected volatility of the stock price of the Company. The dividend yield is calculated based on management's estimate of dividends to be paid on the underlying stock. Exercise price of the option is the contractual exercise price of the option.

Options issued and outstanding at December 31, 2011 and their movements during the year then ended are as follows:

	Option Outstanding			Option Exercisable		
	Number of underlying shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of underlying shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
Balance, January 1, 2011	54,000	3.92	$ 5.00	27,000	3.92	$ 5.00
Granted/Vested	885,440	10.00	$ 1.20	912,440	9.80	$ 1.31
Forfeited	-			-		
Exercised	-			-		
Balance, December 31, 2011	939,440	9.51	$ 1.42	939,440	9.51	$ 1.42

Other information relative to option activity during the years ended December 31, 2011 and 2010 is as follows (in thousands, except weighted average grant date fair value):

Year ended December 31,

	2011	2010
Weighted average grant date fair value of stock options granted	$ 0.37	$ 4.05
Aggregate grant date fair value of stock options vested	437	109
Aggregate intrinsic value for options granted	-	-
Aggregate intrinsic value for options exercisable	-	-

The aggregate unrecognized share-based compensation expenses as of December 31, 2011 and 2010 is approximately US$6,000 and US$299,000, respectively.