



**Annual Report 2005**

**Empowering Global Trade**

**Ninetowns Digital World Trade Holdings Limited**

## COMPANY PROFILE

We are a PRC company that enables enterprises to streamline the import/export process in China. Using our scalable enterprise platform products, our clients have the ability to automate import/export processing over the Internet, which is a more cost-effective and efficient alternative to the traditional paper-based method.

Our American Depositary Shares are traded on The NASDAQ National Market under the symbol NINE. On May 31, 2006, there were 34,991,834 ordinary shares outstanding, where one ordinary share equals one ADS. For more information, please visit [www.ninetowns.com/english](http://www.ninetowns.com/english).

We encourage you to visit [www.sec.gov](http://www.sec.gov) for a copy of our annual report on Form 20-F, as filed with the U.S. Securities and Exchange Commission on June 29, 2006.

## FINANCIAL HIGHLIGHTS

(In US\$ thousands, except per share data)

<b>Fiscal Year Ended December 31</b>	<b>2002</b>	<b>2003<sup>(2)</sup></b>	<b>2004</b>	<b>2005<sup>(1)</sup></b>
Total Net Revenue	\$13,052	\$ 16,058	\$ 24,351	<b>\$29,722</b>
Income from Operations	8,851	6,416	16,875	<b>16,624</b>
Net income	7,860	4,976	16,184	<b>18,785</b>
Diluted net income per share	0.36	0.22	0.57	<b>0.52</b>
<i>Operating margin</i>	<i>67.8%</i>	<i>40.0%</i>	<i>69.3%</i>	<i>55.9%</i>
<i>Net margin</i>	<i>60.2%</i>	<i>31.0%</i>	<i>66.5%</i>	<i>63.2%</i>
<b>At December 31,</b>				
Cash and short-term investments	9,001	28,175	102,446	<b>116,289</b>
Short-term unearned revenue	5,367	8,531	11,748	<b>8,412</b>
Total assets	16,103	39,143	147,667	<b>166,758</b>
Stockholders' equity	8,297	19,999	131,751	<b>154,440</b>
Number of registered licensees of iDeclare	24,560	51,860	95,000	<b>122,000</b>

(1) The conversion of Renminbi into U.S. dollars in this Annual Report, made solely for the convenience of the reader, is based on the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York as of December 31, 2005, which was RMB8.0702 to US\$1.00. The percentages stated in this Annual Report are calculated based on Renminbi amounts.

(2) We recorded a one-time compensation charge of US\$4.23 million in 2003.

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Dear Shareholders:

June 30, 2006

Since Ninetowns' inception in 1995, we have achieved significant growth and high profitability, expanding from a start-up company to an industry leader. We have been widely recognized by our customers, employees and shareholders as the dominant leader in automating the import/export processing in the People's Republic of China. In 2005, we ended the year with strong financial results, a new level of understanding of our customers and a clear goal to ultimately become a one-stop international trade service provider.

### **Overview of Fiscal Year 2005**

Fiscal 2005 was a challenging year for us. In August 2005, the State Administration for Quality Supervision and Inspection and Quarantine of the People's Republic of China (PRC Inspections Administration) decided to launch a free basic e-filing software for import and export enterprises in China. This launch of the government's free software not only greatly reduced the sale of our new iProcess package, which was launched in June 2005, but also significantly affected the sale of our core product, iDeclare.

Despite these difficulties, our management and employees worked very hard at generating sales and maintaining high profitability. For the full year of 2005, we sold approximately 26,100 iDeclare packages, approximately 39,700 iDeclare service contracts and approximately 2,600 iProcess packages. More importantly, we continued to maintain our majority market share of close to 90%, with our installed iDeclare user base increased to 122,000 enterprises in the fourth quarter of 2005 from 119,000 at the end of the third quarter of 2005, and from 95,000 at the end of 2004. Finally, we were selected as the exclusive vendor in providing the free software product to the PRC Inspection Administration. I consider this to be positive since as the sole developer of the free software, which we expect to be used widely in the market place, I perceive increased acceleration of e-filing market penetration in the long term and more opportunities for us to further broaden our potential customer base and to further increase our revenue per customer.

For 2005, we reported total net revenue of \$29.7 million, an increase of 19.0% compared to \$24.4 million for 2004. Net income for 2005 was US\$18.8 million, or US\$0.52 per share on diluted basis, representing an increase of 13.2% compared to net income of US\$16.2 million for 2004. Furthermore, we closed 2005 in a very strong financial position. I am very pleased with our debt-free balance sheet, the cash and short-term investment balance of US\$116.3 million, as well as the unearned revenue balance of US\$8.4 million at end of the year.

### **Our New Business Model**

The government's free software aims to enable more import/export companies to use the efficient electronic processing, which we believe can potentially increase our opportunities to sell premium services to users. Given the regulatory landscape's change, our management re-examined our business model and determined that our ultimate goal is to become a one-stop international trade service provider by focusing on providing premium services to our international trade enterprise clients. This is because we realize that compared to software, Internet-based services can better service, in terms of timing, versatility, and accuracy, the ever-changing and complex needs of our international trade enterprise clients. In addition, premium services are becoming increasingly critical in making the entire import/export process more efficient and effective for the international trade enterprises. These premium services not only include our existing core business in clearance services, but also other services within the international trade value chain such as trade opportunities, logistics, settlement services, etc. We are well-positioned to be the one-stop platform in providing these on-demand services to international trade enterprises because of our nation-wide network, end-to-end architecture solution, diversified customer base, financial power and our technology expertise.

Furthermore, addressing our customers' needs have remained our top priority. Our strong and extensive customer base is one of our greatest assets. We will continue to help our customers in addressing their needs for international trade services by linking our technology and services with their business operation. Ultimately, our goal is to meet our customers' needs with our premium value-added services and to help them increase their competitive advantages in the international trade arena.

## **Business Outlook**

We expect 2006 to be a building year as we continue working with PRC Inspections Administration to ensure the successful rollout of the free basic software, and continue executing on our core business of iDeclare and iProcess enterprise packages. We are also evaluating a series of other growth opportunities, which could allow us to leverage our installed base of 122,000 paying enterprise customers. Our goal will be to launch new products and services in 2006 that can create value for our customers through increased visibility and increased revenue opportunities for their businesses globally. We will focus on those opportunities that we believe can have the greatest potential impact on our long-term revenue growth and profitability.

Despite our new challenges, I remain very confident and excited about our future as we are well-positioned for long-term profitable growth. Finally, I would like to thank our shareholders, customers, suppliers, partners and employees for the tremendous support and understanding you have given us throughout the year.

Best wishes,

A handwritten signature in black ink, appearing to be 'Shuang Wang', with a long horizontal flourish extending to the right.

Shuang Wang  
Chief Executive Officer



**NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS  
ON SEPTEMBER 15, 2006**

The Annual General Meeting of Shareholders of Ninetowns Digital World Trade Holdings Limited (the “Company”) will be held at 2:00 p.m. on September 15, 2006 at Plaza Conference Centre, 5/F, China Life Tower, No.16 Chaowai Street, Chaoyang District, Beijing for the following purposes:

1. to authorize the board of directors of the Company (the “Board”) to appoint, without further ratification, Deloitte Touche Tohmatsu as the Company’s independent auditors for the fiscal year ending December 31, 2006 and to fix the remuneration of Deloitte Touche Tohmatsu for such services;
2. to adopt the audited statement of accounts and report of the auditors for the fiscal year ended December 31, 2005;
3. to approve the Board’s compensation for the fiscal year ended December 31, 2005 and delegate authority to the compensation committee of the Board to fix the remuneration of the Board for the fiscal year ending December 31, 2006;
4. to approve and adopt the Amended and Restated Memorandum and Articles of Association, subject to the approval of the Registrar of Companies in the Cayman Islands;
5. subject to the approval of the Registrar of Companies in the Cayman Islands, to approve the change of the English name of the Company to “Ninetowns Internet Technology Group Company Limited” and the Chinese name of the Company to “九城網絡技術集團有限公司”; and
6. to transact such other businesses as may be brought properly before the meeting.

In accordance with the articles of association of the Company, shareholders of record at the close of business on July 21, 2006 will be entitled to notice of, and to vote at, the meeting.

Please follow the instructions on the enclosed proxy card and kindly mark, sign and date the enclosed proxy card and return it promptly.

Copies of the Company’s annual report for the fiscal year ended December 31, 2005 and the Amended and Restated Memorandum and Articles of Association may be viewed at our website at [www.ninetowns.com/english](http://www.ninetowns.com/english).

**NINETOWNS DIGITAL WORLD TRADE HOLDINGS LIMITED**

**PROXY STATEMENT  
FOR ANNUAL GENERAL MEETING OF SHAREHOLDERS  
TO BE HELD ON SEPTEMBER 15, 2006**

This proxy statement is furnished by Ninetowns Digital World Trade Holdings Limited (the "Company"), in connection with the solicitation by the Company's board of directors (the "Board") of proxies to be voted at the annual general ordinary shareholders' meeting to be held on Friday, September 15, 2006 at 2:00 p.m., or any adjournment or postponement thereof (the "Annual General Meeting").

**PROPOSAL NUMBER ONE  
APPOINTMENT OF AUDITORS**

The shareholders are requested to authorize the Board, without further ratification, to appoint Deloitte Touche Tohmatsu as the Company's independent auditors to audit the Company's financial statements for the fiscal year ending December 31, 2006 and to fix the remuneration of Deloitte Touche Tohmatsu for such services.

**Vote Required and the Board's Recommendation**

The affirmative vote of a majority of the ordinary shares present in person or by proxy at the Annual General Meeting and voting on the proposal is required for the approval of this proposal for the authorization of the Board to appoint, without further ratification, Deloitte Touche Tohmatsu as the Company's independent auditors for the fiscal year ending December 31, 2006.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE AUTHORIZATION OF  
THE BOARD TO APPOINT, WITHOUT FURTHER RATIFICATION,  
DELOITTE TOUCHE TOHMATSU AS THE COMPANY'S INDEPENDENT AUDITORS  
FOR THE FISCAL YEAR ENDING DECEMBER 31, 2006.**

**PROPOSAL NUMBER TWO  
ADOPTION OF AUDITED STATEMENT OF ACCOUNTS  
AND REPORT OF THE AUDITORS**

The full text of the audited statement of accounts and the report of the auditors for the fiscal year ended December 31, 2005 has been presented to the shareholders. The Board recommends that the shareholders adopt the audited statement of accounts and the report of the auditors for the fiscal year ended December 31, 2005 as presented to the shareholders along with this proxy statement.

**Vote Required and the Board's Recommendation**

The affirmative vote of a majority of the ordinary shares present in person or by proxy at the Annual General Meeting and voting on the proposal is required for the adoption of the audited statement of accounts and report of the auditors for the fiscal year ended December 31, 2005.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE ADOPTION OF THE  
AUDITED STATEMENT OF ACCOUNTS AND REPORT OF THE AUDITORS FOR THE  
FISCAL YEAR ENDED DECEMBER 31, 2005.**

**PROPOSAL NUMBER THREE  
APPROVAL OF BOARD COMPENSATION**

The Board has recommended that the aggregate compensation for the Board for the fiscal year ended December 31, 2005 be RMB2,870,000 and to further delegate authority to the compensation committee of the Board to fix the remuneration of the Board for the fiscal year ending December 31, 2006.

**Vote Required and the Board's Recommendation**

The affirmative vote of a majority of the ordinary shares present in person or by proxy at the Annual General Meeting and voting on the proposal is required for the approval of the Board's compensation for the fiscal year ended December 31, 2005 and the delegation of authority to the compensation committee of the Board to fix the remuneration of the Board for the fiscal year ending December 31, 2006.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE APPROVAL OF THE PROPOSED AGGREGATE COMPENSATION FOR THE BOARD FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005 AND THE DELEGATION OF AUTHORITY TO THE COMPENSATION COMMITTEE OF THE BOARD TO FIX THE REMUNERATION OF THE BOARD FOR THE FISCAL YEAR ENDING DECEMBER 31, 2006.**

**PROPOSAL NUMBER FOUR  
APPROVAL AND ADOPTION OF AMENDED AND RESTATED MEMORANDUM AND  
ARTICLES OF ASSOCIATION  
OF THE COMPANY**

Our Amended and Restated Memorandum and Articles of Association (the “Articles”) was adopted by the Board in 2004. The Board proposes to amend the Articles to adopt certain anti-takeover measures, including granting of certain rights to the Board to issue a new class of shares and to fix the designations, powers, preferences and all other rights attached to such new class of shares without shareholders’ approval, election and removal of directors and subject to the approval of the Registrar of Companies in the Cayman Islands, change of the name of the Company. The full text of the Amended and Restated Memorandum and Articles of Association as proposed is set forth as Appendix A to this proxy statement.

**Vote Required and the Board’s Recommendation**

The affirmative vote of not less than two-thirds of the ordinary shares present in person or by proxy at the Annual General Meeting and voting on the proposal is required for the approval and adoption of the Amended and Restated Memorandum and Articles of Association of the Company.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE APPROVAL AND  
ADOPTION OF THE AMENDED AND RESTATED MEMORANDUM AND ARTICLES OF  
ASSOCIATION OF THE COMPANY.**

**PROPOSAL NUMBER FIVE  
APPROVAL OF CHANGE OF COMPANY NAME**

The Board proposes to change the English name of the Company to “Ninetowns Internet Technology Group Company Limited” and the Chinese name of the Company to “九城網絡技術集團有限公司”, subject to the approval of the Registrar of Companies in the Cayman Islands.

**Vote Required and the Board’s Recommendation**

The affirmative vote of not less than two-thirds of the ordinary shares present in person or by proxy at the Annual General Meeting and voting on the proposal is required for the approval of change of the name of the Company.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE APPROVAL OF CHANGE OF  
THE NAME OF THE COMPANY, SUBJECT TO THE APPROVAL OF THE REGISTRAR OF  
COMPANIES IN THE CAYMAN ISLANDS.**

## MANAGEMENT DISCUSSION AND ANALYSIS

### *Overview*

We are a leading PRC software company that enables enterprises and trade-related PRC government agencies to streamline the import/export process in China; we believe we are a leader in our market based on revenues and market share. We achieve this by leveraging our international trade expertise and our insight into the needs and procedures of certain trade-related PRC government agencies. To date, we have focused on providing enterprise software and related customer maintenance services for the completion over the Internet of the declaration process. In order to secure our market position, we assisted in designing and building, and continue to maintain and upgrade, the electronic systems of the State Administration for Quality Supervision and Inspection and Quarantine of the PRC, or PRC Inspections Administration, that enable our enterprise software to process electronic declarations over the Internet.

We generated total net revenues of RMB132.9 million, RMB201.5 million and RMB239.9 million (US\$29.7 million) in 2003, 2004 and 2005, respectively. The increase in our total net revenues was due to increased sales of our enterprise software and related services, increased demand for our software development services and the overall growth of the import/export market in China. Our net income in 2003, which included a stock-based compensation expense of RMB35.0 million, was RMB41.2 million, increasing to RMB134.0 million in 2004. Our net income in 2005 was RMB151.6 million (US\$18.8 million), representing a 13.2% increase from 2004. We believe there were approximately 51,860, 95,000 and 122,000 licensees of our enterprise software registered to effect electronic import/export processing with the PRC Inspections Administration as of December 31, 2003, 2004 and 2005, respectively.

The major factors affecting our results of operations and financial condition include:

### *Focus on sales of enterprise software and software development services*

Our predecessor, Ninetowns Technology, was formed in 1995 to focus on the research and development of software related to the declaration process, in addition to selling computer hardware and accessories. During the first several years of our operations, our net revenues from computer hardware sales constituted almost all of our total net revenues and provided the necessary funding for our development of software related to the declaration process. As we developed, we engaged in three main lines of business: (i) sales of enterprise software and related customer maintenance services, (ii) provision of software development services, and (iii) sales of computer hardware and accessories. Since 2001, we have shifted our business focus from sales of computer hardware and accessories to sales of enterprise software and related customer maintenance services and provision of software development services. Sales of computer hardware and accessories accounted for an insignificant percentage of our total net revenues in 2005 and are expected to be a negligible part of our business in the future. We intend to continue deploying our resources on sales of enterprise software and related customer maintenance services and provision of software development services that enable enterprises and trade-related PRC government agencies to streamline the import/export process in China.

### *Growth of the import/export industry in China*

Our financial results have been, and we expect them to continue to be, affected by the growth of the import/export industry in China. According to Global Insight, the total value of import/export transactions in China reached approximately US\$1.4 trillion in 2005, up from approximately US\$851.6 billion in 2003 and approximately US\$1.2 trillion in 2004. As a result of China's accession into the WTO in 2001, tariffs imposed by China on all imported goods are expected to be reduced and PRC-imposed import quotas and permit requirements are expected to be gradually eliminated. We believe the combination of a rapidly growing PRC economy and China's accession to the WTO will accelerate the growth of the import/export industry in China, and as a result create additional demand for our products and services.

### *Increase in number of potential users*

The number of users of our enterprise software has increased significantly since we first launched our iDeclare.CIQ software products in August 2000. This increase is partially attributable to the increasing number of PRC international trade enterprises and partially attributable to the increasing demand from such enterprises for more efficient import/export processing methods. We expect an increase in the number of PRC international trade enterprises as the PRC economy continues to expand. We believe this in turn will increase demand for our enterprise software and related customer maintenance services and software development services, as international trade enterprises seek an efficient means of completing the declaration process.

In August 2005, the PRC Inspections Administration selected our company as the winning bidder in connection with the PRC Inspections Administration's request for proposals for the development of a software product that has certain basic functionalities similar to those of iDeclare.CIQ and iProcess.CIQ. The PRC Inspections Administration agreed to pay a one-time fee of RMB3.3 million (US\$409,000) to purchase the ownership of the software product that we developed. In February 2006, the PRC Inspections Administration commenced to distribute such software products free-of-charge to end-users. We believe that the distribution of free software products, while in the long run will likely increase the number of e-filers and hence increase demand for our enterprise software services, would have a significant adverse effect on our total net revenue, our results of operations and profitability in the short-term. For example, we sold, together with our franchisees, approximately 1,500 software packages of iDeclare.CIQ during the first quarter of 2006, which is significantly lower than the approximately 8,000 software packages of iDeclare.CIQ sold by our company and our distributors and franchisees during the first quarter of 2005.

### ***Expanding our user base through franchisees***

We believe our user base has substantial growth potential due to the high number of international trade enterprises that possess import/export rights in China. According to the PRC Ministry of Commerce, there were approximately 510,000 foreign-invested companies registered to do business in China as of January 31, 2006. In addition, there are numerous PRC-based companies that possess import/export rights. A key component of our growth strategy is to secure new customers through the efforts of our franchisees and we intend to engage additional franchisees to expand our marketing and distribution network. Currently, we have engaged three franchisees to undertake marketing, distribution and service activities in China.

### **Description of revenues, cost items and trade receivables**

We operate in three lines of business: (i) sales of enterprise software, (ii) software development services, and (iii) sales of computer hardware and accessories. Currently, our total net revenues are primarily derived from our sales of enterprise software. Our net revenues from sales of computer hardware and accessories constituted less than 1.0% of our total net revenues for 2005.

### ***Total net revenues***

Currently, we generate total net revenues primarily from (i) sales of enterprise software products and fees from customer maintenance services, (ii) fees from software development services, and (iii) sales of computer hardware and accessories.

We derived RMB20.4 million, RMB51.7 million and RMB89.1 million (US\$11.0 million), or 15.4%, 25.6% and 37.1% of our total net revenues in 2003, 2004 and 2005, respectively, from our related parties Beijing iTowNet Cyber Technology Ltd., or iTowNet, and eGrid Technology Ltd., or eGrid (formerly known as Beijing Regard Technology Co., Ltd., or Beijing Regard), which are two of our major customers for software development services, and Ninetowns Enke, which is one of our franchisees.

Our total net revenues are net of business tax and VAT, but include VAT refunds as discussed below. Our sales of enterprise software products and computer hardware and accessories are generally subject to a VAT of 17.0%. Our fees charged for software development services and customer maintenance service for enterprise software products are generally subject to a 5.0% business tax. Pursuant to the laws and regulations of the PRC, three of our subsidiaries in China are entitled to a refund of the 14.0% VAT for certain self-developed software products. We recognize the VAT refunds at the same time we recognize net revenues from sales of enterprise software. VAT refunds are included in our net revenues from sales of enterprise software. In 2005, we recognized RMB19.8 million

(US\$2.4 million) in VAT refunds. We cannot predict how much our net revenues from sales of our enterprise software or software development services will increase in the future, or if they will increase at all.

*Enterprise software.* Our net revenues from enterprise software are derived primarily from sales of our iDeclare.CIQ basic package and related customer maintenance service fees. We charge users of iDeclare.CIQ a license fee of RMB4,500 per software package, which includes a one-year customer maintenance service period. We also charge RMB1,500 for each additional year of customer maintenance services. In June 2005, we launched our iProcess.CIQ basic package and related customer maintenance service. We charge users of iProcess.CIQ on the same terms as those for iDeclare.CIQ. Enterprise software revenues and fees from customer maintenance services are recognized ratably over a 12-month period. Enterprise software revenues received or receivable but not yet recognized are accounted for as short-term unearned revenue on our balance sheets. Short-term unearned revenue is reduced proportionately as enterprise software revenues are recognized ratably over the 12-month period.

In addition to direct sales, we also sold our enterprise software to our distributors and franchisees for further sale to users. As of December 31, 2005, the distribution agreements with our former distributors, Guangzhou Panyu Chengchang Trade Development Co., Ltd., or Panyu, and Shanghai Tomorrow Technology Development Co., Ltd., or Tomorrow Technology, expired and we chose not to renew them due to our efforts to develop our franchisee network. In June 2005 and January 2006, we engaged two new franchisees and we currently have three franchisees. Our per-unit license fee for enterprise software products charged to our distributors and franchisee is based on our negotiated sales arrangement with the distributor or franchisee, and is less than the RMB4,500 per-unit license fee we receive from direct sales. We also sell iDeclare.CIQ on a fee-per-declaration filing basis to a limited number of users, substantially all of whom are located in Dongguan, China. Our ability to grow our net revenues from sales of enterprise software will depend on (i) the rate of increase in the number of new users of such product, (ii) the market's acceptance of our planned new software products, (iii) the success of our plans to engage additional franchisees, and (iv) our increased efforts in marketing our customer maintenance services to our users. It is currently unclear how the distribution of free enterprise software by the PRC Inspections Administration affects our ability to grow our net revenues from sales of enterprise software.

Notwithstanding that we intend to charge for such maintenance services, we believe our users and potential customers are not accustomed to being charged for this type of service and it is unclear to us how many of our users will pay for such maintenance services. In 2005, we collected customer maintenance service fees from approximately 44,600 users, representing approximately 47.0% of our users due to renew their maintenance service. We intend to continue to increase our marketing and collection efforts with respect to these customer maintenance service fees. We expect our profit margin from sales of enterprise software to decrease if the VAT refund is eliminated or reduced by the PRC tax authorities. We expect net revenues from per declaration filing fees to increase with our increased sales of enterprise software, but to remain stable as a percentage of our total net revenues.

*Software development services.* Our net revenues from software development services are derived primarily from contracts related to PRC government agency software development projects, such as our services for the PRC Inspections Administration and the data exchange platforms operated by iTowNet, which is our related party, and our services for eGrid, which is also our related party. As we believe is consistent with the practice of other software development companies in China engaged in government-related work, we often commence work on software development projects based on oral commitments from our customer and sign the contract after the commencement of work. Once a contract has been signed, we begin recognizing net revenues from these projects based on the percentage-of-completion method, in which revenue recognition is based on the man-hours spent and the costs invested in the project. Billing is generally done periodically in accordance with predetermined milestones as established by the contract. We expect net revenues from software development services to increase as we are engaged by additional PRC government agencies, such as the Customs General Administration of the PRC, or PRC Customs, to perform such services, but we cannot predict how much such revenues will grow in the future, or if they will grow at all.

*Computer hardware sales.* Until 2002, we derived significant net revenues from sales of personal computers and computer accessories. We recognize net revenues from computer hardware sales when the equipment or accessories are delivered, title has passed to the customer and we have no further obligation to provide services related to the operation of such equipment or accessories. We have shifted our business focus to the sale of enterprise software and the provision of software development services. Although we derived significant net revenues from computer

hardware sales in the past, we expect net revenues from this business to represent an insignificant portion of our total net revenues in the future.

### ***Cost of revenues***

Our cost of revenues consists principally of costs related to sales of our enterprise software and our provision of software development services.

*Enterprise software.* Our enterprise software consists of standardized software, the production of which involves minimal cost. We have production arrangements with several outside contractors, under which they produce the compact discs that contain our software and charges us a fee for such services. We package such compact discs with compact disc holders and ship the packages from our Beijing headquarters to our branch offices, distributors and franchisee. As a result, the cost of revenues for sales of enterprise software consists mainly of outsourcing costs to those outside contractors and costs associated with packaging and shipping of software. We expect our cost of revenues from sales of enterprise software to increase as a percentage of our total net revenues because we will be required to recognize additional cost of revenues after we commercially introduce iMonitor.CGA, since the costs associated with iMonitor.CGA as a percentage of net revenues from sales of enterprise software are higher than the costs associated with iDeclare.CIQ.

*Software development services.* Our cost of software development services is comprised mainly of personnel expenses, office rental expenses and other expenses directly related to our provision of software development services. We record cost of revenues for software development services on a percentage-of-completion method by reference to the man-hours incurred and estimated total project hours. We expect our cost of revenues related to software development services to increase as a percentage of our net revenues from software development services as a result of the requirement for more advanced technologies in new projects. As such, we expect our overall cost of revenues from software development services to increase as we perform more software development services.

*Computer hardware sales.* Our cost of revenues from computer hardware sales is minimal because (i) we do not manufacture these products, but source them from third party manufacturers, (ii) we maintain minimal inventories of computer hardware and accessories, and (iii) we have a very low volume of sales in this line of business.

### ***Gross profit margin***

Our gross profit margin is primarily affected by our net revenues from sales of enterprise software and the cost of revenues for our software development services. For the purpose of calculating our gross profits, costs that are not otherwise specifically allocated are allocated to our costs associated with (i) sales of enterprise software, (ii) software development services, and (iii) sales of computer hardware and accessories, in proportion to the gross profits from these lines of business prior to the allocation of such common costs. We expect our enterprise software gross profit margin to decrease with our expected increase in iMonitor.CGA sales because the costs associated with iMonitor.CGA, as a percentage of net revenues from sales of enterprise software, are higher than the costs associated with iDeclare.CIQ. We expect our software development services gross profit margin to decrease as we invest in more advanced technologies in new software development projects. We do not expect our computer hardware line of business to impact our gross profit as we continue to shift our business focus to our other lines of business.

### ***Operating expenses***

Our operating expenses consist of (i) selling expenses, (ii) general and administrative expenses, (iii) research and development expenses, and (iv) allowance for doubtful debts. We do not allocate operating expenses to individual lines of business when making decisions about allocation of resources or assessing the performance of our lines of business.

*Selling expenses.* Selling expenses consist primarily of sales, marketing and personnel expenses, customer service expenses, associated rental expenses, marketing and advertising expenses and travel and entertainment expenses for our sales and marketing staff. We expense all selling expenses as they are incurred. As we engage additional

franchisees to expand our marketing and distribution network, we expect to significantly decrease the number of our sales and marketing staff. On the other hand, we expect to expand our marketing and advertising campaigns to compete with the free software distributed by the PRC Inspections Administration. In addition, we intend to increase incentive payments to salespersons to promote our enterprise platform products. However, if we decide to engage in a new line of business, we expect to increase the number of our sales and marketing staff to promote that business. As a result of the above, we generally do not expect a significant change in our selling expenses.

*General and administrative expenses.* General and administrative expenses consist primarily of personnel expenses, office rental expenses, general office expenses, travel and entertainment expenses and professional fees. We expense all general and administrative expenses as they are incurred. In 2005, we incurred substantially higher general and administrative expenses than in earlier years (excluding the impact of stock-based compensation charge of RMB35.0 million in 2003) as a result of increases in (i) professional fees incurred related to our status as a public company, (ii) insurance premiums for directors and officers insurance and (iii) depreciation and amortization charges on fixed assets and intangible assets. We do not expect our general and administrative expenses to increase significantly in 2006.

On February 22, 2002, our former principal shareholder, Jitter Bug, transferred a 6.0% ownership interest in our company, which is currently equal to 1,320,000 ordinary shares, to one former and three current members of our senior management for an aggregate consideration of HK\$40. In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," or APB No. 25, we have accounted for this transaction as a contribution to capital by Jitter Bug with an offsetting charge to stock compensation expenses in an amount determined by the difference between the amount paid for, and the fair value of, the shares transferred. We were a shell company on the date of transfer and accordingly there was little or no value attributable to the interest transferred. On September 27, 2003, Jitter Bug transferred all of its interests in our current PRC operating subsidiaries, which were held by Ixworth, to us. Such transfers resulted in a new measurement date for the interests transferred and accordingly, we recorded a compensation charge of RMB35.0 million in 2003. Such compensation charge has been included in general and administrative expenses. In December 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 123 (revised 2004), "Share-Based Payment", or SFAS No. 123-R, which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123-R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on the grant-date fair values. Pro forma disclosure previously permitted under SFAS No. 123 is no longer an alternative. The new standard, as recently amended, will be effective in the annual reporting period beginning after January 1, 2006. As a result, we may incur employee stock-based compensation expenses in the future.

*Research and development expenses.* Research and development expenses consist primarily of research and development personnel expenses and associated rental expenses. We expense research and development expenses as they are incurred. In addition, because technological feasibility for our software products ordinarily occurs right before such products are commercially launched and because costs incurred between technological feasibility and commercial launch are immaterial, such costs are expensed as incurred. We expect our research and development expenses to increase as a result of (i) our investment in the research and development of new enterprise platform products, (ii) an increase in the number of research and development personnel, (iii) an expected increase in our potential new business ventures and (iv) our investment in software licenses for development tools to increase the productivity of our overall research and development efforts.

*Allowance for doubtful debts.* Allowance for doubtful debts represents the expense we recognize on the estimated credit losses from our regular assessments of the collections and current credit information of our outstanding trade receivables. We expect our allowance for doubtful debts to remain stable in the future as a result of our increased efforts in evaluating the credit risk of our customers.

As a result of the cumulative effect of the factors described above, we expect in the future our total operating expenses will increase.

## ***Taxation***

Under the current laws of the Cayman Islands and the British Virgin Islands, neither our company, Ixworth, Better Chance International Limited nor Asia Pacific Logistics Limited is subject to tax on its income or capital gains. In addition, payment of dividends by either company is not subject to withholding tax in those jurisdictions.

*PRC enterprise income tax.* Our PRC operating subsidiaries are subject to PRC EIT on their taxable income. Pursuant to PRC tax laws, EIT is generally assessed at the rate of 33.0% of taxable income.

Beijing New Take Electronic Commerce Limited, or Beijing New Take; Beijing Ninetowns Times Electronic Commerce Limited, or Ninetowns Times; and Ninetowns Digital Technology Limited, or Beijing Digital are afforded favorable tax treatment and are only subject to a 15.0% EIT. Shanghai New Take Digital Technology Co., Ltd., or Shanghai New Take and Beijing Ninetowns Ports Software and Technology Co., Ltd., or Ninetowns Ports are also afforded favorable tax treatment. Shanghai New Take was exempt from EIT from January 1, 2003 to December 31, 2004 and is subject to a 16.5% EIT from January 1, 2005 to December 31, 2007. Ninetowns Ports was exempt from EIT from August 1, 2003 to December 31, 2005 and is subject to a 7.5% EIT for the period from January 1, 2006 to December 31, 2008. Tsingdao Fujin Commerce and Finance Software Limited, or Tsingdao Fujin, and Beijing Ninetowns Network and Software Co., Ltd., or Ninetowns Network have not generated any profits and has not applied for tax exemptions or reductions. Guangdong Ninetowns Technology Co., Ltd., or Guangdong Ninetowns Technology is entitled to exempt from EIT from January 1, 2006 to December 31, 2007. Ninetowns Network is entitled to exempt from EIT from January 1, 2006 to December 31, 2008.

Beijing Digital, Beijing New Take, Ninetowns Times, Ninetowns Ports and Ninetowns Network have qualified as “new and high technology enterprises” and have been granted preferential EIT rates based on such status. Shanghai New Take has also been granted preferential EIT rates based on its status as a software company. Relevant PRC government authorities specify certain financial and operational criteria for a company to comply with in order to maintain its status as a new and high technology enterprise.

*PRC business tax.* Our PRC operating subsidiaries are also subject to PRC business tax. We primarily pay business tax on our net revenues generated from software development services and customer maintenance services. Our PRC operating subsidiaries generally pay a 5.0% business tax on our net revenues derived from software development services and customer maintenance services and this business tax is deducted from our total net revenues.

*Value-added tax.* Our PRC operating subsidiaries are also generally subject to a 17.0% VAT on sales of computer hardware and accessories and our enterprise software products. Pursuant to PRC tax regulations, Ninetowns Times, Beijing Digital and Ninetowns Ports are entitled to a 14.0% VAT refund on sales of certain registered self-developed software products. Our net revenues from sales of such enterprise software include VAT refunds in the amount of RMB10.9 million, RMB17.4 million and RMB19.8 million (US\$2.4 million) in 2003, 2004 and 2005, respectively.

Upon expiration of these preferential EIT rates and VAT refunds, we will consider available options, if any, in accordance with applicable law, that would enable us to qualify for further tax incentives.

### ***Trade receivables***

Our trade receivables from external customers and trade receivables from related parties consist primarily of amounts due from our distributors and franchisee for enterprise software delivered to them and amounts billed but not paid for our software development services. Our trade receivables balance due from related parties was RMB29.8 million (US\$3.7 million) in 2005.

### ***Operating results***

The following table sets forth the results of our operations expressed as a percentage of our total net revenues for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

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**Year ended  
December 31,**

	2003	2004	2005
<b>Total net revenues:</b>			
Enterprise software	85.6%	93.6%	84.8%
Software development services	14.3	6.3	14.9
Computer hardware sales	0.1	0.1	0.3
<b>Cost of revenues:</b>			
Enterprise software	1.2	0.7	0.2
Software development services	3.7	1.5	7.6
Computer hardware sales	–	–	0.2
Gross profit	95.1	97.8	92.0
<b>Operating expenses:</b>			
Selling expenses	10.3	7.9	10.7
General and administrative expenses	41.6	17.8	20.3
Research and development expenses	2.0	2.4	4.7
Allowance for doubtful debts	1.1	0.4	0.3
Income from operations	40.1	69.3	55.9
Interest expenses	–	–	–
Interest income	0.9	1.9	7.4
Other income	0.1	0.6	0.2
Income before income taxes	41.1	71.8	63.5
Income taxes	3.1	0.9	0.3
Income before minority interests	38.0	70.9	63.2
Minority interests	7.0	4.4	–
Net income	31.0%	66.5%	63.2%

## 2005 compared to 2004

### *Total net revenues*

We generated total net revenues of RMB239.9 million (US\$29.7 million) in 2005, an increase of 19.0% over our total net revenues of RMB201.5 million in 2004. This revenue growth was principally the result of the expansion of both of our enterprise software business and software development business and the recognition of net revenues from sales of enterprise software that were made in 2004.

*Enterprise software.* Net revenues from sales of our enterprise software increased by 7.8% to RMB203.5 million (US\$25.2 million) in 2005 from RMB188.7 million in 2004, primarily as a result of an increase in the number of users of our enterprise software, which is partially attributable to the increasing number of international trade enterprises operating in China and also attributable to the increasing demand for more efficient import/export processing methods. The increase in our net revenues from enterprise software is also attributable to the increase in the number of customer maintenance service contracts sold to our existing users. In 2005, we signed customer maintenance service contracts with approximately 44,600 users whose customer maintenance service contracts were due for renewal in 2005. We recognized net revenues of RMB33.2 million (US\$4.1 million) from provision of customer maintenance services in 2005. Of our net revenues from sales of enterprise software, RMB24.1 million and RMB23.6 million (US\$2.9 million) were from per declaration filing fees in 2004 and 2005, respectively, representing a year-on-year decrease of 2.1%. As of December 31, 2005, we believe there were approximately 122,000 licensees of our enterprise software registered to effect electronic import/export processing over the data exchange platforms of iTowNet, an increase of 28.4% from approximately 95,000 of such licensees as of December 31, 2004.

*Software development services.* Net revenues from our software development services increased significantly to RMB35.7 million (US\$4.4 million) in 2005 from RMB12.7 million in 2004. This increase is attributable to the fact that a number of software development projects were initiated in 2004 based on oral commitments from our customers but contracts for such projects were not signed until 2005, and therefore net revenues were not recognized until 2005.

*Computer hardware sales.* Net revenues from computer hardware sales comprised less than 1.0% of our total net revenues as we gradually exited this line of business.

### ***Cost of revenues***

*Enterprise software.* Cost of revenues from sales of enterprise software decreased by 67.6% to RMB495,000 (US\$61,000) in 2005 as compared to RMB1.5 million in 2004, due to the effects of more stringent cost controls.

*Software development services.* Cost of revenues from software development services increased significantly to RMB18.2 million (US\$2.3 million) in 2005 from RMB3.0 million in 2004, primarily as a result of our work on software development projects in 2004 based on oral commitments from our customers but contracts for such projects were not signed until 2005, and therefore the cost for such projects were not recognized until 2005. As of December 31, 2005, the Company has capitalized costs related to such projects totaling RMB153,000 (US\$19,000), which represents a significant decrease from the prior year's balance of RMB6.7 million as of December 31, 2004.

*Computer hardware sales.* Cost of revenues from computer hardware sales was insignificant in 2005.

### ***Gross profit margin***

*Enterprise software.* Gross profit margin for sales of enterprise software in 2005 remained stable at 99.8% compared to 99.2% in 2004 primarily because our costs of producing our enterprise software are relatively low and did not change between the periods presented.

*Software development services.* Gross profit margin for software development services in 2005 decreased to 49.0% compared to 76.7% in 2004, which is mainly attributable to an increase in software development personnel expenses.

*Computer hardware sales.* Gross profit margin for computer hardware sales decreased to 28.9% in 2005 from 91.3% in 2004, primarily due to increased sales of lower-margin products such as desktop computers.

### ***Operating expenses***

Operating expenses increased by 50.8% to RMB86.5 million (US\$10.7 million) in 2005 from RMB57.4 million in 2004, primarily as a result of our efforts to expand our business through increased sales, additional staff and increased research and development.

#### ***Selling expenses***

Selling expenses increased by 61.2% to RMB25.7 million (US\$3.2 million) in 2005 from RMB16.0 million in 2004, primarily due to an increase in advertising, office, rental, staff and travel expenses related to increased sales and the expansion of our distribution network.

#### ***General and administrative expenses***

General and administrative expenses increased by 36.0% to RMB48.8 million (US\$6.0 million) in 2005 from RMB35.9 million in 2004, primarily due to increases in (i) professional fees incurred in relation to compliance requirements applicable to us as a public company in the United States, (ii) depreciation and amortization charges on fixed assets and intangible assets and (iii) general personnel expenses, office expenses, communication expenses, traveling expenses and insurance expenses, in each case associated with the increase in the scale of our operations.

#### ***Research and development expenses***

Research and development expenses increased by 133.4% to RMB11.2 million (US\$1.4 million) in 2005 from RMB4.8 million in 2004, primarily due to an increase in staff costs related to the research and development of our new products such as a PRC Customs declaration filing system and an electronic payment system.

#### ***Allowance for doubtful debts***

Allowance for doubtful debts remained stable at RMB760,000 (US\$94,000) in 2005, compared to RMB700,000 in 2004.

#### ***Interest income***

Interest income increased significantly to RMB17.6 million (US\$2.2 million) in 2005 from RMB3.8 million in 2004, primarily due to interest income derived from our net proceeds from our initial public offering in December 2004.

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

Other income decreased by 66.6% to RMB447,000 (US\$55,000) in 2005 from RMB1.3 million in 2004. This was attributable to our receipt of a RMB1.0 million government subsidy for research and development work from the Electronic Information Industry Fund of the Ministry of Information Industry of the PRC in 2004. We did not receive such subsidy in 2005.

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

Income taxes decreased by 65.7% to RMB626,000 (US\$78,000) in 2005 from RMB1.8 million in 2004, primarily due to the increasing operations of Ninetowns Ports, which was exempt from enterprise income tax in 2005.

#### ***Net income***

Net income increased by 13.2% to RMB151.6 million (US\$18.8 million) in 2005 from RMB134.0 million in 2004 as a result of the cumulative effect of the factors described above.

### **2004 compared to 2003**

#### ***Total net revenues***

We generated total net revenues of RMB201.5 million in 2004, an increase of 51.6% over our total net revenues of RMB132.9 million in 2003. This revenue growth was principally the result of the expansion of our enterprise software business, offset by a reduction in revenues recognized from our work on software development projects in 2004. This reduction is attributable to the fact that a number of software development projects were initiated in 2004 based on oral commitments from our customers but for which the contracts for such projects were not signed until 2005, and therefore net revenues were not recognized until 2005.

*Enterprise software.* Net revenues from sales of our enterprise software increased by 65.8% to RMB188.7 million in 2004 from RMB113.8 million in 2003, primarily as a result of an increase in the number of users of our enterprise software, which is partially attributable to the increasing number of international trade enterprises operating in China and also attributable to the increasing demand for more efficient import/export processing methods. Our net revenues from enterprise software also increased in 2004 because we began marketing customer maintenance service contracts to our existing users. As a result, in 2004, we collected customer maintenance service fees of RMB23.6 million from approximately 15,700 users whose customer maintenance service contracts were due for renewal in 2004. Of our net revenues from sales of enterprise software, RMB23.1 million and RMB24.1 million were from per declaration filing fees in 2003 and 2004, respectively, representing a year-on-year increase of 4.2%, due to the increased number of declaration filings made by our customers in Dongguan, China, in 2004 compared to 2003. As of December 31, 2004, we believe there were approximately 95,000 licensees of our enterprise software registered to effect electronic import/export processing over the data exchange platforms of iTowNet, an increase of 83.2% from approximately 51,860 of such licensees as of December 31, 2003.

*Software development services.* Net revenues from our software development services decreased by 33.2% to RMB12.7 million in 2004 from RMB19.0 million in 2003. This reduction is attributable to the fact that a number of software development projects were initiated in 2004 based on oral commitments from our customers but contracts for such projects were not signed until 2005, and therefore net revenues were not recognized until 2005.

*Computer hardware sales.* Net revenues from computer hardware sales comprised less than 1.0% of our total net revenues as we gradually exited this line of business.

### ***Cost of revenues***

*Enterprise software.* Cost of revenues from sales of enterprise software remained stable at RMB1.5 million in 2004 as compared to RMB1.5 million in 2003, due to the effects of more stringent cost controls, offset by our higher sales of enterprise software packages in 2004 as compared to 2003.

*Software development services.* Cost of revenues from software development services decreased by 39.9% to RMB3.0 million in 2004 from RMB4.9 million in 2003, primarily as a result of our work on software development projects in 2004 based on oral commitments from our customers but contracts for such projects were not signed until 2005, and therefore the cost for such projects were not recognized until 2005. As of December 31, 2004, the Company has capitalized costs related to such projects totaling RMB6.7 million, which represents an increase of 100.0% over the prior year's balance of nil as of December 31, 2003.

*Computer hardware sales.* Cost of revenues from computer hardware sales was insignificant in 2004.

### ***Gross profit margin***

*Enterprise software.* Gross profit margin for sales of enterprise software in 2004 remained stable at 99.2% compared to 98.7% in 2003 primarily because our costs of producing our enterprise software are relatively low and did not change between the periods presented.

*Software development services.* Gross profit margin for software development services in 2004 remained stable at 76.7% compared to 74.1% in 2003, as cost savings realized through use of our existing software technologies were offset by an increase in software development personnel expenses.

*Computer hardware sales.* Gross profit margin for computer hardware sales increased to 91.3% in 2004 from 33.3% in 2003, primarily due to increased sales of higher-margin products such as computer accessories.

### ***Operating expenses***

Operating expenses decreased by 21.7% to RMB57.4 million in 2004 from RMB73.3 million in 2003, primarily as a result of RMB35.0 million in stock-based compensation expenses in 2003, which we did not incur in 2004.

#### ***Selling expenses***

Selling expenses increased by 16.8% to RMB16.0 million in 2004 from RMB13.7 million in 2003, primarily due to an increase in staff, travel and entertainment expenses related to increased sales, offset by a decrease in commissions and sales incentives paid to our sales and marketing employees. This decrease resulted from our decrease in cash payments to our employees due to our change from a cash-based incentive system to a share option-based incentive system.

#### ***General and administrative expenses***

General and administrative expenses decreased significantly to RMB35.9 million in 2004 from RMB55.4 million in 2003, primarily due to RMB35.0 million of stock-based compensation expenses in 2003 from the transfer of a 6.0% equity interest in our company by Jitter Bug to one former and three current members of our senior management, offset by an increase in general personnel expenses, advertising expenses, communication expenses and insurance expenses, in each case associated with the increase in the scale of our operations. We did not incur any significant stock-based compensation expense in 2004.

#### ***Research and development expenses***

Research and development expenses increased by 79.1% to RMB4.8 million in 2004 from RMB2.7 million in 2003, primarily due to an increase in staff and other expenses related to the research and development of our new products

such as a PRC Customs declaration filing system, an electronic payment system and a foreign enterprise ERP system.

#### *Allowance for doubtful debts*

Allowance for doubtful debts decreased by 53.8% to RMB700,000 in 2004, compared to RMB1.5 million in 2003, as an improved outlook for trade receivables repayment offset a significant increase in our trade receivables.

#### *Interest income*

Interest income increased by 208.9% to RMB3.8 million in 2004 from RMB1.2 million in 2003, primarily due to the increase in our bank balances from the deposit of our net proceeds from our initial public offering in December 2004.

#### *Other income*

Other income increased to RMB1.3 million in 2004 from RMB211,000 in 2003, as a result of our receipt of a RMB1.0 million government subsidy for research and development work from the Electronic Information Industry Fund of the Ministry of Information Industry of the PRC.

#### *Income taxes*

Income taxes decreased by 55.7% to RMB1.8 million in 2004 from RMB4.1 million in 2003, primarily due to the increasing operations of Ninetowns Ports, which was exempt from enterprise income tax in 2004.

#### *Net income*

Net income increased by 225.2% to RMB134.0 million in 2004 from RMB41.2 million in 2003 as a result of the cumulative effect of the factors described above.

#### *Liquidity and capital resources*

Our primary sources of liquidity have been net cash provided by operating activities and the net proceeds from our equity offerings. We had no outstanding debt as of December 31, 2005. The following table sets forth the summary of our cash flows for the periods indicated:

	For the year ended December 31,				
	2002	2003	2004	2005	2005
	(in millions)				
Net cash provided by operating activities	RMB 58.6	RMB 46.4	RMB 58.0	RMB 90.3	US\$11.2
Net cash provided by / (used in) investing activities	16.0	1.2	(94.2)	(54.7)	(6.8)
Net cash provided by / (used in) financing activities	(30.5)	70.2	565.6	2.0	0.3
Effect of exchange rate changes	-	-	-	(3.1)	(0.4)
Net increase in cash and cash equivalents	44.1	117.8	529.5	34.5	4.3
Cash and cash equivalents, beginning of year/period	5.6	49.7	167.5	697.0	86.3
Cash and cash equivalents, end of year/period	RMB 49.7	RMB 167.5	RMB 697.0	RMB731.5	US\$90.6

Substantially all of our operations are in China. The ability of our PRC operating subsidiaries to convert Renminbi into U.S. dollars and transfer such U.S. dollars to us is subject to PRC foreign exchange regulations, including the restriction that foreign invested enterprises may only buy, sell and/or remit foreign currencies at banks in the PRC authorized to conduct foreign exchange business after providing valid commercial documents.

#### *Cash flow from operating activities*

We provided cash in operating activities of RMB90.3 million (US\$11.2 million) in 2005. This was primarily attributable to our cash receipts from sales of enterprise software offset by our placement of RMB56.1 million (US\$7.0 million) in term deposits. We generated cash from operating activities of RMB58.0 million in 2004. This was primarily attributable to our cash receipts from sales of enterprise software offset by our placement of RMB85.2 million in term deposits. We generated cash from operating activities of RMB46.4 million in 2003. This was

primarily attributable to our cash receipts from sales of enterprise software offset by our placement of RMB40.8 million in term deposits.

#### ***Cash flow from investing activities***

Cash used in investing activities was RMB54.8 million (US\$6.8 million) in 2005. This was primarily attributable to a deposit payment for the acquisition of an additional floor of the building under construction in Beijing and purchases of property, plant and equipment. Investing activities used cash of RMB94.2 million in 2004. This was primarily attributable to our purchase of three floors and the naming rights of a building under construction in Beijing, computer equipment, furniture, fixtures and office equipment and the acquisition of minority interests in our subsidiaries, offset by the repayment of loans by Import & Export. Investing activities provided cash of RMB1.2 million in 2003. This was primarily attributable to our receipt of loan repayments from iTowNet and Import & Export offset by purchases of property, plant and equipment, which primarily consisted of computer equipment, fixtures and office furniture for our representative office in Hong Kong.

#### ***Cash flow from financing activities***

Financing activities provided cash of RMB2.0 million (US\$253,000) in 2005. This was comprised primarily of receipt of proceeds on exercise of stock options by our employees offset by our repayment of outstanding advances from shareholders. Financing activities provided cash of RMB565.6 million in 2004. This was comprised primarily of the net proceeds from our initial public offering in December 2004 of RMB531.4 million and approximately US\$3.0 million of escrowed net proceeds from our capital-raising activities in 2003, which we received from escrow in September 2004, offset by our repayment of loans to Jitter Bug. Financing activities provided cash of RMB70.2 million in 2003. This was comprised primarily of the net proceeds from our equity offerings in 2003.

#### ***Capital resources***

Our primary source of liquidity is cash flow from operating activities and the net proceeds from our equity offerings. Our cash and cash equivalents primarily consist of cash on hand and bank deposits. As of December 31, 2005, we had RMB731.5 million (US\$90.6 million) in cash and cash equivalents. In addition, as of December 31, 2005, we had invested RMB207.0 million (US\$25.7 million) in term deposits, which are payable at varying maturities from 3 to 6 months.

We believe that our available cash and cash equivalents and cash provided by operating activities will be sufficient to meet our capital needs for at least the next 12 months. Except for our net cash provided by operating activities, we currently have no plans to seek additional sources of liquidity in the near future. However, we cannot assure you that our business or operations will not change in a manner that would consume our available capital resources more rapidly than anticipated, especially as we continue to evaluate other investment and acquisition opportunities. As of December 31, 2005, we had no lines of credit or other credit facilities.

#### ***Capital expenditures***

For details of our capital expenditures, see Item 4 of this annual report, “Information on the Company – History and development of the company.”

#### ***Research and development***

Our research and development department works continuously to develop new software products as well as new software functions with additional import/export related applications to complement our existing enterprise software, thereby enhancing value for our users. Our research and development department is divided into the following three sub-departments:

- *Business development department* — our business development department is responsible for business strategies and research to identify users’ needs in order to formulate new product designs.

- *Systems development department* — our systems development department is responsible for product development in accordance with the designs proposed by the business development department, as well as software testing and quality control.
- *Project management department* — our project management department is responsible for the allocation of staff and resources, employee training, product analysis and the registration of new software products with the relevant PRC government authorities.

In the past, we have developed products and services both independently and through cooperation with a variety of database providers, enterprise resource planners, decision support statistical consultants, software integration providers and others. Although we intend to continue to work closely with outside third parties in product development efforts, we expect the core technology and know-how for future enhancements to our existing and new products will be developed internally and may be supplemented by technology licensed from third parties. See Item 3 of this annual report, “Key Information — Risk factors — Risks related to our business — We may not be able to adequately protect our intellectual property rights and others may claim that we have infringed on their intellectual property rights, which could cause us to be less competitive, may expose us to litigation and may negatively impact our business, results of operations and financial condition.” We have not granted any ownership interest in any of our products to any party that has worked with us in our product development efforts. In the past, we shared ownership in a foreign trade business system software with Jingjiang A-Bin Software Workshop, or A-Bin, and a declaration software system that is not a part of iDeclare.CIQ, with Beijing Regard. We are not selling either software and, to our knowledge, neither A-Bin nor Beijing Regard is currently selling such software.

As of December 31, 2005, we had 307 employees dedicated to research and development, 18 of whom have master’s degrees and two of whom have Ph.D. degrees. Most of our research and development efforts are located in our principal executive offices in Beijing and in our research and development center in Fengtai.

Our expenses for research and development activities totaled RMB2.7 million in 2003, RMB4.8 million in 2004 and RMB11.2 million (US\$1.4 million) in 2005.

We believe that timely development of new and enhanced products and services is necessary for us to remain competitive in the marketplace. Accordingly, we intend to continue recruiting and hiring research and development personnel and to make other investments in research and development. We are in the process of establishing two additional research and development centers, one in the eastern region of China and one in the southern region of China, and we expect those research and development centers to be fully functional by the end of 2006.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our consolidated financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. We have summarized below our accounting policies that we believe are both important to the portrayal of our financial results and involve the need to make estimates about the effect of matters that are inherently uncertain.

### *Revenue recognition*

We account for the sales of our enterprise software in accordance with American Institute of Certified Public Accountants, or AICPA, Statement of Position (SOP) 97-2, "Software Revenue Recognition." The application of SOP 97-2 requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence, or VSOE, of fair value exists for those elements. Our customers receive certain elements of our enterprise software over a period of time, including post-delivery repair and enterprise software maintenance, training, telephone support and nonspecific enhancements of the software on a when-and-if-available basis. As no fair value of these elements can be assessed reliably, we recognize such revenues ratably over the contract period of the software arrangement, which is usually 12 months. Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, and the fair value of the respective elements could all materially impact the amount of earned and unearned revenue. Enterprise software revenues received or receivable but not yet recognized are accounted for as short-term unearned revenue on our balance sheet. Short-term unearned revenue is reduced proportionately as enterprise software revenues are recognized ratably over the 12-month period.

As we believe is consistent with the practice of other software development companies in China engaged in government-related work, we often commence work on software development projects based on oral commitments from our customer and sign the contract after the commencement of work. Once a contract has been signed, we begin recognizing revenues from these projects based on the percentage-of-completion of the contracts, in which revenue recognition is based on the man-hours spent and the costs invested in the projects. Billing is generally done periodically in accordance with predetermined milestones as established by the contract. The determination of percentage-of-completion with reference to man-hours spent and the costs invested in the projects requires significant judgment.

### *Research and development costs*

We account for research and development costs in accordance with several accounting pronouncements, including SFAS 2, "Accounting for Research and Development Costs," and SFAS 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." SFAS 86 specifies that costs incurred internally in creating a computer software product should be charged to expense when incurred as research and development until technological feasibility has been established for the product. Once technological feasibility is established, all software costs should be capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our products is reached shortly before the products are commercially launched. Costs incurred after technological feasibility is established are not material, and accordingly, we expense all research and development costs when incurred.

### *Stock-based compensation*

Our 2003 Plan and our Amended and Restated 2004 Plan allow the grant of share options to our employees and directors. We account for all employee stock-based compensation in accordance with APB No. 25, which requires us to record a compensation charge for the excess of the fair value for the stock at the grant date over the amount an employee must pay to acquire the stock. We determine the fair value of our ordinary shares underlying share options granted under our 2003 Plan based on several factors, including the price of our then-most-recent ordinary share placement.

In addition, our principal shareholder, Jitter Bug, transferred a 6.0% ownership interest in our company to one former and three current members of our senior management for an aggregate consideration of HK\$40 in 2002. In accordance with APB No. 25, we have accounted for this transaction as a contribution to capital by Jitter Bug with an offsetting charge to stock compensation expenses in an amount equal to the difference between the amount paid for, and the fair value of, the shares transferred. In September 2003, Jitter Bug transferred all of the interests in our current operating subsidiaries in China, which it held through Ixworth, to us. This corporate restructuring resulted in a new measurement date for the 6.0% interest transferred by Jitter Bug in 2002. We therefore recorded a compensation charge of RMB35.0 million in 2003 for the difference between the amount paid by those executive officers for such 6.0% ownership interest and the fair value of the shares transferred.

We did not record a compensation charge for the options granted to our employees under our 2003 Plan because we determined that the exercise price of the options was not less than the fair value of our ordinary shares as of the grant date. Had different assumptions or criteria been used to determine the fair value of our ordinary shares, materially different amounts of stock-based compensation could have been reported. We similarly did not record a compensation charge for the options granted to our employees under our 2004 Plan because the exercise price of such options was set at the closing price of our ADSs on the Nasdaq National Market on the date of grant.

Commencing from January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment", or SFAS No.123-R, which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123-R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". Generally, the approach in SFAS No. 123-R is similar to the approach described in SFAS No. 123. However, SFAS No. 123-R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on the grant-date fair values. Pro forma disclosure previously permitted under SFAS No. 123 is no longer an alternative.

#### ***Trade receivables***

We perform ongoing credit evaluations of our customers and adjust credit limits based on payment history and the customer's current credit-worthiness, as determined by our review of their current credit information. We extended three months of credit to our former distributors and franchisees pursuant to our distribution and franchise agreements. However, it took on average five to six months for our distributors and franchisees, who are also our major customers, to settle their debts to us. Therefore, in some fiscal periods, our trade receivables increased, and may increase in the future, to an amount which is approximately equal to our total net revenues for such period. We continuously monitor collections and payments from our customers and maintain a 5.0% provision on the period-end balance of the trade receivables for estimated credit losses from our non-government related customers, distributors and franchisee based upon our historical experience. We typically write-off trade receivables that are over 360 days outstanding. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have had in the past. Since we have not experienced any significant payment problems from our government-related customers in the past, we do not maintain any provision for such customers. The trade receivables from iTowNet, which we believe is our only customer that is a PRC government entity or is controlled by a government entity, were approximately 17.5% of our total trade receivables as of December 31, 2005. The trade receivables from our non-government customers were approximately 82.5% of our total trade receivables as of December 31, 2005. Since our trade receivables are concentrated in a relatively small number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse impact on the collectibility of our trade receivables and our future operating results.

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Ninetowns Digital World Trade Holdings Limited:

We have audited the accompanying consolidated balance sheets of Ninetowns Digital World Trade Holdings Limited and its subsidiaries (the "Company") as of December 31, 2004 and 2005 and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows for each of the three years in the period ended December 31, 2005, all expressed in Renminbi. Our audits also include the financial statement schedule listed in the Index at Schedule I. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and related financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit includes 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 audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2005 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

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

/s/ Deloitte Touche Tohmatsu  
Hong Kong  
June 19, 2006

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

	December 31,		
	2004 RMB	2005 RMB	2005 US\$
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	696,993	731,474	90,639
Inventories	8,123	7,722	957
Trade receivables from:			
- external customers, less allowance for doubtful accounts of RMB4,540 in 2004 and RMB5,300 in 2005	38,190	17,459	2,163
- related parties, less allowance for doubtful accounts of RMBNil in 2004 and 2005	30,940	29,752	3,687
Prepaid expenses and other current assets	37,686	43,832	5,431
Term deposits	150,913	207,000	25,650
Total current assets	962,845	1,037,239	128,527
Property, plant and equipment, net	5,259	33,484	4,149
Deposits paid for acquisition of property, plant and equipment	49,652	73,040	9,050
Goodwill	193,570	193,570	23,986
Intangible assets, net	10,856	8,440	1,046
<b>TOTAL ASSETS</b>	<b>1,222,182</b>	<b>1,345,773</b>	<b>166,758</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable and accrued expenses	19,061	12,039	1,492
Customers' deposits	-	10,639	1,318
Short-term unearned revenue	97,230	67,886	8,412
Amounts due to shareholders	5,360	-	-
Income tax payable	5,465	5,388	668
Other taxes payable	4,014	2,856	354
Total current liabilities	131,130	98,808	12,244
Minority interests	600	600	74
Commitments (Note 13)			
Shareholders' equity:			
Ordinary shares of par value HK\$0.025 each: 8,000,000,000 shares authorized; 34,391,834 in 2004 and 34,991,834 in 2005 shares issued and outstanding	911	918	114
Additional paid-in capital	845,730	853,127	105,713
Retained earnings	243,811	395,415	48,997
Accumulated other comprehensive loss	-	(3,095)	(384)
Total shareholders' equity	1,090,452	1,246,365	154,440
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>1,222,182</b>	<b>1,345,773</b>	<b>166,758</b>

CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except share and per share data)

	Year ended December 31,			
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>
	RMB	RMB	RMB	US\$
<b>Net revenues:</b>				
Enterprise software				
external customers	111,882	146,635	142,534	17,661
related parties (Note 10)	1,909	42,085	60,954	7,553
Software development services				
external customers	545	3,130	7,600	942
related parties (Note 10)	18,500	9,593	28,100	3,482
Computer hardware sales	72	104	678	84
<b>Total net revenues</b>	<b>132,908</b>	<b>201,547</b>	<b>239,866</b>	<b>29,722</b>
<b>Cost of revenues:</b>				
Enterprise software	(1,532)	(1,528)	(495)	(61)
Software development services	(4,939)	(2,970)	(18,192)	(2,254)
Computer hardware sales	(48)	(9)	(482)	(60)
<b>Total cost of revenues</b>	<b>(6,519)</b>	<b>(4,507)</b>	<b>(19,169)</b>	<b>(2,375)</b>
<b>Gross profit</b>	<b>126,389</b>	<b>197,040</b>	<b>220,697</b>	<b>27,347</b>
<b>Operating expenses:</b>				
Selling expenses	(13,674)	(15,977)	(25,752)	(3,191)
General and administrative expenses (including stock-based compensation of RMB35,000 for 2003, nil for 2004 and 2005)	(55,395)	(35,872)	(48,778)	(6,044)
Research and development expenses	(2,691)	(4,819)	(11,249)	(1,394)
Allowance for doubtful debts	(1,516)	(700)	(760)	(94)
<b>Income from operations</b>	<b>53,113</b>	<b>139,672</b>	<b>134,158</b>	<b>16,624</b>
Interest income	1,220	3,768	17,625	2,184
Other income	211	1,340	447	55
<b>Income before income tax expenses</b>	<b>54,544</b>	<b>144,780</b>	<b>152,230</b>	<b>18,863</b>
Income tax expenses	(4,116)	(1,823)	(626)	(78)
<b>Income after taxes before minority interests</b>	<b>50,428</b>	<b>142,957</b>	<b>151,604</b>	<b>18,785</b>
Minority interests	(9,239)	(9,006)	-	-
<b>Net income</b>	<b>41,189</b>	<b>133,951</b>	<b>151,604</b>	<b>18,785</b>
<b>Net income per share:</b>				
Basic	RMB1.82	RMB4.96	RMB4.39	US\$0.54

Diluted	RMB1.82	RMB4.74	RMB4.25	US\$0.53
Shares used in computation:				
Basic	22,659,048	27,022,057	34,539,976	34,539,976
Diluted	22,659,048	28,279,061	35,706,894	35,706,894

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(In thousands, except share and per share data)

	Ordinary shares		Additional	Retained	Accumulated other	Total	Comprehensive
	<u>Shares</u>	<u>Amount</u>	paid-in	earnings	comprehensive		<u>income</u>
		RMB	capital		loss		
Balance as of January 1, 2003	22,000,000	-	-	68,671	-	68,671	
Employee stock-based compensation	-	-	35,000	-	-	35,000	
Transfer on reorganization	-	583	(583)	-	-	-	
Issuance of shares	780,000	21	20,649	-	-	20,670	
Net income and comprehensive income	-	-	-	41,189	-	41,189	41,189
Balance as of December 31, 2003	22,780,000	604	55,066	109,860	-	165,530	
Issuance of shares on acquisition of 10% minority interest of subsidiaries	2,002,312	53	181,259	-	-	181,312	
Issuance of shares upon the initial public offering, net of offering expenses	6,400,000	169	531,244	-	-	531,413	
Transfer from mezzanine equity upon lapse of put option and issuance of 16 additional shares	2,964,016	79	71,662	-	-	71,741	
Exercise of share options	245,506	6	6,499	-	-	6,505	
Net income and comprehensive income	-	-	-	133,951	-	133,951	133,951
Balance as of December 31, 2004	34,391,834	911	845,730	243,811	-	1,090,452	
Issuance of shares for employee share options	600,000	7	7,397	-	-	7,404	
Net income	-	-	-	151,604	-	151,604	151,604
Foreign currency translation adjustments	-	-	-	-	(3,095)	(3,095)	(3,095)
Comprehensive Income	-	-	-	-	-	-	148,509
Balance as of December 31, 2005	34,991,834	918	853,127	395,415	(3,095)	1,246,365	
		US\$114	US\$105,713	US\$48,997	US\$(384)	US\$154,440	

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands except share and per share data)

	Year ended December 31,			
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>
	RMB	RMB	RMB	US\$
<b>Operating activities:</b>				
Net income	41,189	133,951	151,604	18,785
Adjustments to reconcile net income to net cash provided by operating activities:				
Loss on disposal of property, plant and equipment	-	-	263	33
Depreciation of property, plant and equipment	874	1,315	2,877	356
Amortization of intangible assets	-	805	2,416	299
Allowance for doubtful debts	1,516	700	760	94
Minority interests in profit of subsidiaries	9,239	9,006	-	-
Employee stock-based compensation	35,000	-	-	-
Changes in operating assets and liabilities:				
Inventories	(313)	(7,665)	401	50
Trade receivables from external customers	(4,433)	(7,794)	19,971	2,475
Trade receivables from related parties	(22,885)	945	1,188	147
Prepaid expenses and other current assets	(7,953)	(22,666)	(6,146)	(762)
Term deposits	(40,832)	(85,249)	(56,087)	(6,950)
Accounts payable and accrued expenses	(476)	13,849	(7,022)	(870)
Customers' deposits	-	-	10,639	1,318
Short-term unearned revenue	26,188	26,622	(29,344)	(3,636)
Income taxes payable	2,181	533	(77)	(9)
Other taxes payables	7,117	(6,331)	(1,158)	(143)
<b>Net cash provided by operating activities</b>	<b>46,412</b>	<b>58,021</b>	<b>90,285</b>	<b>11,187</b>
<b>Investing activities:</b>				
Purchase of property, plant and equipment	(2,208)	(2,856)	(31,376)	(3,887)
Deposits paid for acquisition of property, plant and equipment	-	(49,652)	(23,388)	(2,898)
Acquisition of additional interest in subsidiaries	-	(48,637)	-	-
Decrease in amounts due from related parties	3,411	6,989	-	-
<b>Net cash provided by (used in) investing activities</b>	<b>1,203</b>	<b>(94,156)</b>	<b>(54,764)</b>	<b>(6,785)</b>
<b>Financing activities:</b>				

Exercise of share options	-	6,505	7,404	917
Increase (decrease) in amounts due to shareholders	-	5,360	(5,360)	(664)
Net proceeds on issue of shares	67,607	531,413	-	-
Collection of subscription receivables	-	24,804	-	-
Contribution from minority shareholder of a subsidiary	-	600	-	-
Increase (decrease) in cash advance from a shareholder	2,643	(3,085)	-	-
Net cash provided by financing activities	70,250	565,597	2,044	253
Effect of exchange rate changes	-	-	(3,084)	(382)
Net increase in cash and cash equivalents	117,865	529,462	34,481	4,273
Cash and cash equivalents at the beginning of the year	49,666	167,531	696,993	86,366
Cash and cash equivalents at the end of the year	167,531	696,993	731,474	90,639
Non-cash investing activities:				
Consideration for acquisition of subsidiaries settled				
through issuance of shares	-	181,312	-	-
Non-cash financing activities:				
Issuance of shares to employees for services	35,000	-	-	-
Supplemental cash flow information:				
Cash paid during the year for income taxes	1,935	1,290	703	87
Interest paid during the year	-	-	-	-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Ninetowns Digital World Trade Holdings Limited ("Ninetowns") was incorporated as an exempted company with limited liability in the Cayman Islands on February 8, 2002 under the Companies Law of the Cayman Islands.

Ninetowns and its subsidiaries (collectively the "Company") are principally engaged in the sale of enterprise software and the provision of related after-sales services, the provision of software development services and the sale of computer hardware and accessories, in the People's Republic of China (the "PRC").

At the time of its incorporation, all of the outstanding share capital of Ninetowns was held by Jitter Bug Holdings Limited ("Jitter Bug"). Substantially all of its business is conducted in the PRC through four subsidiaries in which the Company indirectly held a 90% interest and a fifth subsidiary in which its effective interest was 81%, collectively the "operating subsidiaries". The Company holds its interests in the operating subsidiaries indirectly through Ixworth Enterprises Limited or "Ixworth", which is wholly owned by Ninetowns and is incorporated in the British Virgin Islands.

Prior to September 27, 2003, Jitter Bug held its interests in the operating subsidiaries through Ixworth. On September 27, 2003, Ninetowns issued 21,999,996 additional shares to Jitter Bug. Jitter Bug simultaneously transferred 100% of the equity interests in Ixworth to the Company. This transaction has been accounted for as a legal reorganization of entities under common control. The accompanying consolidated financial statements have been prepared to reflect the consolidated financial position, results of operations and cash flows of Ninetowns and its subsidiaries for all the years presented in a manner similar to the pooling-of-interests method. All significant intra-Company transactions and balances have been eliminated on consolidation.

During 2004, the Company acquired the 10% minority interest in the operating subsidiaries, making all of them wholly-owned subsidiaries of the Company. See note 3 for details.

As of December 31, 2005, details of the subsidiaries of Ninetowns are as follows:

<u>Name of entity</u>	<u>Place of incorporation/ establishment</u>	<u>Date of incorporation/ establishment</u>	<u>Effective ownership interest</u>	<u>Principal activities</u>
Asia Pacific Logistics Limited ("Asia Pacific")	BVI	October 1, 2003	100%	Investment holding
Beijing New Take Electronic Commerce Limited ("Beijing New Take") (note i)	PRC	May 22, 2000	100%	Inactive
Beijing Ninetowns Digital	PRC	March 22, 1995	100%	Sale of enterprise software

Technology Limited ("Beijing Ninetowns Digital Technology")					and provision of related after-sales services, and sale of computer hardware and accessories and provision of software development services
Beijing Ninetowns Ports Software and Technology Co., Ltd. ("Beijing Ninetowns Ports")	PRC	August 1, 2003	100%		Sale of enterprise software and provision of related after-sales services, and sale of computer hardware and accessories and provision of software development services
Beijing Ninetowns Times Electronic Commerce Limited ("Beijing Ninetowns Times") (note i)	PRC	June 2, 2000	100%		Provision of software development services
Better Chance International Limited ("Better Chance")	BVI	July 8, 2003	100%		Investment holding
Guangdong Ninetowns Technology Co. Ltd. ("Guangdong Ninetowns")	PRC	September 26, 2005	100%		Not yet commenced operations
Ixworth Enterprises Limited	British Virgin Islands ("BVI")	December 22, 1999	100%		Investment holding
New Take Limited	Hong Kong	February 25, 1998	100%		Investment holding
Shanghai New Take Digital Technology Limited ("Shanghai New Take") (note ii)	PRC	September 13, 2001	100%		Sale of enterprise software and provision of related after-sales services,

sale of computer and hardware and accessories and provision of software development services

Shielder Limited	Hong Kong	February 25, 1998	100%	Investment holding
Tsingdao Fujin Commerce and Finance Software Limited ("Tsingdao Fujin")	PRC	May 26, 2004	70%	Inactive

*Notes:*

- (i) These subsidiaries were incorporated as Sino-foreign joint venture limited companies for a term of 25 years.
- (ii) Shanghai New Take was incorporated for a term of 8 years commencing September 13, 2001. The Company initially held a 90% equity interest in Shanghai New Take and on June 30, 2004, the Company acquired the 10% minority interest for a consideration of RMB50.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

***Basis of presentation*** - The consolidated financial statements of the Company have been prepared in accordance with the accounting principles generally accepted in the United States of America ("U.S. GAAP").

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

***Significant risks and uncertainties*** - The Company participates in a high-technology industry and believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations, or cash flows: advances and trends in new technologies and industry standards; changes in government policies, standards, rules and regulations; competition from other competitors; changes in key suppliers; changes in certain strategic relationships or customer relationships; regulatory or other risks; risks associated with the Company's ability to attract and retain employees necessary to support its growth.

***Use of Estimates*** - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company bases its estimates on historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Significant accounting estimates reflected in the Company's consolidated financial statements include allowance for doubtful account, the useful lives and impairment of property, plant and equipment and of intangible assets, and impairment of goodwill.

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

**Term deposits** - Term deposits consists of deposits placed with financial institutions with original maturity terms of greater than 3 months but less than 1 year.

**Inventories** - Inventories are stated at the lower of cost or market. Cost is determined by the weighted average method.

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

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

**Acquired intangible assets** - Acquired intangible assets, which consist primarily of software development contracts, customer lists and relationships and completed technology, are carried at cost, less accumulated amortization. Amortization is calculated on a straight-line basis over the expected useful life of the assets of 2 to 5 years.

Amortization expenses for the years ended December 31, 2003, 2004 and 2005 were nil, RMB805 and RMB2,416, respectively.

**Impairment of long-lived assets** - Pursuant to Statement of Financial Accounting Standard ("SFAS") No. 144 "Accounting for the Impairment or Disposal of Long-lived Assets", the Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, the Company measures impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, the Company would recognize an impairment loss based on the fair value of the assets.

**Goodwill** - Goodwill represents the excess of the cost of acquisition over the fair value of the identifiable assets and liabilities acquired.

Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. The Group completes a two-step goodwill impairment test. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill.

**Income taxes** - Deferred income taxes are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, net operating loss carryforwards and credits by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Current income taxes are provided for in accordance with the laws of the relevant taxing authorities.

**Revenue recognition** - Revenue from sales of enterprise software and related after sales and maintenance services is generally recognized upon delivery as short-term unearned revenue due to the presence of undelivered elements, including post-delivery repair and maintenance, training, telephone support and in certain instances the rights to receive unspecified enhancements of the software on a when-and-if-available basis. As the Company does not have vendor-specific objective evidence to establish the fair value of the undelivered elements, the Company recognizes revenue earned from such contracts, whether made through direct sales or received from its distributors and franchisee, on a straight-line basis over the contract period, which is typically 12 months. In addition, the Company would only recognize revenue if it has determined that collectibility is reasonably assured.

For certain customers, the Company installs the software at the customer's place of business and charges the customer a fixed price per use of the software and accordingly the Company recognizes the related revenue when the customer uses the software.

The Company generally recognizes contract revenues generated from the provision of software development services and the related costs on a percentage-of-completion method, and begins recognizing such revenues at the time the contract is signed. Percentage-of-completion is measured principally by the percentage of man-hours incurred to date for each contract to the estimated total hours to be incurred for each contract at completion. Revenue from software development services are also comprised of certain system integrations projects. The Company recognizes revenues for systems integrations upon the receipt of written acceptance from the customer at the time the project is completed, because the Company does not have vendor-specific objective evidence to allow for separating the various components of the systems integration contracts into separate units of accounting. Amounts received from customers before the Company provides the software development services are recorded as customers' deposits on the balance sheet.

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

Pursuant to "Certain Policies to Encourage the Development of Software and Integrated Circuit Industries as New and High Technology Enterprises", Beijing Ninetowns Times, Beijing Ninetowns Digital Technology and Beijing Ninetowns Ports are entitled to a refund of value-added tax paid at a rate of 14% of the sales value for self-developed software products, which does not include revenues from maintenance services and upgrade rights sold separately. Revenues from sales of software products include the refund of such value-added tax and the refund was RMB10,867, RMB17,382 and RMB19,766 for the years ended December 31, 2003, 2004 and 2005, respectively.

The Company presents sales net of value added tax and business tax incurred, which amount to RMB20,348, RMB32,517 and RMB40,034 for the years ended December 31, 2003, 2004 and 2005, respectively.

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

Costs that can be directly associated with a specific anticipated contract to be accounted for under the percentage-of-completion method are deferred when the Company has evaluated that their recoverability

from that contract is probable. Such costs are deferred and presented as work in process in the inventories until the contract is executed, at which point the deferred costs are included in the costs of that contract. Pre-contract costs relating to a specific contract that is subsequently rejected would be expensed immediately.

**Research and Development** - Research and development expenses include payroll, employee benefits and other headcount-related costs associated with product development. Technological feasibility for the Company's software products is reached shortly before the products are released to production. Costs incurred after technological feasibility is established are not material, and accordingly, the Company expenses all research and development costs when incurred.

**Advertising expenses** - Advertising expenses are charged to the consolidated statements of operations in the period incurred. The Company incurred advertising expenses amounting to RMB353, RMB591 and RMB1,979 for the years ended December 31, 2003, 2004 and 2005, respectively.

**Government subsidies** - Government subsidies are recognized when received and when all the conditions for their receipt have been met.

**Foreign currency translation** - The functional currency of the Company's subsidiaries established in the PRC is Renminbi ("RMB"). Transactions dominated in other currencies are recorded in RMB at the rates of exchange prevailing when the transactions occur. Monetary assets and liabilities denominated in other currencies are translated into RMB at rates of exchange in effect at the balance sheet dates. Exchange gains and losses are recorded in the income statements.

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

Total comprehensive income is comprised of net income and foreign currency translation adjustments and amounted to RMB41,189, RMB133,951 and RMB148,509 for the years ended December 31, 2003, 2004 and 2005, respectively.

**Translation into United States Dollars** - The financial statements of the Company are stated in RMB. The translation of RMB amounts at and for the year ended December 31, 2005 into United States dollar ("US\$") is included solely for the convenience of readers and have been made at the rate of RMB8.0702 to US\$1 at December 31, 2005. Such translations should not be construed as representations that RMB amounts could be converted into US\$ at that rate or any other rate.

**Foreign currency risk** - The RMB is not a freely convertible currency. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of Renminbi into foreign currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. The cash and cash equivalents and term deposits of the Company included aggregate amounts of RMB134,882 and RMB150,271 at December 31, 2004 and RMB588,836 and RMB207,000 at December 31, 2005, respectively, which were denominated in RMB.

The PRC subsidiaries conduct their business substantially in the PRC, and their financial performance and position are measured in terms of RMB. Any devaluation of the RMB against the United States dollar would consequently have an adverse effect on the financial performance and asset values of the Company when measured in terms of United States dollar. The PRC subsidiaries' products and services are primarily sold and delivered in the PRC for RMB. Thus, their revenues and profits are predominantly denominated in RMB, and will have to be converted by the Company to pay dividends to the Company in Hong Kong or United States dollars. Should the RMB devalue against the Hong Kong or United States dollar, such

devaluation could have a material adverse effect on the Company's profits and the foreign currency equivalent of such profits repatriated by the PRC entities to the Company.

**Concentration of credit risk** - Financial instruments that potentially expose the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, trade receivables. The Company places its cash and cash equivalents with financial institutions with high-credit ratings and quality.

The Company conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Company establishes an allowance for doubtful accounts primarily based upon the age of the receivables and factors surrounding the credit risk of specific customers.

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

**Stock-based compensation** - The Company grants stock options to its employees and directors. The Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees", and its related interpretations which require the Company to record a compensation charge for the excess of the fair value for the stock at the grant date over the amount an employee must pay to acquire the stock. The compensation expense is recognized over the applicable service period, which is usually the vesting period.

On February 22, 2002, prior to the legal reorganization of the entities under common control, Jitter Bug, the then ultimate holding company of the Company, transferred a 6% ownership interest in the Company to certain executive officers for a nominal sum. In accordance with APB No. 25 and its related interpretation, the Company has accounted for this transaction as a contribution to capital by Jitter Bug with the offsetting charge to stock compensation for an amount determined by the difference between the amount paid and the fair value of the shares transferred. On the date of grant, Ninetowns was a shell company and as such, there was no value attributable to the interest transferred. As discussed in Note 1, on September 27, 2003, Jitter Bug transferred all of its interests in the operating subsidiaries to Ninetowns. The equity restructuring of the entities under common control resulted in a new measurement date for the interest transferred to the executive officers and, as such, the Company recorded a compensation charge in the year ended December 31, 2003 of RMB35,000, which was based on the fair value of the equity interests transferred. The fair value was established based on the price of shares sold to independent third parties shortly after restructuring. Had compensation cost for the options granted to employees in 2003 and 2005 under the Company's employee share option schemes (the "Plan") (see Note 12) been determined based on the fair value at the grant date, as prescribed in SFAS No. 123, the Company's pro forma net income would have been as follows:

	<u>Year ended December 31,</u>		
	<u>2003</u> RMB	<u>2004</u> RMB	<u>2005</u> RMB
Net income as reported	41,189	133,951	151,604
Add: Stock-based compensation as reported	-	-	-
Less: Stock-based compensation determined using the fair value method	(88)	(484)	(14,616)
Pro forma net income	41,101	133,467	136,988
Shares used in computation			
Basic	22,659,048	27,022,057	34,539,976
Diluted	22,659,048	28,279,061	35,706,894

Net income per share:			
Basic, as reported	1.82	4.96	4.39
Basic - pro forma	1.81	4.94	3.97
Diluted, as reported	1.82	4.74	4.25
Diluted - pro forma	1.81	4.72	3.84

The fair value of each option granted is estimated on the date of grant using the minimum value method for options granted before Ninetowns became a public company, as permitted for non-public companies, and using the Black-Scholes option pricing model for options granted after Ninetowns became a public company, with the following assumptions used for grants during the applicable period.

	Year 2003 under <u>2003 Plan</u>	Year 2005 under <u>2004 Plan</u>
<u>Options grants</u>		
Average risk-free rate of return	5%	5%
Weighted average expected option life	9.875 years	6.25 years
Volatility rate	N/A	55%
Dividend yield	0%	0%

**Comprehensive income** - The Company has adopted SFAS No. 130, "Reporting Comprehensive Income", which establishes standards for reporting and display of comprehensive income, its components and accumulated balances. Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Among other disclosures, SFAS No. 130 requires that all items that are required to be recognized under current accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. During the years presented, the Company's comprehensive income represents its net income and foreign currency translation adjustments, if any.

**Net income per share** - Basic net income per share is computed by dividing net income attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. Diluted net income per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised into ordinary shares. Ordinary share equivalents are excluded from the computation of the diluted net income per share in periods when their effect would be anti-dilutive. Options to purchase 2,574,400 shares were outstanding as of December 31, 2003, but were not included in the computation of diluted net income per share because the exercise price of the options was greater than the estimated fair value of the ordinary shares, and therefore the effect would be anti-dilutive.

**Recently Issued Accounting Pronouncements** - In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123 (revised 2004) ("SFAS No. 123-R"). "Share-Based Payment", which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123-R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". Generally, the approach in SFAS No. 123-R is similar to the approach described in SFAS No. 123. However, SFAS No. 123-R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on the grant-date fair values. Pro forma disclosure previously permitted under SFAS No. 123 is no longer an alternative. The new standard, as recently amended, will be effective for the Company in the annual reporting period beginning after January 1, 2006. Under SFAS No. 123-R, the Company could elect the modified prospective or modified retroactive option for transition on the adoption of this new standard. Under the modified retroactive option, prior periods are adjusted on a basis consistent with the proforma disclosures previously required for those periods by SFAS No. 123. Under the modified prospective option, compensation expense

for all unvested stock options must be recognized on or after the required effective date based on the grant-date fair value of those stock options. The Company would follow the same guidelines in the modified prospective transition method for awards granted subsequent to adoption and those that were granted after it became a public company and not yet vested. Prior to the adoption of SFAS No. 123-R, the Company has continued to utilize the accounting method prescribed by APB Opinion No. 25 and has adopted the disclosure requirements of SFAS No. 148 as allowed by SFAS No. 123.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4" ("SFAS No.151"). SFAS No. 151 clarifies the accounting that requires abnormal amounts of idle facility expenses, freight, handling costs, and spoilage costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred on or after July 1, 2005. The adoption of this standard did not have a material effect on the Company's financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29" ("SFAS 153"), which amends Accounting Principles Board Opinion No. 29, "Accounting for Nonmonetary Transactions" to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS 153 is effective for nonmonetary assets exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not anticipate that the adoption of this statement will have a material effect on the Company's financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154") which replaces Accounting Principles Board Opinions No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements - An Amendment of APB Opinion No. 28." SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not anticipate that the adoption of this statement will have a material effect on the Company's financial position or results of operations.

In September 2005 the Emerging Issues Task Force ("EITF") published Issue 04-13, *Accounting for Purchases and Sales of Inventory with the Same Counterparty*. The Issue addresses the accounting and disclosure requirements of accounting for purchases and sales of inventory with the same counterparty. In certain situations, as discussed further in the Issue, generally accepted accounting principles may require these types of transactions be carried at historical cost of inventory as opposed to the inventory's fair value, and potentially to defer revenue recognition primarily in situations wherein the transactions may not represent a completed revenue earnings cycle. The Issue is applicable for arrangements entered into by entities for interim or annual periods beginning after March 15, 2006, the Company does not anticipate that the adoption of this Issue will have a material effect on the Company's financial position or results of operations.

In March 2005, the FASB issued FASB Interpretation No. ("FIN") 47, "Accounting for Conditional Assets Retirement Obligations, an interpretation of SFAS No. 143". FIN 47 clarifies that an entity is required to recognize a liability for legal obligation to perform an asset retirement activity if the fair value can be reasonably estimated even though the timing and/or method of settlement are conditional on a future event. FIN 47 is required to be adopted for annual reporting periods ending after December 15, 2005. The Company does not anticipate that the adoption of this interpretation will have a material impact on the Company's financial position, results of operations or cash flows.

### 3. ACQUISITION

In June of 2004, the Company entered into an agreement with Value Chain International Limited ("Value Chain"), a company beneficially owned by Mr. Wang Shuang, the Chief Executive Officer of Ninetowns, and Ms. Dong Min, a member of the senior management of Ninetowns and spouse of Mr. Wang Shuang, to acquire the 10% minority interest in the operating subsidiaries held by Value Chain, Better Chance and Asia Pacific. The aggregate purchase price of US\$27,806 was determined based on negotiations between the Company's Board of Directors and the holders of the minority interests. The purchase consideration

consists of (i) US\$4,140 in cash, (ii) the assumption of loans payable to Value Chain of US\$1,736, and (iii) the issuance of 2,002,312 shares of the Company's ordinary share valued at US\$10.95 per share. In determining the fair value of the shares exchanged, the Company used a market-based approach. In September of 2004, the consideration was fully settled by cash payments of RMB48,637 for items (i) and (ii) and issuance of 2,002,312 shares to Value Chain.

The Company's purchase price allocation is follows:

	RMB
Net tangible assets acquired	26,280
Intangible assets	11,661
Goodwill	<u>191,956</u>
<b>Total consideration</b>	<b><u>229,897</u></b>

Intangible assets related to this acquisition of the 10% minority interest in the operating subsidiaries consisted of RMB279 allocated to software development contracts, RMB6,131 to customer lists and relationships and RMB5,251 to completed technology. Acquired intangibles are amortized over a period of 2 years for software development contracts, 5 years for customer lists and relationships and 5 years for completed technology.

#### 4. INVENTORIES

	<u>At December 31,</u>	
	<u>2004</u>	<u>2005</u>
	RMB	RMB
Inventories consist of the following:		
Computer accessories	1,332	2,276
Software products	21	5,277
Consumables	27	16
Work in progress	6,743	153
	<u>8,123</u>	<u>7,722</u>

#### 5. PROPERTY, PLANT AND EQUIPMENT, NET

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

	<u>At December 31,</u>	
	<u>2004</u>	<u>2005</u>
	RMB	RMB
Cost		
Buildings	-	18,789
Leasehold improvements	2,690	5,104
Furniture, fixtures and office equipment	1,822	2,798
Computer equipment	4,020	10,250
Motor vehicles	1,102	3,651
<b>Total</b>	<b>9,634</b>	<b>40,592</b>
Less: Accumulated depreciation and amortization	(4,375)	(7,108)
<b>Property, plant and equipment, net</b>	<b><u>5,259</u></b>	<b><u>33,484</u></b>

Depreciation and amortization expenses for the years ended December 31, 2003, 2004 and 2005 were RMB874, RMB1,315 and RMB2,877, respectively.

6. INTANGIBLE ASSETS, NET

Acquired intangible assets, net consist of the following:

	<u>At December 31,</u>	
	<u>2004</u>	<u>2005</u>
	RMB	RMB
Cost		
Software development contracts	279	279
Customer lists and relationships	6,131	6,131
Completed technology	5,251	5,251
Total	11,661	11,661
Less: Accumulated amortization	(805)	(3,221)
Intangible assets, net	<u>10,856</u>	<u>8,440</u>

For each of the next five years, annual amortization expenses of the software development contracts, customer lists and relationships, and completed technology will be approximately RMB93, RMB1,226 and RMB1,050, respectively.

7. OTHER INCOME

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
	RMB	RMB	RMB
Government subsidies	-	1,000	300
Others	211	340	147
	<u>211</u>	<u>1,340</u>	<u>447</u>

8. INCOME TAX EXPENSES

The Company is a tax exempted company incorporated in the Cayman Islands.

No provision for Hong Kong Profits Tax has been made as the subsidiaries incorporated in Hong Kong had no assessable profits earned or derived from Hong Kong during the three years ended December 31, 2003, 2004 and 2005.

The subsidiaries incorporated in the PRC other than Hong Kong are governed by the Income Tax Law of PRC Concerning Foreign Investment and Foreign Enterprises and various local income tax laws (the "Income Tax Laws").

Beijing New Take and Beijing Ninetowns Times were awarded the certificate of "New and High Technology Enterprise" by Beijing Municipal Science and Technology Committee on March 30, 2001 and,

as such, were exempted from the enterprise income tax for the two years ended December 31, 2002, followed by a 50% tax reduction for the three years ended December 31, 2005 at an income tax rate of 7.5%. Commencing from January 1, 2006, Beijing New Take and Beijing Ninetowns Times will be subject to an enterprise income tax rate of 15%.

Beijing Ninetowns Infrastructure Technology Development Centre, the predecessor of Beijing Ninetowns Digital Technology, was awarded the certificate of "New and High Technology Enterprise" on May 23, 1995 and was exempted from the enterprise income tax for the three years ended July 31, 1998 followed by a 50% tax reduction for the three years ended July 31, 2001 at an income tax rate of 7.5%. Such preferential tax treatment was inherited by Beijing Ninetowns Digital Technology, following its establishment on July 25, 2000. From August 1, 2001, Beijing Ninetowns Digital Technology was subject to an enterprise income tax rate of 15%.

Shanghai New Take was exempted from enterprise income tax for the two years ended December 31, 2004, followed by a 50% tax reduction for the three years ending December 31, 2007 at an income tax rate of 15%. Commencing from January 1, 2008, Shanghai New Take will be subject to an enterprise income tax rate of 33%.

Beijing Ninetowns Ports was awarded the certificate of "New and High Technology Enterprise" and is exempted from the enterprise income tax for the three years ended December 31, 2005.

No deferred taxes have been recorded as there were no significant taxable temporary differences during the tax exemption period of the PRC subsidiaries.

During the years ended December 31, 2003, 2004 and 2005, if the Company's subsidiaries in the PRC were neither in the tax holiday period nor had they been specifically allowed special tax concessions, they would have recorded additional income tax expense of RMB12,988, RMB23,558 and RMB13,519, respectively, the Company's net income would have been decreased by RMB11,687, RMB21,973 and RMB13,519, and basic and diluted net income per share would have been decreased to RMB1.30, RMB4.14 and RMB4.00, and RMB1.30, RMB3.96 and RMB3.87 for the years ended December 31, 2003, 2004 and 2005, respectively.

Reconciliation between the provision for income tax computed by applying the PRC enterprise income rate of 15% to income before income taxes and the actual provision for income taxes is as follows:

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
PRC enterprise income tax	15.0%	15.0%	15.0%
Expenses not deductible for tax purposes	12.3%	3.4%	10.2%
Income not subject to tax	(4.9%)	(1.2%)	(5.9%)
Tax exemption and tax relief granted			
to PRC subsidiaries	(14.7%)	(16.7%)	(18.9%)
Others	(0.2%)	0.8%	-
	<u>7.5%</u>	<u>1.3%</u>	<u>0.4%</u>

9. OTHER TAXES PAYABLE

<u>At December 31,</u>	
<u>2004</u>	<u>2005</u>
RMB	RMB

Individual income tax	165	196
Business tax payable	1,342	1,877
Value added taxes payable, net	2,507	783
	<u>4,014</u>	<u>2,856</u>

The Company's subsidiaries in the PRC other than Hong Kong are subject to a 17% value added tax on revenues from sales of hardware to customers and, in addition, are subject to business tax and value added tax at the rates of 5% and 6%, respectively, on service revenues from software development and sales of software, respectively. Value added taxes payable on revenues is equal to an amount net of the value added tax paid on inventory purchases. The Company is also required to withhold PRC individual income tax on employees' payroll for remittance to the tax authorities.

## 10. RELATED PARTY TRANSACTIONS AND BALANCES

### *Investment activities:*

In September 2002, the Company set up Shenzhen Ninetowns Enke Software Technology Co., Ltd. (formerly known as Shenzhen Jinwangge Software Co., Ltd.) ("Ninetowns Enke") in the PRC, together with certain members of senior management of the Company and certain independent third parties. The Company contributed RMB4,080 for a 51% equity interest in Ninetowns Enke. In May 2003, the Company disposed of its entire interest in Ninetowns Enke, which had not yet begun operations, at cost to Beijing Yadi Yangguang Technology Development Co., Ltd. ("Beijing Yadi Yangguang"), a company wholly owned by Mr. Wang Shuang and Ms. Dong Min, a member of the senior management of the Company and the spouse of Mr. Wang Shuang, for a consideration of RMB4,080. No gain or loss was recorded in relation to this disposition.

In June 2004, the Company entered into agreements for the acquisition of office premises for an aggregate consideration of RMB49,652. Certain of these properties are being acquired from Beijing Heng Fu Plaza Development Company Ltd., a company in which Mr. Ko Jin Heng is a director, for a consideration of RMB47,339. Mr. Ko Jin Heng is also a director of Jitter Bug. In 2005, the Company acquired an additional premise from Beijing Hong Fu Plaza Development Company, Ltd for a consideration of RMB18,617. As of December 31, 2004 and 2005, the Company had paid accumulated amounts of RMB47,339 and RMB65,956, respectively, with respect to these acquisitions. Since these acquisitions had not been completed and the risk and reward of the ownership of the properties concerned had not been transferred to the Company as of December 31, 2004 and 2005, the payments of RMB47,339 and RMB65,956, respectively, were included in deposits paid for acquisition of property, plant and equipment in the consolidated balance sheets.

### *Software development services:*

During the years ended December 31, 2003, 2004 and 2005, the Company provided software development services, directly or indirectly, to Beijing iTowNet Cyber Technology Ltd. ("Beijing iTowNet") in which Mr. Wang Shuang and Ms. Dong Min have beneficial interests. Mr. Ren Xiaoguang, a member of the senior management of the Company, is a non-executive director of Beijing iTowNet. Mr. Wu Bolin, another member of the senior management of the Company, is the sole supervisor of Beijing iTowNet. In 2003, the Company entered into various software development services contracts with eGrid Technology Ltd. ("eGrid") (formerly known as Beijing Regard Technology Co., Ltd.) to provide software development services to Beijing iTowNet as the ultimate user. eGrid is a company established in the PRC by Beijing Yadi Yangguang and certain individuals. In March 2003, Beijing Yadi Yangguang disposed of its 73.75% interest in eGrid to another individual. The Company recognized net revenues of RMB18,500 and RMB22,160 from such indirect services to Beijing iTowNet in 2003 and 2005, respectively. No such services were provided by the Company to Beijing iTowNet in 2004. For the years ended December 31,

2004 and 2005, RMB3,593 and RMB270 were recognized from direct software development services provided to Beijing iTowNet. The Company also provided platform maintenance services to Beijing iTowNet directly and indirectly in the years ended December 31, 2004 and 2005 and recognized net revenues of RMB6,000 and RMB5,670, respectively, from such services.

*Sales of enterprises software:*

In September 2003, the Company entered into a distribution agreement with Ninetowns Enke for the distribution of the Company's enterprise software in the southern region of the PRC. During the years ended December 31, 2003, 2004 and 2005, the Company recognized net revenues of RMB1,394, RMB25,245 and RMB47,500, respectively, from sales of enterprise software to Ninetowns Enke.

In addition, the Company sold software products to Beijing iTowNet, directly and indirectly, amounting to RMB515, RMB16,840 and RMB13,454 in the years ended December 31, 2003, 2004 and 2005, respectively.

*Others:*

In November 2004, the Company entered into an agreement with Mr. Wang Shuang, Ms. Dong Min and Ninetowns Import & Export e-Commerce to the effect that Ninetowns Import & Export e-Commerce would sell its 49% interest in Beijing iTowNet to the Company at the Company's request if, at any time while the Company's ordinary shares or ADSs are registered with the SEC, Ninetowns Import & Export e-Commerce is allowed to sell such interest to the Company under the relevant PRC law and the policies of the State Administration for Quality Supervision and Inspection and Quarantine of the PRC (the "PRC Inspections Administration"). The Company's rights under the agreement is subject to the statutory right of first refusal of the PRC Inspections Administration to purchase such interest. The Company has agreed, if exercising its rights under the agreement, to purchase the 49% interest in Beijing iTowNet at a purchase price of US\$25 million, plus a compounded interest rate of 5% per year for each year that Ninetowns Import & Export e-Commerce has held the interest since August 23, 2001, but deducting any dividend or distribution that Ninetowns Import & Export e-Commerce has received or in the future receives from Beijing iTowNet.

*Related party balances:*

As of December 31, 2004, the amounts due to shareholders represented the net proceeds to certain selling shareholders that had been collected by the Company on behalf of such selling shareholders and remained outstanding.

In addition, trade receivables included amounts of RMB8,015 and RMB8,240 at December 31, 2004 and 2005 receivable from Beijing iTowNet, respectively. These receivables relate to revenues generated from the provision of the software development services and sales of enterprise software disclosed above. Trade receivables also included amounts of Nil and RMB3,005 at December 31, 2004 and 2005, respectively, receivable from eGrid, with respect to the provision of software development services and sales of enterprise software disclosed above. Trade receivables also included amounts of RMB22,925 and RMB18,507 at December 31, 2004 and 2005, respectively, from Ninetowns Enke with respect to the sale of enterprise software disclosed above.

The amounts are unsecured, interest free and repayable on demand. The carrying amounts as of December 31, 2005 approximate their fair value.

## 11. CAPITAL STRUCTURE

The Company has a simple capital structure with one class of ordinary shares.

On February 8, 2002, the Company issued 4 shares for par value of HK\$0.025 on incorporation. On September 27, 2003, in connection with a legal reorganization, the Company issued 21,999,996 shares on a

pro-rata basis to the shareholders of the Company. The Company has accounted for the issuance of shares in connection with this reorganization as a legal reorganization of entities under common control in a manner similar to the pooling-of-interests and accordingly all shares and per share data have been restated to give retroactive effect to this transaction.

In October 2003, the Company raised capital through the issuance of 780,000 shares in a private placement at a price of HK\$25 per share for a total consideration of RMB20,670.

In October and December of 2003, the Company raised additional capital through the issuance of 2,964,000 shares in a private placement at a price of HK\$25 per share for a total consideration of RMB71,741 (net of share issue expenses of RMB6,805). In connection with their subscription of ordinary shares, the investors received a put option, which permits them to sell back the shares at the subscription price plus a rate of return of 10% per annum, if the Company does not successfully register its shares by December 31, 2004, in a "qualified initial public offering". A qualified initial public offering is defined as one in which the price per share will generate an absolute return of at least 35%, if the initial public offering occurs within October 9, 2004, or an internal rate of return of at least 35% per annum from October 9, 2003 (the contract date). The put option period is from January 1, 2005 to June 30, 2005. Stock subscription proceeds of RMB24,804 were outstanding as of December 31, 2003. The amount was fully settled in 2004 and 16 additional ordinary shares were issued in accordance with the terms of the placement. Upon the listing of the Company's American Depositary Shares ("ADSs"), each representing one ordinary share of the Company, on the Nasdaq National Market in December 2004, the put option lapsed and the mezzanine equity was reclassified to the Company's shareholders' equity.

In October and November of 2004, Mr. Wang Shuang and Ms. Dong Min exercised 174,914 and 70,592 stock options, respectively, at an exercise price of HK\$25 each.

On November 9, 2004, the Company's shareholders approved a four-for-one share split. All share and per share data have been restated to give retroactive effect to this stock split.

In December of 2004, the Company offered 6,400,000 ADSs, representing 6,400,000 ordinary shares, at US\$11 each to the public, raising proceeds of RMB531,413, net of offering expenses of RMB7,600. The Company's ADSs are quoted on the Nasdaq National Market.

In February 2005, Ninetowns issued 600,000 ordinary shares to its depository bank and received 600,000 American Depositary Shares ("ADSs") for issuance to employees upon their exercise of vested share options. As of December 31, 2005, 284,774 ADSs out of such 600,000 ADSs have been issued to the employees and the remaining 315,226 ADSs continue to be held by Ninetowns for future issuances.

## 12. SHARE OPTION PLANS

### The 2003 Plan

Under the share option plan adopted in November of 2003 (the "2003 Plan"), Ninetowns may grant options to purchase up to 2,574,400 ordinary shares to employees and directors at prices as determined by Ninetowns' Board of Directors. The 2003 Plan will remain in effect for 10 years starting from the date of adoption.

On November 18, 2003, Ninetowns granted 2,574,400 options to purchase 2,574,400 ordinary shares to certain employees and directors at an exercise price of HK\$25 per share (equivalent to RMB26), which was determined by the Board of Directors by reference to the subscription price of HK\$25 per share for shares issued to independent investors in October and December of 2003. 25% of the options vested and became exercisable on May 18, 2004 while the remaining 75% vest over a three-year period with one-third of such options vesting each year beginning on November 18, 2004. All the options granted, which have not been exercised, will expire on November 17, 2013.

As of December 31, 2004 and 2005, options to purchase 2,328,894 and 2,044,120 ordinary shares were outstanding, respectively. As of December 31, 2004 and 2005, no option to purchase ordinary shares was available under the 2003 Plan for future grants.

#### The 2004 Plan and the Amended and Restated 2004 Plan

On October 27, 2004, Ninetowns adopted another share option plan (the "2004 Plan") for its employees. Under the 2004 Plan, Ninetowns may grant options to purchase up to 1,800,000 ordinary shares to employees at prices as determined by the Ninetowns' Board of Directors. The 2004 Plan will remain in effect for 10 years starting from the date of adoption.

The board of directors adopted the Amended and Restated 2004 Plan on October 21, 2005 and the shareholders approved the Amended and Restated 2004 Plan on December 2, 2005. The Amended and Restated 2004 Plan contains certain amendments to the 2004 Plan, including an increase in the aggregate number of ordinary shares that may be issued under the Amended and Restated 2004 Plan from 1.8 million ordinary shares to 4.3 million ordinary shares, an addition of an "ever-green" provision and the ability to grant share appreciation rights, restricted share awards and performance awards.

The Amended and Restated 2004 Plan provides for the grant of incentive share options to Ninetowns' employees.

The board of directors or a committee appointed by the board of directors administers the Amended and Restated 2004 Plan. The administrator has the power to determine the terms of the share options, including the exercise price, the number of shares subject to each such award and the circumstances for vesting.

The administrator determines the exercise price of options granted under the Amended and Restated 2004 Plan, but with respect to incentive share options, the exercise price must at least be equal to 100.0% of the fair market value of Ninetowns' ordinary shares on the date of grant. The term of an incentive share option may not exceed ten years from the grant date, except that with respect to any participant who owns 10.0% or more of the voting power of all classes of our outstanding stock, the term must not exceed five years from the grant date and the exercise price must equal at least 110.0% of the fair market value on the grant date.

After termination of an employee, director or consultant, he or she may exercise his or her option for the period of time stated in the option agreement. Generally, (i) if termination is due to death or disability, the option will remain exercisable for one year following such termination; (ii) if termination is due to retirement, the option will remain exercisable for six months following such termination; and (iii) if termination is for cause, the option will be forfeited immediately. In all other cases, the option will generally remain exercisable for 30 days following such termination. However, an option generally may not be exercised after the expiration of its term.

The Amended and Restated 2004 Plan generally does not allow for the transfer of options and only the recipient of an option may exercise an award during his or her lifetime.

The Amended and Restated 2004 Plan generally provides that in the event of a "change of control" involving Ninetowns, the administrator may arrange for the successor corporation to assume or substitute an equivalent award for each outstanding option. The administrator may in the alternative pay cash or other consideration in exchange for cancellation of the outstanding options.

The Amended and Restated 2004 Plan will automatically terminate in 2015, unless Ninetowns terminates it sooner. In addition, the board of directors has the authority to amend, alter, suspend, discontinue or terminate the Amended and Restated 2004 Plan provided such action does not impair the rights of any participant.

On February 23, 2005, Ninetowns granted 890,000 options to purchase 890,000 ordinary shares to certain employees at an exercise price of US\$8.6 (equivalent to RMB71) per share, which was determined by the

Board of Directors by reference to the closing price of Ninetowns' ADSs as reported by the Nasdaq National Market before the date of grant. 25% of the options shall become vested on each of the first annual anniversary dates after the date of grant. All the options granted, which have not been exercised, will expire on February 22, 2015.

As of December 31, 2005, options to purchase 890,000 ordinary shares were outstanding and 3,410,000 options to purchase ordinary shares were available under the Amended and Restated 2004 Plan for future grants.

A summary of the share option activities is as follows:

	Number of options	Weighted average exercise prices	RMB equivalent
Granted and outstanding at December 31, 2003	2,574,400	HK\$25	26
Exercised during the year under the 2003 Plan	(245,506)	HK\$25	26
Outstanding at December 31, 2004	2,328,894	HK\$25	26
Exercised during the year under the 2003 Plan	(284,774)	HK\$25	26
Granted during the year under the Amended and Restated 2004 Plan	890,000	US\$8.6	71
Forfeited during the year under the Amended and Restated 2004 Plan	(57,023)	US\$8.6	71
Outstanding at December 31, 2005	<u>2,877,097</u>		<u>37</u>

The weighted average fair value per share of the 2003 Plan and the Amended and Restated 2004 Plan as of the date of grant was HK\$0.286 and US\$4.896, respectively.

The following table summarizes information with respect to share options outstanding on December 31, 2005:

Option Plans	Options outstanding as at December 31, 2005		
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise prices
2003 Plan	2,044,120	8.875	HK\$25
Amended and Restated 2004 Plan	832,977	9.167	US\$8.6
	<u>2,877,097</u>		

### 13. COMMITMENTS

The Company has operating lease agreements principally for its office properties in the PRC. Such leases have remaining terms ranging from 12 to 36 months and are renewable subject to negotiation. Rental expense was RMB3,714, RMB4,439 and RMB6,581 for the years ended December 31, 2003, 2004 and 2005, respectively.

Future minimum lease payments under non-cancellable operating lease agreements at December 31, 2005 were as follows:

RMB

Fiscal year	
2006	1,907
2007	279
Total	2,186

#### 14. SEGMENT INFORMATION

*Description of the Types of Products and Services from which each Reportable Segment Derives its Revenues* - As of December 31, 2005, the Company has three reportable segments: the enterprise software segment, the software development services segment and the computer hardware sales segment. The enterprise software segment is engaged in the development, distribution and sale of software products, the provision of customer maintenance services to the end-users and all of the research and development of new enterprise software. The software development services segment is responsible for the development and integration of software in accordance with the customers' specifications and requirements and subsequent maintenance services. The computer hardware sales segment is engaged in the sales of computer hardware and accessories.

*Measurement of Segment Profit and Loss and Segment Assets* - The accounting policies underlying the financial information provided for the segments are based on the accounting principles and the relevant financial regulations applicable to enterprises with foreign investment as established by the Ministry of Finance of the PRC ("PRC GAAP"). The principal measurement differences between PRC GAAP and U.S. GAAP as they relate to the Company are the result of differences in the accounting for (i) revenue recognition from sales of enterprise software, and (ii) reclassification of PRC value added tax refund.

*Factors Management Used to Identify the Company's Reportable Segments* - The Company's reportable segments offer different products and services. Each reportable segment is the responsibility of a member of the senior management of the Company who has knowledge of product and service specific operational risks and opportunities. None of the operating segments of the Company have been combined for presentational purposes.

*Analysis of Reportable Segments (Management Information - PRC GAAP basis)*

	Year ended December 31, 2003			
	Enterprise software RMB	Software development services RMB	Computer hardware sales RMB	Total RMB
Net revenues from external customers	108,767	545	72	109,384
Net revenues from related parties	7,739	18,500	-	26,239
Segment profit	114,974	14,106	24	129,104

	Year ended December 31, 2004			
	Enterprise software RMB	Software development services RMB	Computer hardware sales RMB	Total RMB
Net revenues from external customers	135,885	3,130	104	139,119
Net revenues from related parties	52,277	9,593	-	61,870
Segment profit	186,634	9,753	95	196,482

Year ended December 31, 2005

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

The Company does not allocate operating expenses to individual segments when making decisions about resources to be allocated to the segment and assessing its performance.

*Reconciliations of Reportable Segment Totals to Consolidated Totals* - The amounts presented for reportable segments reconcile to the consolidated totals as follows:

	<u>Year ended December 31,</u>		
	<u>2003</u> RMB	<u>2004</u> RMB	<u>2005</u> RMB
Net revenues from external customers	109,384	139,119	117,300
U.S. GAAP adjustments:			
Unearned income for enterprise software	(7,557)	(1,838)	21,232
Reclassification of PRC value added tax refund	10,672	12,588	12,280
Total net revenues from external customers	112,499	149,869	150,812
Net revenues from related parties	26,239	61,870	67,181
U.S. GAAP adjustments:			
Unearned income for enterprise software	(6,025)	(14,986)	14,387
Reclassification of PRC value added tax refund	195	4,794	7,486
Total net revenues from related parties	20,409	51,678	89,054
Segment profit	129,104	196,482	165,312
U.S. GAAP adjustments:			
Unearned income for enterprise software	(13,582)	(16,824)	35,619
Reclassification of PRC value added tax refund	10,867	17,382	19,766
Gross profit	126,389	197,040	220,697
Operating expenses	(73,276)	(57,368)	(86,539)
Income from operations	53,113	139,672	134,158
Interest income	1,220	3,768	17,625
Other income	211	1,340	447
Income before income tax expenses	54,544	144,780	152,230

*Geographical Disclosures -*

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

15. MAJOR CUSTOMERS

Details of the customers accounting for 10% or more of total sales are as follows:

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Guangzhou Panyu Chengchang Trade Development Co., Ltd.	21%	20%	18%
eGrid	14%	-	10%
Shanghai Xianghua Shipping Consulting Company	14%	1%	-
Beijing iTowNet	1%	12%	7%
Ninetowns Enke	1%	14%	20%
Shanghai Tomorrow Technology Development Co., Ltd.	2%	15%	12%

The account receivable from a customer with the largest receivable balance represents 33% and 39% of the balance of the accounts at December 31, 2004 and 2005, respectively.

16. EMPLOYEE BENEFIT PLANS

Employees of the Company located in the PRC other than Hong Kong are covered by the retirement schemes defined by local practice and regulations, which are essentially defined contribution schemes. The calculation of contributions for these eligible employees is based on 20% of the applicable payroll cost. Certain employees of the Company who are located in Hong Kong have joined the Mandatory Provident Fund ("MPF") Scheme which is also a defined contribution scheme. The contribution to the MPF Scheme is calculated based on the rules set out in the MPF Ordinance in Hong Kong which is 5% on the relevant income of the employee with a specific ceiling. The expenses paid by the Company to these defined contribution schemes were RMB436, RMB863 and RMB2,566 for the years ended December 31, 2003, 2004 and 2005, respectively.

In addition, the Company is required by law to contribute approximately 10% and 0.3% of applicable salaries of certain employees for medical and unemployment benefits and workers compensation, respectively. The PRC government is directly responsible for the payments of the benefits to these employees. The amounts contributed were RMB240, RMB487 and RMB1,523 for the years ended December 31, 2003, 2004 and 2005, respectively.

17. DISTRIBUTION OF PROFITS

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprises, Ninetowns' subsidiaries in the PRC other than Hong Kong are required to make appropriations from net income as determined under PRC GAAP to non-distributable reserves which include a general reserve, an enterprise expansion reserve and a staff welfare and bonus reserve. Wholly-owned PRC subsidiaries are not required to make appropriations to the enterprise expansion reserve but appropriations to the general reserve are required to be made at not less than 10% of the profit after tax as determined under PRC GAAP. The staff welfare and bonus reserve is determined by the board of directors.

The general reserve is used to offset future extraordinary losses. The subsidiaries may, upon a resolution passed by the stockholders, convert the general reserve into capital. The staff welfare and bonus reserve is

used for the collective welfare of the employees of the subsidiaries. The enterprise expansion reserve is used for the expansion of the subsidiaries' operations and can be converted to capital subject to approval by the relevant authorities. These reserves represent appropriations of retained earnings determined according to Chinese law and may not be distributed. There were no appropriations to reserves by Ninetowns' subsidiaries in the PRC other than Hong Kong during the years ended December 2003 and 2004. RMB28,553 was appropriated to reserves by a subsidiary of Ninetowns during the year ended December 31, 2005. As a result of these laws, approximately RMB40,950 and RMB58,355 are not available for distribution as of December 31, 2004 and 2005, respectively.

As a result of relevant PRC laws and regulations, Ninetowns' PRC subsidiaries are restricted in their abilities to transfer a portion of their net assets to Ninetowns. As of December 31, 2005, the amount of restricted net assets was approximately RMB499,859.

#### 18. SUBSEQUENT EVENTS

Subsequent to December 31, 2005, the Company approved an acquisition of a non-controlling interest in a business for a consideration of approximately US\$10,000.

In February 2006, the PRC Inspections Administration entered into a contract with the Company to purchase the ownership of the software product that the Company developed for a consideration of RMB3,300 (US\$409) ; and commenced to distribute such software products free-of-charge to end-users.

## OTHER CORPORATE INFORMATION

### Directors and Executive Officers

#### DIRECTORS

**Ng, Kin Fai**  
Director

**Lee, Mark Ming Hsun**  
Independent Director

**Wang, Shuang**  
Director

**Sun, Xiaomin**  
Independent Director

**Zhang, Dachun**  
Independent Director

**Chen, Fushan**  
Independent Director

#### CORPORATE GOVERNANCE

**Audit Committee**  
**Nominating Committee**  
**Compensation Committee**

Lee, Mark Ming Hsun  
Sun, Xiaomin  
Zhang, Dachun

#### EXECUTIVE OFFICERS

**Wang, Shuang**  
Chief Executive Officer

**Wu, Bolin**  
Chief Technology Officer

**Wang, John**  
Senior Vice President  
Business Development

**Ren, Xiaoguang**  
President

**Ho, Eric**  
Chief Strategy Officer

**Dong, Min**  
Senior Vice President  
Legal Affairs and Human Resources

**Fork, Tommy**  
Chief Financial Officer

## OTHER CORPORATE INFORMATION

### Corporate Information

#### Corporate Headquarter

Ninetowns Digital World Trade Holdings Limited  
5<sup>th</sup> Floor, Union Plaza  
20 Chaowai Street  
Chaoyang District  
Beijing, PRC 100020

#### Independent Auditor

Deloitte Touche Tohmatsu  
26/F, Wing On Centre  
111 Connaught Road  
Central, Hong Kong

#### Investor Relations

Investor inquiries may be directed to:  
Lisa Zheng  
Ninetowns Digital World Trade Holdings Limited  
5<sup>th</sup> Floor, Union Plaza  
20 Chaowai Street  
Chaoyang District  
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Telephone: 86-10-6588-2256  
Fax: 86-10-6588-2290  
Email: [ir@ninetowns.com](mailto:ir@ninetowns.com)  
Website: [www.ninetowns.com/english](http://www.ninetowns.com/english)

#### Stock Exchange Listing

Ninetowns American Depositary Receipt  
(one ADS = one ordinary share)  
trades on the Nasdaq National Market  
under the symbol NINE

#### ADR Depositary Bank

JPMorgan Chase Bank  
P.O. Box 43013  
Providence, Rhode Island 02940-3013  
(800) 990-1135  
Email: [adr@jpmorgan.com](mailto:adr@jpmorgan.com)  
Website: [www.adr.com](http://www.adr.com)

#### Annual General Meeting

The annual meeting of  
shareholders will be held  
on Friday, September 15, 2006 at 2:00pm at:  
Plaza Conference Centre  
5/F, China Life Tower  
No.16 Chaowai Street  
Chaoyang District, Beijing

[www.ninetowns.com](http://www.ninetowns.com)

**Ninetowns Digital World Trade Holdings Limited**

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