



Annual Report 2006

Empowering Global Trade

COMPANY PROFILE

We are a leading provider of online solutions for international trade, with key services in (i) automating import/export e-filing, and (ii) in tootoo.com, a leading B2B search and service provider for international trade in China.

Our American Depositary Shares are traded on The NASDAQ Global Market under the symbol NINE. On May 31, 2007, there were 34,991,834 ordinary shares outstanding, where one ordinary share equals one ADS. For more information, please visit www.ninetowns.com/english.

We encourage you to visit 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 July 17, 2007.

FINANCIAL HIGHLIGHTS

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

Fiscal Year Ended December 31	2003⁽²⁾	2004	2005	2006⁽¹⁾
Total Net Revenue	\$ 16,058	\$ 24,351	\$29,722	\$19,637
Income from Operations	6,416	16,875	16,624	3,544
Net income	4,976	16,184	18,785	5,885
Diluted net income per share	0.22	0.57	0.53	0.17
<i>Operating margin</i>	<i>40.0%</i>	<i>69.3%</i>	<i>55.9%</i>	<i>18.0%</i>
<i>Net margin</i>	<i>31.0%</i>	<i>66.5%</i>	<i>63.2%</i>	<i>30.0%</i>
At December 31,				
Deferred revenue	8,531	11,748	8,412	3,381
Total assets	39,143	147,667	166,758	174,945
Stockholders' equity	19,999	131,751	154,440	167,217
Number of registered licensees of iDeclare	51,860	95,000	122,000	130,000

(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 29, 2006, which was RMB7.8041 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:

September 30, 2007

2006 was a turning point for Ninetowns as we addressed the challenges facing our business and began to capitalize on new opportunities. We continued to innovate and to enhance our core market-leading B2G (“business-to-government”) products and services, in addition to extensively researching the B2B (“business-to-business”) market as a part of the international trade value chain. As a major milestone in the development of our growing B2B offering of services, we made a critical investment in a leading B2B trade facilitator. Together, these developments helped us to achieve many of our objectives, but more importantly, positioned us for an exciting 2007 and beyond.

Core B2G Business Overview

2006 was a critical year for us due to the strategic challenges faced by Ninetowns resulting from the provision of the free import/export e-filing software from the State Administration for Quality Supervision and Inspection and Quarantine of the People’s Republic of China (the “PRC Inspections Administration”). The PRC Inspections Administration’s free software not only prevented the license sale of our new iProcess basic version, but also significantly affected the sale of our core flagship product iDeclare and its associated services.

Despite these difficulties, I am glad to report that Ninetowns has maintained industry leadership with a dominant market share of close to 90%. In addition, our management team and employees worked very hard on various fronts to revitalize our core B2G operations. First, for the full year 2006, we increased our installed customer base to 130,000 through the sale of approximately 8,250 iDeclare packages. Second, we continued to gain iDeclare service contracts through the sale of approximately 29,000 iDeclare service contracts for the year, representing a healthy service renewal rate of about 24% at the end of the year. Finally, we assisted the PRC Inspections Administration in installing 28,500 free import/export iProcess user accounts at the end of the year. This achievement is a positive step for Ninetowns and broadens our customer base for future services and upgrades.

In 2006, we reported total net revenue of US\$19.6 million, a decrease of 36.1% compared to US\$29.7 million in 2005. Net income in 2006 was US\$5.9 million, or US\$0.17 per share on a diluted basis, representing a decrease of 69.7%, compared to that of US\$18.8 million for 2005. The reason for the revenue decrease is mainly due to the decline in sales of our core enterprise software iDeclare product and services. The reasons for the net income decrease are due to both the revenue decline and gross margin contraction. The margin contraction is the result of the change in revenue mix where lower margin software development services revenue increased relative to the higher margin enterprise software sales. Despite these declines, we closed 2006 in a solid financial position. I am pleased to report a debt-free balance sheet, cash and term deposit balance of US\$116.1 million, as well as deferred revenue of US\$3.4 million at end of the year.

New B2B Business Development

Throughout 2006, we conducted an extensive study of our existing customer base to gain a better understanding of their needs for international trade services, and to help them to increase their competitive advantage in the international trade arena. As a result, we focused our strategy on offering B2B trade services to enhance the revenue generating capabilities of our customers, in addition to the cost savings achievable through our core B2G e-filing services. In order to achieve this strategy, we will leverage Ninetowns’ existing broad customer base and our unique market intelligence.

As an initial step in executing our B2B strategy, we acquired a 16.25% equity interest in Global Market Group Limited (“Global Market”), a leading Chinese B2B trade facilitator headquartered in Guangzhou for US\$5 million. Specifically, Global Market offers international marketing services to suppliers and manufacturers based in China, and integrated sourcing services to international volume buyers. I am confident that Global Market’s proven B2B trade platform, coupled with Ninetowns’ strong customer base and extensive domestic support and service networks, will help our customers to reduce their operating costs through the efficiencies of our core B2G e-filing services, and expand their revenue streams through the B2B trade facilitation.

Business Outlook

For 2007, we expect to continue executing on iDelcare and iProcess, our core B2G enterprise packages. In addition, we expect to continue expanding our efforts in building our B2B platform. At the time of writing this letter, we have already acquired a majority stake in an advanced B2B vertical search technology company and launched our own B2B search platform. I believe the combination of our B2G and B2B operations will enhance value for our customers and shareholders, and will ultimately drive Ninetowns' long-term revenue growth and profitability.

As we prepare for the future, I am confident that our talented team will continue to turn market potential into financial success. We are enthused by the prospect of another exciting year and will focus our energy on continued execution. Finally, I would like to thank our shareholders, customers, suppliers, partners and employees for the tremendous support and understanding you have extended to 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 NOVEMBER 30, 2007**

The Annual General Meeting of Shareholders of Ninetowns Internet Technology Group Company Limited (the “Company”) will be held at 2:00 p.m. on November 30, 2007 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, 2007 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, 2006;
3. to approve the Board’s compensation for the fiscal year ended December 31, 2006 and delegate authority to the compensation committee of the Board to fix the remuneration of the Board for the fiscal year ending December 31, 2007;
4. 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 October 15, 2007 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, 2006 may be viewed at our website at www.ninetowns.com/english.

NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED

**PROXY STATEMENT
FOR ANNUAL GENERAL MEETING OF SHAREHOLDERS
TO BE HELD ON NOVEMBER 30,, 2007**

This proxy statement is furnished by Ninetowns Internet Technology Group Company 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, November 30, 2007 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, 2007 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, 2007.

**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, 2007.**

**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, 2006 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, 2006 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, 2006.

**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, 2006.**

**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, 2006 be RMB3,111,000 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, 2007.

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, 2006 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, 2007.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE "FOR" THE APPROVAL OF THE
PROPOSED AGGREGATE COMPENSATION FOR THE BOARD FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2006 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, 2007.**

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 (or PRC Inspections Administration), that enable our enterprise software to process electronic declarations over the Internet.

We generated total net revenues of RMB201.5 million, RMB239.9 million and RMB153.2 million (US\$19.6 million) in 2004, 2005 and 2006, respectively. The decrease in our total net revenues was due to the PRC Inspections Administration's free distribution of products that are similar to our iDeclare.CIQ product series. Our net income in 2004 was RMB134.0 million increasing to RMB151.6 million in 2005. Our net income in 2006 was RMB45.9 million (US\$5.9 million) representing a 69.7% decrease from 2005. We believe there were approximately 95,000, 122,000 and 130,000 licensees of our enterprise software registered to effect electronic import/export processing with the PRC Inspections Administration as of December 31, 2004, 2005 and 2006, 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 2006 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\$1.7 trillion in 2006, up from approximately US\$1.2 trillion in 2004 and approximately US\$1.4 million in 2005. 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 product series. The PRC Inspections Administration agreed to pay a one-time fee of RMB3.3 million (US\$423,000) 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 and 2,200 software packages of iDeclare.CIQ during the first quarter of 2006 and 2007, respectively, which is significantly lower than the approximately 8,000 software packages of iDeclare.CIQ sold by our company and our former distributors and franchisees during the first quarter of 2005. In May 2007, the PRC Inspections Administration selected our company as one of the winning bidders in connection with the PRC Inspections Administration's request for proposals for servicing the free import/export e-filing software provided by the PRC Inspections Administration.

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 609,276 foreign-invested companies registered to do business in China as of May 31, 2007. 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 four franchisees to undertake marketing, distribution and service activities in China.

Description of revenues, cost items and trade receivables

We primarily 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 0.3% of our total net revenues for 2006. In May 2007, we launched tootoo.com, our new B2B vertical search platform.

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 RMB51.7 million, RMB89.1million and RMB37.6 million (US\$4.8 million), or 25.6%, 37.1% and 24.6% of our total net revenues in 2004, 2005 and 2006, respectively, from our related parties Beijing iTowNet Cyber Technology Ltd., (or iTowNet) and eGrid Technology Ltd. (or eGrid), which are two of our major customers for software development services, and Shenzhen Ninetowns Enke Software Technology Co., Ltd., (or 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 2006, we recognized RMB10.5 million (US\$1.3 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 our iDeclare.CIQ product series a license fee of RMB4,500 per software package, which includes a one-year basic customer maintenance service period. We also charge RMB1,500 for each additional year of customer maintenance services, which includes a number of value-added services in addition to the basic maintenance services. We charge users of iProcess.CIQ product series on the same terms as those for iDeclare.CIQ product series. 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 deferred revenue on our balance sheets. Deferred 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 former distributors and franchisees for further sale to users. As of December 31, 2005, the distribution agreements with our former distributors, Panyu Chengchang Trade Development Co., Ltd., (or Panyu Chengchang), 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 May 2005, January 2006 and October 2006, we engaged three new franchisees and we currently have four franchisees. Our per-unit license fee for enterprise software products charged to our former distributors and franchisees is based on our negotiated sales arrangement with the former distributor or franchisee, and is less than the RMB4,500 per-unit license fee we receive from direct sales. We also sell iDeclare.CIQ products on a fee-per-declaration filing basis to a limited number of users, substantially all of whom are located in Guangdong Province, 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 2006, we collected customer maintenance service fees from approximately 29,000 users, representing approximately 23.8% 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 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. 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 charge 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, former distributors and franchisees. 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. Currently, we also distribute our enterprise software procedures through the Internet. 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 our iMonitor.CGA product series, since the costs associated with our iMonitor.CGA product series as a percentage of net revenues from sales of enterprise software are higher than the costs associated with our iDeclare.CIQ product series.

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 manhours 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 our iDeclare.CIQ product series. 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 and (iii) research and development expenses. 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. Effective January 1, 2006, the Company adopted SFAS 123R which supercedes APB 25 and recognized stock-based compensation cost on a straight-line basis over the requisite service period, which is the vesting method.

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. This, after netting off the effect of the increase in our stock-based compensation expenses, resulted in a significant decrease in our selling expenses for 2006. We expect to expand our marketing and advertising campaigns to compete with the free software distributed by the PRC Inspections Administration and we intend to increase incentive payments to salespersons to promote our enterprise platform products. In addition, 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 expect a gradual increase 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, professional fees and allowance for doubtful debts. We expense all general and administrative expenses as they are incurred. In 2006, 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 and our acquisition and investment activities, (ii) depreciation and amortization charges on fixed assets and intangible assets, (iii) increase in stock-based compensation expenses and (iv) increase in the number of employees due to our expansion into the B2B business. We expect our general and administrative expenses to increase continuously in 2007.

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 increase in stock-based compensation expenses, (iv) an expected increase in our potential new business ventures and (v) our investment in software licenses for development tools to increase the productivity of our overall research and development efforts.

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 our company is not subject to tax on its income or capital gains. In addition, payment of dividends by us is not subject to withholding tax in the Cayman Islands.

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% enterprise income tax, or EIT, rate. 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. Guangdong Ninetowns Technology Co., Ltd., or (Guangdong Ninetowns Technolog) is entitled to an exemption from EIT from January 1, 2006 to December 31, 2007. . Beijing Ninetowns Network and Software Co., Ltd., (or Ninetowns Network) is entitled to an exemption from EIT from January 1, 2006 to December 31, 2008. Ronghe Tongshang and Beijing Baichuan Tongda Science and Technology Development Company Ltd., (or Baichuan) are currently subject to a 33% EIT.

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, Ninetowns 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 RMB17.4 million, RMB19.8 million and RMB10.5 million (US\$1.3 million) in 2004, 2005 and 2006, 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 franchisees 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 RMB4.0 million (US\$0.5 million) as of December 31, 2006.

2006 compared to 2005

Total net revenues

We generated total net revenues of RMB153.2 million (US\$19.6 million) in 2006, a decrease of 36.1% over our total net revenues of RMB239.9 million in 2005. This revenue decrease was principally the result of the PRC Inspections Administration's free distribution of products that are similar to our iDeclare product series.

Enterprise software. Net revenues from sales of our enterprise software decreased by 42.6% to RMB116.8 million (US\$15.0 million) in 2006 from RMB203.5 million in 2005, primarily as a result of the PRC Inspections Administration's free distribution of products that are similar to our iDeclare product series. The availability of a free software product that has similar functions as iDeclare caused our sales of our iDeclare product series to decline significantly. In 2006, we signed customer maintenance service contracts with approximately 29,000 users whose customer maintenance service contracts were due for renewal in 2006. We recognized net revenues of RMB41.5 million (US\$5.3 million) from provision of customer maintenance services in 2006. Of our net revenues from sales of enterprise software, RMB23.6 million and RMB21.9 million (US\$2.8 million) were from per declaration filing fees in 2005 and 2006, respectively, representing a year-on-year decrease of 7.2%. As of December 31, 2006, we believe there were approximately 130,000 licensees of our enterprise software registered to effect electronic import/export processing over the data exchange platforms of iTowNet, an increase of 6.6% from approximately 122,000 of such licensees as of December 31, 2005.

Software development services. Net revenues from our software development services increased by 0.9% from RMB35.7 million in 2005 to RMB36.0 million (US\$4.6 million) in 2006. In 2006, we did not enter into as many software development contracts as compared to 2005, but we completed some project milestones and recognized revenue for software development contracts signed in 2005.

Computer hardware sales. Net revenues from computer hardware sales comprised less than 0.3% 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 100% to nil in 2006 as compared to RMB495,000 in 2005. Since iDeclare is now generally distributed through the Internet, we incurred

minimal outsourcing costs to outside contractors and costs associated with packaging and shipping of software.

Software development services. Cost of revenues from software development services decreased to RMB16.8 million (US\$2.2 million) in 2006 from RMB18.2 million in 2005, primarily as a result of fewer number of software development service contracts signed in 2006. As of December 31, 2006, the Company did not have capitalized costs related to such projects which represents a decrease of 100% over the prior year's balance of RMB153,000 as of December 31, 2005.

Computer hardware sales. Cost of revenues from computer hardware sales was insignificant in 2006.

Gross profit margin

Enterprise software. Gross profit margin for sales of enterprise software in 2006 was 100% compared to 99.8% in 2005 primarily because iDeclare is now generally distributed through the Internet and we incurred minimal outsourcing costs to outside contractors and costs associated with packaging and shipping of software.

Software development services. Gross profit margin for software development services in 2006 remained relatively stable at 53.3% compared to 49.0% in 2005.

Computer hardware sales. Gross profit margin for computer hardware sales increased to 66.3% in 2006 from 28.9% in 2005, primarily due to decreased sales of lower-margin products such as desktop computers.

Operating expenses

Operating expenses increased by 26.4% to RMB109.4 million (US\$14.0 million) in 2006 from RMB86.5 million in 2005, primarily as a result of our efforts to expand our business through new business models, additional staff, increase in stock-based compensation costs and increased research and development.

Selling expenses

Selling expenses decreased by 47.2% to RMB13.6 million (US\$1.7 million) in 2006 from RMB25.7 million in 2005, primarily due to our change in business model from direct sales to franchise sales.

General and administrative expenses

General and administrative expenses increased by 33.1% to RMB65.9 million (US\$8.4 million) in 2006 from RMB49.5 million in 2005, primarily due to increases in (i) professional fees incurred in relation to our acquisition and investment activities and compliance requirements applicable to us as a public company in the United States, (ii) depreciation and amortization charges on fixed assets and intangible assets, (iii) stock-based compensation costs and (iv) 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 significantly by 165.1% to RMB29.8 million (US\$3.8 million) in 2006 from RMB11.2 million in 2005, primarily due to an increase in (i) stock-based compensation costs and (ii) staff costs related to the research and development of our new products primarily related to our new B2B business.

Government subsidies

We received government subsidies of RMB705,000 (US\$90,000) in 2006, which represented an increase of 57.8% from RMB 477,000 in 2005, primarily attributable to the receipt of government subsidies for research and development of an electronic platform from the Committee of Zhongguancun Science Park.

Interest income

Interest income increased to RMB19.3 million (US\$2.5 million) in 2006 from RMB17.6 million in 2005, primarily due an increase in the amount of our term deposits.

Income taxes

Income taxes increased by 64.7% to RMB1.0 million (US\$132,000) in 2006 from RMB626,000 in 2005, as Ninetowns Ports, who is one of our major operating subsidiaries and was exempt from EIT from August 1, 2003 to December 31, 2005, became subject to a 7.5% EIT starting from January 1, 2006.

Net income

Net income decreased significantly by 69.7% to RMB45.9 million (US\$5.9 million) in 2006 from RMB151.6 million in 2005 as a result of the cumulative effect of the factors described above.

2005 compared to 2004

Total net revenues

We generated total net revenues of RMB239.9 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 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 from provision of customer maintenance services in 2005. Of our net revenues from sales of enterprise software, RMB24.1 million and RMB23.6 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 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 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 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 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 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 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 35.5% to RMB49.5 million in 2005 from RMB36.6 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 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.

Government subsidies

Government subsidies decreased by 66.6% to RMB447,000 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.

Interest income

Interest income increased significantly to RMB17.6 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.

Income taxes

Income taxes decreased by 65.7% to RMB626,000 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 in 2005 from RMB134.0 million in 2004 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. We had no outstanding debt as of December 31, 2006. The following table sets forth the summary of our cash flows for the periods indicated:

	For the years ended December 31,				
	2003	2004	2005	2006	2006
			(in millions)		
Net cash provided by operating activities		RMB		RMB	40.8
	RMB	87.2	RMB	143.3	RMB
Net cash used in investing activities		(39.6)		(110.9)	(176.5)
	RMB	70.2		2.0	6.3
Net cash provided by financing activities		70.2		2.0	6.3
Net increase / (decrease) in cash and cash equivalents		117.8		(34.5)	(132.8)
	RMB	117.8		(34.5)	(132.8)
Cash and cash equivalents, beginning of year/period		49.7		697.0	731.5
	RMB	49.7		697.0	731.5
					93.7
					US\$
					5.2
					(22.6)
					0.8
					(17.0)
					93.7

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 from operating activities of RMB40.8 million (US\$5.2 million) in 2006. This was primarily attributable to our cash receipts from sales of enterprise software and software development services. We provided cash in operating activities of RMB146.4 million in 2005. This was primarily attributable to our cash receipts from sales of enterprise software and software development services. We generated cash from operating activities of RMB143.3 million in 2004. This was primarily attributable to our cash receipts from sales of enterprise and software development services.

Cash flow from investing activities

Cash used in investing activities was RMB176.5 million (US\$22.6) million in 2006. This was primarily attributable to our purchase of property and equipment for our new B2B business and our investment in Global Market, our purchase of intangible assets and increase of term deposits.

Cash used in investing activities was RMB110.9 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, our purchases of property and equipment and an increase in our term deposits. Investing activities used cash of RMB179.4 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, the acquisition of minority interests in our subsidiaries and increase of term deposits, offset by the repayment of loans by Import & Export.

Cash flow from financing activities

Financing activities generated cash of RMB6.3 million (US\$0.8 million), in 2006. This was comprised primarily of employee's exercise of their vested share options. Financing activities provided cash of RMB2.0 million 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.

Capital resources

Our primary source of liquidity is cash flow from operating activities. Our cash and cash equivalents primarily consist of cash on hand and bank deposits. As of December 31, 2006, we had RMB598.6 million (US\$76.7 million) in cash and cash equivalents. In addition, as of December 31, 2006, we had invested RMB307.2 million (US\$39.4 million) in term deposits, which are payable at varying maturities from three to six 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, 2006, we had no lines of credit or other credit facilities.

Capital expenditures

For details of our capital expenditures, see Item 4 of our annual report on Form 20-F, “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. In the past, we shared ownership in a foreign trade business system software with Jingjiang A-Bin Software Workshop, or ABin, and a declaration software system that is not a part of our iDeclare.CIQ product series, with Beijing Regard Technology Co., Ltd., or (Beijing Regard). We are not selling either software and, to our knowledge, neither ABin nor Beijing Regard is currently selling such software.

As of December 31, 2006, we had 424 employees dedicated to research and development, 22 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 RMB4.8 million in 2004, RMB11.2 million in 2005 and RMB29.8 million (US\$3.8 million) in 2006.

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 middle of 2008.

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 deferred revenue on our balance sheet. Deferred 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 actual hours spent and the estimated costs to complete 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 actual hours spent and the estimated costs to complete the projects requires significant judgment.

Stock-based compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R, using the modified prospective transition method. Under this method, share-based compensation expense recognized beginning January 1, 2006 includes: (a) compensation expense for all share-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the fair market value as of the grant date, measured in accordance with the Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" issued by FASB and (b) compensation expense for all share-based compensation awards granted on or subsequent to January 1, 2006, based on grant-date fair value estimated in accordance with the provisions of SFAS 123R. We recognize share-based compensation costs on a straight-line basis over the requisite service period which is generally the vesting period. For share-based compensation awards that were granted before we became a public company and are not yet vested, the fair value is measured using the minimum value method and we continue to report these options under APB 25. For options vested prior to January 1, 2006, we accounted for share-based compensation plans in accordance with APB 25.

We recorded a compensation charge of RMB10.3 million for the options granted to our employees under our 2004 Plan.

As we have not granted options to our employees under the 2006 Share Incentive Plan, we do not have compensation charges that are associated with the 2006 Share Incentive Plan to record.

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 former 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 customers and franchisees 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. The trade receivables from Ninetowns Enke, iTowNet and eGrid, which are our customers that are related to us, were approximately 18.1% of our total trade receivables as of December 31, 2006. The trade receivables from our customers and franchisees, which are unrelated to us, were approximately 81.9% of our total trade receivables as of December 31, 2006. 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.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. We completed a two-step goodwill impairment test for 2004, 2005 and 2006. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Based on the Company's assessment, there was no impairment of goodwill for the years ended December 31, 2004, 2005 and 2006.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of
NINETOWNS INTERNET TECHNOLOGY GROUP COMPANY LIMITED:

We have audited the accompanying consolidated balance sheets of Ninetowns Internet Technology Group Company Limited (formerly "Ninetowns Digital World Trade Holdings Company Limited"), its subsidiaries, and its variable interest entity (the "Company") as of December 31, 2005 and 2006 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, 2006 (expressed in Renminbi), and the related financial statement schedule included in Schedule I. These consolidated financial statements and the related financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the 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, 2005 and 2006 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 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.

In 2006 the Company changed its method of accounting for stock-based compensation to conform to Statement of Financial Accounting Standard No. 123 (Revised 2004), "Share-based Payment", effective on January 1, 2006.

Our audits also comprehended the translation of Renminbi amounts into United States dollar amounts and such United States dollar amounts are presented solely for the convenience of the readers.

/s/ Deloitte Touche Tohmatsu CPA Ltd.
Beijing, China
July 12, 2007

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

	December 31,		
	<u>2005</u> RMB	<u>2006</u> RMB	<u>2006</u> US\$
ASSETS			
Current assets:			
Cash and cash equivalents	731,474	598,648	76,709
Term deposits	207,000	307,209	39,365
Trade receivables from customers:			
Billed, less allowance for doubtful accounts			
of RMB4,851 in 2005 and RMB1,088 in 2006	17,459	17,943	2,299
Unbilled	28,537	25,199	3,229
Trade receivables from related parties	29,752	3,963	508
Inventories	7,722	6,820	874
Prepaid expenses and other current assets	15,295	28,509	3,653
Deferred tax assets	-	1,698	218
Total current assets	<u>1,037,239</u>	<u>989,989</u>	<u>126,855</u>
Property and equipment, net	33,484	46,693	5,983
Deposits paid for acquisition of property and equipment	73,040	73,411	9,407
Investment under cost method	-	38,929	4,988
Acquired intangible assets, net	8,440	22,697	2,908
Goodwill	193,570	193,570	24,804
TOTAL ASSETS	<u>1,345,773</u>	<u>1,365,289</u>	<u>174,945</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued expenses	12,039	14,312	1,833
Customer deposits	10,639	10,321	1,323
Deferred revenue	67,886	26,383	3,381
Income taxes payable	5,388	6,334	812
Other taxes payable	2,856	2,332	299
Total current liabilities	<u>98,808</u>	<u>59,682</u>	<u>7,648</u>
Deferred tax liability	-	627	80
Total liabilities	<u>98,808</u>	<u>60,309</u>	<u>7,728</u>
Minority interest	600	-	-
Commitments and contingencies (Note 15)			
Shareholders' equity:			
Ordinary shares, par value RMB0.027 (HK\$0.025) per share; 8,000,000,000 shares authorized; 34,991,834 shares issued and outstanding in 2005 and 2006	926	926	119
Additional paid-in capital	861,315	871,642	111,689
Retained earnings	395,415	441,343	56,553
Treasury shares, at cost, 315,226 shares and 47,862 shares in 2005 and 2006, respectively	(8,196)	(1,268)	(162)
Accumulated other comprehensive loss	(3,095)	(7,663)	(982)
Total shareholders' equity	<u>1,246,365</u>	<u>1,304,980</u>	<u>167,217</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>1,345,773</u>	<u>1,365,289</u>	<u>174,945</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

Years ended December 31,

	2004	2005	2006	2006
	RMB	RMB	RMB	US\$
Net revenues:				
Enterprise software				
external customers	146,635	142,534	92,127	11,805
related parties (Note 13)	42,085	60,954	24,706	3,166
Software development services				
external customers	3,130	7,600	23,084	2,958
related parties (Note 13)	9,593	28,100	12,933	1,657
Computer hardware sales	104	678	398	51
Total net revenues	201,547	239,866	153,248	19,637
Cost of revenues:				
Enterprise software	(1,528)	(495)	-	-
Software development services (including share-based compensation expense of nil in 2004 and 2005, and RMB1,039 in 2006)	(2,970)	(18,192)	(16,805)	(2,153)
Computer hardware sales	(9)	(482)	(134)	(17)
Total cost of revenues	(4,507)	(19,169)	(16,939)	(2,170)
Gross profit	197,040	220,697	136,309	17,467
Operating expenses:				
Selling (including share-based compensation expense of nil in 2004 and 2005, and RMB3,371 in 2006)	(15,977)	(25,752)	(13,604)	(1,743)
General and administrative (including share-based compensation expense of nil in 2004 and 2005, and RMB4,074 in 2006)	(36,572)	(49,538)	(65,928)	(8,448)
Research and development (including share-based compensation expense of nil in 2004 and 2005, and RMB1,843 in 2006)	(4,819)	(11,249)	(29,825)	(3,822)
Total operating expenses	(57,368)	(86,539)	(109,357)	(14,013)
Government subsidies	1,340	447	705	90
Income from operations	141,012	134,605	27,657	3,544
Interest income	3,768	17,625	19,302	2,473
Income before provision for income taxes and minority interest	144,780	152,230	46,959	6,017
Provision for income taxes	(1,823)	(626)	(1,031)	(132)
Income before minority interest	142,957	151,604	45,928	5,885
Minority interest	(9,006)	-	-	-
Net income	133,951	151,604	45,928	5,885
Net income per share:				
Basic	4.96	4.39	1.32	0.17
Diluted	4.74	4.25	1.30	0.17
Shares used in computation:				
Basic	27,022,057	34,539,976	34,773,005	34,773,005
Diluted	28,279,061	35,706,894	35,368,882	35,368,882

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

	Ordinary shares		Additional paid-in capital RMB	Treasury shares		Retained earnings RMB	Accumulated other comprehensive loss RMB	Total RMB	Comprehensive income RMB
	Shares	Amount RMB		Shares	Amount RMB				
Balance as of January 1, 2004	22,780,000	604	55,066	-	-	109,860	-	165,530	
Shares issued for the acquisition of minority interest	2,002,312	53	181,259	-	-	-	-	181,312	
Shares issued upon initial public offering, net of issuance costs	6,400,000	169	531,244	-	-	-	-	531,413	
Expiration of put options and Issuance of ordinary shares	2,964,016	79	71,662	-	-	-	-	71,741	
Exercise of share options	245,506	6	6,499	-	-	-	-	6,505	
Net income	-	-	-	-	-	133,951	-	133,951	133,951
Balance as of December 31, 2004	34,391,834	911	845,730	-	-	243,811	-	1,090,452	
Ordinary shares converted to ADR shares for future exercises of share options	600,000	15	15,585	(600,000)	(15,600)	-	-	-	
Issuance of ADR shares for the exercises of employee share options	-	-	-	284,774	7,404	-	-	7,404	
Net income	-	-	-	-	-	151,604	-	151,604	151,604
Foreign currency translation adjustments	-	-	-	-	-	-	(3,095)	(3,095)	(3,095)
Balance as of December 31, 2005	34,991,834	926	861,315	(315,226)	(8,196)	395,415	(3,095)	1,246,365	
Issuance of ADR shares for the exercises of employee share options	-	-	-	267,364	6,928	-	-	6,928	
Employee share-based compensation	-	-	10,327	-	-	-	-	10,327	
Net income	-	-	-	-	-	45,928	-	45,928	45,928
Foreign currency translation adjustments	-	-	-	-	-	-	(4,568)	(4,568)	(4,568)
Balance as of December 31, 2006	34,991,834	926	871,642	(47,862)	(1,268)	441,343	(7,663)	1,304,980	41,360
		US\$119	US\$111,689	US\$(162)	US\$56,553	US\$(982)	US\$167,217		

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

	Years ended December 31,			
	<u>2004</u> RMB	<u>2005</u> RMB	<u>2006</u> RMB	<u>2006</u> US\$
Cash flows from operating activities:				
Net income	133,951	151,604	45,928	5,885
Adjustments to reconcile net income to net cash				
Provided by operating activities:				
Loss on disposal of property and equipment	-	263	511	65
Depreciation of property and equipment	1,315	2,877	6,194	794
Amortization of acquired intangible assets	805	2,416	2,943	377
Provision of allowance for doubtful debts	700	760	2,487	319
Bad debt recoveries	-	-	(4,008)	(514)
Minority interests	9,006	-	-	-
Employee share-based compensation	-	-	10,327	1,323
Changes in operating assets and liabilities:				
Inventories	(7,665)	401	903	116
Trade receivables from customers	(13,517)	(2,843)	2,854	366
Trade receivables from related parties	945	1,188	27,311	3,500
Prepaid expenses and other current assets	(16,943)	16,668	(12,313)	(1,578)
Accounts payable and accrued expenses	13,849	(7,022)	164	21
Customer deposits	-	10,639	(318)	(41)
Deferred revenue	26,622	(29,344)	(41,503)	(5,318)
Deferred taxes, net	-	-	(1,071)	(137)
Income taxes payable	533	(77)	947	121
Other taxes payables	(6,331)	(1,158)	(524)	(67)
Net cash provided by operating activities	<u>143,270</u>	<u>146,372</u>	<u>40,832</u>	<u>5,232</u>
Cash flows from investing activities:				
Increase of term deposits	(85,249)	(56,087)	(100,209)	(12,841)
Cash paid for investment under cost method	-	-	(38,929)	(4,987)
Purchase of property and equipment	(2,856)	(31,376)	(19,774)	(2,534)
Purchase of intangible assets	-	-	(17,200)	(2,204)
Deposits paid for acquisition of property and equipment	(49,652)	(23,388)	(371)	(48)
Acquisition of additional interest in subsidiaries	(48,637)	-	-	-
Payment for amounts due from related parties	6,989	-	-	-
Net cash used in investing activities	<u>(179,405)</u>	<u>(110,851)</u>	<u>(176,483)</u>	<u>(22,614)</u>
Cash flows from financing activities:				
Exercise of share options	6,505	7,404	6,928	888
Return of capital to minority shareholder upon dissolution of a subsidiary	-	-	(600)	(77)
Increase (decrease) in amounts due to shareholders	5,360	(5,360)	-	-
Proceeds from issuance of ordinary shares, net of issuance costs	531,413	-	-	-
Collection of share subscription receivables	24,804	-	-	-
Contribution from minority shareholder of a subsidiary	600	-	-	-
Repayment of cash advance from a shareholder	(3,085)	-	-	-
Net cash provided by financing activities	<u>565,597</u>	<u>2,044</u>	<u>6,328</u>	<u>811</u>
Effect of exchange rate changes	-	(3,084)	(3,503)	(449)
Net increase (decrease) in cash and cash equivalents	<u>529,462</u>	<u>34,481</u>	<u>(132,826)</u>	<u>(17,020)</u>
Cash and cash equivalents at the beginning of the year	167,531	696,993	731,474	93,729
Cash and cash equivalents at the end of the year	<u>696,993</u>	<u>731,474</u>	<u>598,648</u>	<u>76,709</u>

Supplemental non-cash investing activities:				
Consideration for acquisition of subsidiaries settled through issuance of shares	181,312	-	-	-
Supplemental cash flow information:				
Cash paid during the year for income taxes	1,290	703	1,156	148

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Ninetowns Internet Technology Group Company Limited (previously known as “Ninetowns Digital World Trade Holdings Limited”) (“Ninetowns”) was incorporated as an exempted limited liability company in the Cayman Islands on February 8, 2002 under the Companies Law of the Cayman Islands. At the time of its incorporation, all of the outstanding ordinary shares of Ninetowns were held by Jitter Bug Holdings Limited (“Jitter Bug”). Substantially all of Ninetown's business is conducted in the People's Republic of China (the “PRC”) through its subsidiaries. Ninetowns, its subsidiaries, and its variable interest entity (“VIE”) (collectively, the “Company”) are principally engaged in the sale of enterprise software, the provision of the related after-sales services, and software development services in the PRC.

As of December 31, 2006, a summary of the subsidiaries and VIE of Ninetowns were as follows:

Name of entity	Place of Incorporation/ Establishment	Effective ownership interest	Principal activities
Subsidiaries:			
Ixworth Enterprises Limited (“Ixworth”)	British Virgin Islands (“BVI”)	100%	Investment holding
Asia Pacific Logistics Limited (“Asia Pacific”)	BVI	100%	Investment holding
Better Chance International Limited (“Better Chance”)	BVI	100%	Investment holding
Beprecise Investments Limited (“Beprecise”)	BVI	100%	Investment holding
New Take Limited	Hong Kong	100%	Investment holding
Shielder Limited	Hong Kong	100%	Investment holding
Beijing New Take Electronic Commerce Limited (“Beijing New Take”) (note i)	PRC	100%	Inactive
Beijing Ninetowns Times Electronic Commerce Limited (“Beijing Ninetowns Times”) (note i)	PRC	100%	Provision of software development services
Beijing Ninetowns Digital Technology Limited (“Beijing Ninetowns Digital Technology”)	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Beijing Ninetowns Ports Software and Technology Co., Ltd (“Beijing Ninetowns Ports”)	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Beijing Ninetowns Network Software Co., Limited (“Beijing Ninetowns Network”)	PRC	100%	Sale of enterprise software and provision of the related after-sales services, and provision of technique consulting services
Guangdong Ninetowns Technology Co., Ltd. (“Guangdong Ninetowns”)	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services

1. ORGANIZATION AND PRINCIPAL ACTIVITIES – continued

Name of entity	Place of Incorporation/ Establishment	Effective ownership interest	Principal activities
Shanghai New Take Digital Technology Limited ("Shanghai New Take") (note ii)	PRC	100%	Sale of enterprise software and provision of the related after-sales services, sale of computer hardware and accessories, and provision of software development services
Variable interest entity:			
Beijing Ronghe Tongshang Network Technology Limited ("Ronghe Tongshang")	PRC	100%	Provision of online solution for international trade

- (i) These subsidiaries were incorporated as Sino-foreign joint venture limited companies for a term of 25 years and renewable at the end of the operating period.
- (ii) Shanghai New Take was incorporated for a term of eight years commencing September 13, 2001, renewable at the end of the operating period. 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.

Ixworth is wholly owned by Ninetowns and was incorporated in the British Virgin Islands on December 22, 1999. Ixworth was established for the purpose of holding Ninetowns' investment interests. Ixworth did not have other business activities during 2004, 2005 and 2006.

Prior to 2004, Ixworth held a 90% interest in each of Beijing New Take, Beijing Ninetowns Time, Beijing Ninetowns Digital Technology and Beijing Ninetowns Ports. During 2004, Ixworth acquired the remaining 10% interest in each of these subsidiaries and they became wholly-owned subsidiaries of Ixworth (Note 3).

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

- The Company has the sole discretion to determine the amount of the fees it will receive and it intends to transfer substantially all of the economic benefits of Ronghe Tongshang to the Company.
- The equity owners irrevocably granted the Company the right to make all operating and business decisions for Ronghe Tongshang on behalf of the equity owners;
- All registered capital owned by the three equity owners were pledged to the Company as a collateral against the service fee payable to the Company;
- The Company provides guarantees on the execution of all business contracts entered by Ronghe Tongshang in its business operation. Ronghe Tongshang pledges its assets to the Company as a collateral for such guarantee. Through December 31, 2006, Ronghe Tongshang has not yet entered into any business contracts that would require guarantees from the Ninetowns;

1. ORGANIZATION AND PRINCIPAL ACTIVITIES – continued

- The Company may dispose of the collateralized registered capital at its sole discretion without limitation or restriction. The Company has the right and sole discretion to purchase all or part of the registered capital from equity owners when such purchase becomes legally allowable;
- The equity owners may not dispose of or enter into any other agreements involving the common shares without prior agreement by the Company.

Because the designated equity owners of Ronghe Tongshang do not have the ability to make business and operating decisions for Ronghe Tongshang as a result of assigning their controlling interest to the Company, Ronghe Tongshang met the definition as a VIE in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46 (Revised), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51" ("FIN 46R"). The Company, as the primary beneficiary, consolidates Ronghe Tongshang from its inception.

The following financial statement amounts and balances of Ronghe Tongshang were included in the accompanying consolidated financial statements as of and for the year ended December 31, 2006.

	December 31, 2006
	RMB
Total assets	396
Total liabilities	(1,000)
	Year ended December 31, 2006
	RMB
Total revenue	-
Total net loss	(1,604)

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

Basis of presentation - The consolidated financial statements of the Company have been prepared in accordance with the accounting principles generally accepted in the United States of America ("US GAAP"). All amounts in the accompanying consolidated financial statements and the related notes are expressed in Renminbi ("RMB"). The amounts expressed in United States dollars ("US\$") are presented solely for the convenience of the readers and are translated at a rate of RMB7.8041 to US\$1, the approximate rate of exchange at December 31, 2006. Such translations should not be construed to be the amounts that would have been reported under US GAAP.

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

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

Use of estimates - The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company bases its estimates on historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Significant accounting estimates reflected in the Company's consolidated financial statements include allowance for doubtful accounts, estimated cost to complete in a percentage of completion arrangement, share-based compensation, estimated useful lives and impairment of property and equipment and acquired intangible assets, valuation of inventories, valuation of deferred tax 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 have remaining maturities of three months or less when purchased.

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

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

Accounts receivable and allowance for doubtful accounts - Accounts receivable mainly represents amounts earned and are collectible from customers. Accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make the required payments and uses the specific identification method to record such allowances. If payments are collected from a customer whose account balance was specifically reserved previously, the recorded allowance against the customer's account receivable is reversed against the provision for bad debts. Management of the Company considers the following factors when determining the collectibility of accounts receivable: a customer's credit-worthiness, past collection history, and changes in a customer's payment terms. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to operating expenses and a credit to allowance for doubtful accounts. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the allowance for doubtful accounts and a credit to accounts receivable.

Changes in the allowance for doubtful accounts were as follows:

	<u>2005</u> RMB	<u>2006</u> RMB
Balance at January 1,	4,091	4,851
Provision for allowance for doubtful debts	760	2,487
Recovery		(4,008)
Write offs	-	(2,242)
Balance at December 31,	4,851	1,088

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

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

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

Acquired intangible assets - Acquired intangible assets, which consist primarily of software development contracts, customer lists, 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 two to five years. Amortization expenses for the years ended December 31, 2004, 2005 and 2006 were RMB805, RMB2,416 and RMB2,943, respectively.

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

Goodwill - Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. The 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 impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Based on the Company's assessment, there was no impairment of goodwill for the years ended December 31, 2004, 2005 and 2006.

Investment under cost method - For investment in an investee over which the Company does not have significant influence, the Company carries the investment at cost and recognizes income when receiving dividends from distribution of investee's earnings. The Company reviews the investment under cost method for impairment whenever events or changes in circumstances indicate that the carrying value may no longer be recoverable. An impairment loss is recognized in earnings equal to the difference between the investment cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. The fair value of the investment would then become the new cost basis of the investment. The Company invested in a cost method investment during 2006. No impairment charges were recorded during 2006.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

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 carry forwards 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 is recognized when earned, net of applicable business taxes. Payments received in advance of revenue recognition are recorded as deferred revenue until earned.

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

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

Revenues from software development services requiring significant production, modification, or customization of the software are recognized over the installation and customization period based on the percentage of completion method as prescribed by Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Product-Type Contracts". Percentage-of-completion is measured principally by the percentage of actual hours incurred to date for each contract to the estimated total hours to be incurred for each contract at completion. Revenue from software development services also includes certain system integrations projects. The Company recognizes revenues for systems integrations when a written acceptance from the customer is received after the project is completed.

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

The Company reports revenue net of business taxes which amounted to RMB32,517, RMB40,034, and RMB15,802 for the years ended December 31, 2004, 2005 and 2006, respectively. Software revenue includes the benefit of the rebate of value added taxes on the sales of software and software-related services received from the Chinese tax authorities as part of the PRC government's policy of encouraging of software development in the PRC. Pursuant to certain PRC rules relating to value-added taxes, Beijing Ninetowns Times, Beijing Ninetowns Digital Technology, and Beijing Ninetowns Ports are entitled to a refund of value-added taxes paid at a rate of 14% of the sales value for self-developed software products, excluding revenues from maintenance services and upgrade rights that are sold separately. Revenues from the sales of software products include the refund of such value-added tax which totaled RMB17,382, RMB19,766, and RMB10,500 for the years ended December 31, 2004, 2005 and 2006, respectively.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

Cost of revenue - Cost of revenue includes production and shipping and handling costs for products sold, and direct costs associated with the delivery of software development and maintenance services, including salaries, employee benefits and overhead costs associated with employees providing the related services. Shipping and handling costs are not billable to customers. Costs that are directly associated with a contract accounted for under percentage-of-completion method are initially deferred and reported as work in process inventory until the related revenue is recognized. Pre-contract costs relating to a contract that is subsequently abandoned are expensed immediately.

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

Advertising costs - Advertising costs are expensed in the period incurred. The Company incurred advertising costs totaling RMB591, RMB1,979 and RMB2,281 during the years ended December 31, 2004, 2005 and 2006, respectively.

Government subsidies - Government subsidies represent amounts granted by local governments to reward companies that have made contributions in the development of the electronic and software industries as well as those companies that contribute significantly to local taxes. The Company reports government subsidies as other operating income when it becomes due and receivable and the Company does not have any obligations to repay the amounts received.

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

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

Comprehensive income - Comprehensive income includes net income and foreign currency translation adjustments and is reported as a component of consolidated statements of shareholders' equity.

Foreign currency risk - The RMB is not a freely convertible currency. The State Administration for Foreign Exchange under the authority of the People's Bank of China controls the conversion of the RMB into foreign currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. Cash and cash equivalents and term deposits of the Company included aggregate amounts of RMB795,836 at December 31, 2005 and RMB830,155 at December 31, 2006 which were denominated in RMB.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - continued

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

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

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

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

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

	<u>Years ended December 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
	RMB	RMB	RMB
Net income, as reported	133,951	151,604	45,928
Add: Share-based compensation, as reported	-	-	10,327
Less: Share-based compensation determined using the fair value method	(484)	(14,616)	(10,384)
Pro forma net income	<u>133,467</u>	<u>136,988</u>	<u>45,871</u>

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

Weighted average shares used in computation			
Basic	27,022,057	34,539,976	34,773,005
Diluted	28,279,061	35,706,894	35,368,882
Net income per share:			
Basic, as reported	4.96	4.39	1.32
Basic – pro forma	4.94	3.97	1.32
Diluted, as reported	4.74	4.25	1.30
Diluted - pro forma	4.72	3.84	1.30

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 years ended December 31, 2004, 2005 and 2006.

	<u>The 2003 Plan</u>	<u>The 2004 Plan</u>
<u>Options grants</u>		
Weighted average risk-free rate of return	5%	5%
Weighted average expected option life	9.875 years	6.25 years
Weighted average volatility rate	N/A	55%
Weighted average dividend yield	0%	0%

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.

Embedded derivatives - Embedded derivative instruments are bifurcated and accounted for separately from the host instrument as assets or liabilities if they are not clearly and closely related to the host instrument. Multiple embedded derivatives within the same host instrument that are required to be bifurcated are bundled together and reported as a single, compound embedded derivative instrument. Embedded derivative instruments that are required to be bifurcated are marked to market on each balance sheet date. Changes in the fair values between balance sheet dates are reported in the accompanying consolidated statements of operations.

Reclassification - Certain amounts in the 2004 and 2005 consolidated financial statements have been reclassified to conform to the 2006 presentation.

2. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES – continued

Recently Issued Accounting Pronouncements – In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140.” SFAS No. 155 amends SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis. SFAS No. 155 amends SFAS No. 140, “Accounting for the Impairment or Disposal of Long-Lived Assets”, to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity’s first fiscal year that begins after September 15, 2006, with earlier application allowed. The Company does not expect the adoption of SFAS No. 155 to have a material impact on its consolidated results of operations and financial condition.

In June 2006, the FASB ratified the provisions of the Emerging Issue Task Force Issue No. 06-3 “How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement” (“EITF 06-3”), which requires the Company to disclose how it accounts for taxes imposed on and concurrent with a specific revenue-producing transaction. EITF 06-3 will be effective for the Company starting January 1, 2007. The Company does not believe that the application of EITF 06-03 will have a material effect on its financial position, cash flow and results of operations

In July 2006, the FASB issued FIN 48, “Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109” which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize and disclose in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 became effective for the Company on January 1, 2007, with the cumulative effect of the change in accounting principle, if any, recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 and its impact on its consolidated financial position, results of operations, and cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No.157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly does not require any new fair value measurements. SFAS No.157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating whether the adoption of SFAS No. 157 will have a material effect on its consolidated results of operations and financial position.

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

3. ACQUISITION

In June of 2004, the Company acquired the 10% minority interests in Better Chance and Asia Pacific from an affiliated entity. The aggregate purchase price of RMB229,897 (US\$27,806) consisted of (i)

RMB34,265 (US\$4,140) in cash, (ii) the assumption of loans payable to the selling affiliate from the selling affiliate's equity owners of RMB14,368 (US\$1,736), and (iii) the issuance of 2,002,312 shares of the Company's ordinary shares with a fair value of RMB90.63 (US\$10.95) per share on the commitment date for a total value of RMB181,506 (US\$21,930). The Company used a market-based approach to estimate the fair value of the shares issued.

The Company's purchase price was allocated as follows:

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

Intangible assets consisted of RMB279 of software development contracts, RMB6,131 of customer lists and relationships, and RMB5,251 of completed technology. Acquired intangible assets are amortized over the estimated useful lives of two years for software development contracts, five years for customer lists and relationships, and five years for completed technology.

4. INVENTORIES

Inventories consisted of the following:

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
	RMB	RMB
Computer accessories	2,276	5,777
Third party software products	5,277	1,041
Other supplies	16	2
Work in progress	<u>153</u>	<u>-</u>
	<u>7,722</u>	<u>6,820</u>

Inventories were purchased for software development service projects after the requirements for such projects were determined. No obsolete or impaired inventories were considered necessary because inventories were purchased only for on-going software development service projects where the specific inventory requirements have been agreed to in contracts with the customers and the customers must pay a significant deposit for such projects prior to their inception. Work in progress represented software development projects that had been initiated but the related contracts between the Company and the customers had not yet been signed.

5. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expense and other current assets consisted of the following:

	<u>December 31,</u>	
	<u>2005</u> RMB	<u>2006</u> RMB
Prepaid expenses	7,675	10,383
Deposits for exhibition, office rental and utilities	4,550	10,885
Interest receivable for term deposits	1,970	6,602
Value added tax recoverable	1,013	425
Other receivables	87	214
	<u>15,295</u>	<u>28,509</u>

Prepaid expenses primarily consisted of prepaid amounts in connection with the purchase of computer hardware for resale.

6. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consisted of the following:

	<u>December 31,</u>	
	<u>2005</u> RMB	<u>2006</u> RMB
Buildings	18,789	20,108
Leasehold improvements	5,104	8,244
Furniture, fixtures and office equipment	2,798	3,216
Computer equipment	10,250	23,940
Motor vehicles	3,651	3,746
Total	40,592	59,254
Less: accumulated depreciation and amortization	(7,108)	(12,561)
Property and equipment, net	<u>33,484</u>	<u>46,693</u>

Depreciation and amortization expenses for the years ended December 31, 2004, 2005 and 2006 were RMB1,315, RMB2,877 and RMB6,194, respectively.

7. INVESTMENT UNDER COST METHOD

In September 2006, the Company entered into a subscription agreement with Global Market Group Limited ("Global Market") to subscribe 1,940,000 Series A preferred shares, which represents 16.25% of the fully dilute equity interest in Global Market on an if-converted basis, for a cash consideration of RMB38,929 (US\$5,000). Because the Company cannot exercise significant influence, the investment is accounted for under the cost method. Global Market is engaged in the business of Chinese B2B trade facilitator and is headquartered in the Guangdong province, PRC.

The subscription agreement contains put and call options. The call option gives the Company a right to acquire a variable number of Global Market's ordinary shares at a nominal price of US\$1 in the event Global Market's earnings fall below a predetermined level or receive cash if additional earnings requirements are not met. The put option gives Global Market a right to repurchase up to 285,000 of issued ordinary shares from the Company at a nominal price of US\$1 when Global Market's earnings are above a predetermined level. The put and call options are accounted for as embedded derivatives and because they are not clearly and closely related to the Series A preferred share agreement, they should be bifurcated and marked to market on each balance sheet date. These embedded derivatives are bundled together and reported as a single, compound embedded derivative instrument. As of December 31, 2006, the fair value of this bundled derivative instrument was not material because the Company had only had its investment in Global Market for a short period of time and Global Market's projected operating results are expected to be within a reasonable range that will not cause a significant change in the Company's investment value.

8. ACQUIRED INTANGIBLE ASSETS, NET

Acquired intangible assets, net consisted of the following:

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
	RMB	RMB
Software development contracts	279	279
Customer lists and relationships	6,131	6,131
Completed technology	5,251	5,251
Acquired software	-	17,200
Total	11,661	28,861
Less: accumulated amortization	(3,221)	(6,164)
Acquired intangible assets, net	8,440	22,697

Amortization expenses for the years ended December 31, 2004, 2005, and 2006 were RMB805, RMB2,416, and RMB2,943 respectively. For each of the next five years through 2011, annual amortization expenses of the acquired intangible assets will be approximately RMB5,716, RMB5,716, RMB4,958, RMB3,440, and RMB2,867, respectively.

9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses included the following:

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
	RMB	RMB
Salary and wages	2,427	4,381
Staff welfare	730	508
Professional fees	2,499	4,283
Accounts payable and office expenses payable	4,771	4,131
Accrued expenses	<u>1,612</u>	<u>1,009</u>
	<u>12,039</u>	<u>14,312</u>

10. PROVISION FOR INCOME TAXES

Ninetowns is a tax exempted company incorporated in the Cayman Islands. No provision for Hong Kong Profits Tax has been made as the subsidiaries incorporated in Hong Kong had no assessable profits earned or derived from Hong Kong during the three years ended December 31, 2004, 2005 and 2006. 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 were exempted from the enterprise income tax for the two years ended December 31, 2002, followed by a 50% tax reduction for the three years ended December 31, 2005 at an income tax rate of 7.5%. Commencing from January 1, 2006, Beijing New Take and Beijing Ninetowns Times were subject to an enterprise income tax rate of 15%.

Beijing Ninetowns Digital Technology is qualified as a "New and High Technology Enterprise" and is 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 16.5%. Commencing on 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, followed by a 50% tax reduction for the three years ending December 31, 2008 at an income tax rate of 7.5%.

Guangdong Ninetowns has been awarded the certificate of "New and High Technology Enterprise" and is exempted from the enterprise income tax for the two years ending December 31, 2007. Guangdong Ninetowns will be subjected to an enterprise income tax rate of 15% beginning on January 1, 2008.

10. PROVISION FOR INCOME TAXES – continued

Beijing Ninetowns Network Software has been awarded the certificate of “New and High Technology Enterprise” and is exempted from the enterprise income tax for the three years ending December 31, 2008, followed by a 50% tax reduction for the three years ending December 31, 2011 at an income tax rate of 7.5%.

Beijing Ronghe Tongshang was newly established in 2006 and does not have any business operations in 2006. Ronghe Tongshang is qualified as a “New and High Technology Enterprise” and is subject to an enterprise income tax rate of 15%.

During the years ended December 31, 2004, 2005 and 2006, if the Company’s subsidiaries in the PRC had not been awarded tax holidays or had special tax concessions, they would have recorded additional provision for income taxes totaling RMB49,635, RMB43,235, and RMB11,251, respectively. The Company’s net income would have been decreased by RMB46,407, RMB43,235 and RMB11,251. Basic net income per share would have been decreased to RMB3.23, RMB3.14, and RMB0.99, and diluted net income per share would have been decreased to RMB3.10, RMB3.04, and RMB0.97 for the years ended December 31, 2004, 2005, and 2006, respectively.

Provision for income taxes consisted of the following:

	<u>December 31</u>		
	2004	2005	2006
Current tax	1,823	626	2,102
Deferred tax	-	-	(1,071)
	1,823	626	1,031

As of December 31, 2006, significant temporary differences between the tax basis and financial statement basis of accounting for assets and liabilities that gave rise to deferred taxes were principally related to the following:

	<u>December 31, 2006</u>
	RMB
Current deferred tax assets:	
Short-term deferred revenue	2,260
Less: valuation allowance	(562)
Current deferred tax assets	1,698
Non-current deferred tax assets (liabilities):	
Net operating loss carried forward	4,610
Accelerated depreciation of equipment	(627)
Less: valuation allowance	(4,610)
Non-current deferred tax assets (liabilities)	(627)

10. PROVISION FOR INCOME TAXES – continued

The Company has operating loss carried forwards totaling RMB30,652 for the year ended December 31, 2006. Of the amount, net operating loss carried forwards of RMB30,168 from the PRC subsidiaries will expire on various dates from December 31, 2007 to December 31, 2010. Net operating loss carried forward of RMB484 for the Hong Kong subsidiaries may be carried forward indefinitely.

As of December 31, 2006, a valuation allowance of RMB4,610 was provided against deferred tax assets arising from net operating loss carry-forward and short-term deferred revenue of certain PRC subsidiaries and VIE due to the uncertainty of realization. Adjustment will be made to the valuation allowance if events occur in the future that indicates changes in the amount of deferred tax assets that may be realized.

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

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

	<u>2004</u>	<u>Years ended December 31,</u>	
		<u>2005</u>	<u>2006</u>
PRC statutory income tax	33.0%	33.0%	33.0%
Expenses not deductible for tax purposes	3.4%	10.2%	2.9%
Permanent differences	(1.2%)	(5.9%)	(5.1%)
Tax exemption and tax relief granted			
to PRC subsidiaries	(34.7%)	(36.9%)	(28.6%)
Others	0.8%	-	-
	<u>1.3%</u>	<u>0.4%</u>	<u>2.2%</u>

11. OTHER TAXES PAYABLE

	<u>December 31,</u>	
	<u>2005</u>	<u>2006</u>
	RMB	RMB
Individual income tax withholding	196	209
Business tax payable	1,877	2,491
Value added taxes payable, net	<u>783</u>	<u>(368)</u>
	<u>2,856</u>	<u>2,332</u>

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

12. NET INCOME PER SHARE

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

	<u>Years ended December 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Numerator used in basic net income per share:			
Net income	133,951	151,604	45,928
Shares (denominator):			
Weighted average ordinary shares outstanding	27,022,057	34,539,976	34,773,005
Plus: incremental shares from assumed conversion of stock options	1,257,004	1,166,918	595,877
Weighted average ordinary shares outstanding used in computing diluted net income per ordinary share	28,279,061	35,706,894	35,368,882
Net income per ordinary share - basic	4.96	4.39	1.32
Net income per ordinary share - diluted	4.74	4.25	1.30

13. RELATED PARTY TRANSACTIONS AND BALANCES

Purchase of office spaces

In June 2004, the Company acquired office premises with an aggregate purchase price of RMB47,339 from a company affiliated with a director of Jitter Bug. In 2005, the Company acquired an additional office space from the same seller for a consideration of RMB18,617. Through December 31, 2006, the Company had paid the full amount of the purchase of RMB65,956. Because the acquired office spaces was still under construction as of December 31, 2005 and 2006, the amount paid was reported as deposits paid for the acquisition of property and equipment in the accompanying consolidated balance sheets.

Software development services

During the years ended December 31, 2004, 2005 and 2006, the Company provided software development services to Beijing iTowNet Cyber Technology Ltd. ("Beijing iTownNet") in which two of the Company's senior management serve as director and supervisor.

The Company provides software development services to eGrid Technology Ltd. ("eGrid") which in turn provides the services to Beijing iTowNet. The Company recognized net revenues of RMBnil, RMB22,160, and RMB7,263 from services provided indirectly to Beijing iTowNet through eGrid during 2004, 2005 and 2006, respectively. For the years ended December 31, 2004, 2005 and 2006, RMB3,593, RMB270, and RMBnil were recognized from software development services provided directly to Beijing iTowNet. The Company also provided platform maintenance services to Beijing iTowNet directly as well as indirectly through eGrid during the years ended December 31, 2004, 2005 and 2006, and recognized net revenues of RMB6,000, RMB5,670, and RMB5,670, respectively, from such services.

13. RELATED PARTY TRANSACTIONS AND BALANCES – continued

Sales of enterprises software:

The Company has an agreement with Shenzhen Ninetowns Enke Software Technology Co., Ltd. ("Ninetowns Enke"), a company owned by two of the Company's senior management, for the distribution of the Company's enterprise software in the southern region of the PRC. During the years ended December 31, 2004, 2005 and 2006, the Company recognized net revenues of RMB25,245, RMB47,500 and RMB21,240, respectively, from the sales of enterprise software to Ninetowns Enke.

The Company sold software products to Beijing iTowNet, directly and indirectly, amounting to RMB16,840, RMB13,454 and RMB3,466 in the years ended December 31, 2004, 2005 and 2006, respectively.

Other:

In November 2004, the Company entered into an option agreement to acquire 49% of ownership interest in Beijing iTowNet exercisable at the Company's option. In the event such purchase becomes permissible under the relevant laws of the PRC and the Company exercises its option, the purchase price will be RMB206,915 (US\$25 million) plus an amount calculated at 5% per year compounded annually for the years the selling company held an ownership interest in iTowNet less any dividends or distributions the selling company received during its ownership of Beijing iTowNet.

Related party balances:

Trade receivables at December 31, 2005 and 2006 included RMB21,447 and RMB11,407 from Beijing iTowNet, RMB17,319 and RMB15,739 from eGrid, and RMB18,507 and RMB1,183 from Ninetowns Enke, respectively. The amounts were unsecured, interest free, and repayable on demand. No allowances for bad debt were recorded against related party receivables at December 31, 2005 and 2006.

14. SHARE OPTION PLANS

The 2003 Plan

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

As of December 31, 2005 and 2006, options to purchase 2,044,120 and 1,716,653 ordinary shares were outstanding, respectively. As of December 31, 2005 and 2006, there were no options available under the 2003 Plan for future grants.

The 2004 Plan (as amended)

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

14. SHARE OPTION PLANS – continued

The 2004 Plan (as amended) – continued

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

Ninetowns' ordinary shares the day before the grant date. The options will vest over four years at 25% per year from the grant date. Any options granted but not exercised will expire on February 22, 2015.

As of December 31, 2005 and 2006, options to purchase 890,000 and 784,294 ordinary shares were outstanding, respectively. As of December 31, 2005 and 2006, 3,410,000 options to purchase ordinary shares were available under the 2004 Plan, as amended, for future grants.

The 2006 Plan

In December 2005, the shareholders of Ninetowns approved the 2006 stock incentive plan (the "2006 Plan") which allows the Company to offer a variety of share-based awards to employees and employees of the Company's affiliates and subsidiaries including share options, restricted shares, and other similar awards. The exercise price must be at least equal to 100% of the fair market value of the ordinary shares on the grant date. The 2006 Plan will be automatically terminated in 2015. At December 31, 2006, the Company had not granted any options or other types of awards under the 2006 Plan.

A summary of the share option activities was as follows:

	<u>Years ended December 31,</u>					
	<u>2004</u>		<u>2005</u>		<u>2006</u>	
	<u>Number</u> <u>of</u> <u>options</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>price</u>	<u>Number</u> <u>of</u> <u>options</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u>	<u>Number</u> <u>of</u> <u>options</u>	<u>Weighted</u> <u>average</u> <u>exercise</u> <u>price</u>
Outstanding at beginning of year	2,574,400	26	2,328,894	26	2,877,097	39
Granted	-	-	890,000	71	-	-
Exercised	(245,506)	26	(284,774)	26	(267,364)	26
Cancelled	-	-	(57,023)	71	(108,786)	46
Outstanding at end of year	<u>2,328,894</u>	<u>26</u>	<u>2,877,097</u>	<u>39</u>	<u>2,500,947</u>	<u>40</u>
Exercisable at end of year	<u>398,094</u>	<u>26</u>	<u>1,400,520</u>	<u>26</u>	<u>1,920,366</u>	<u>31</u>

The intrinsic value per share of the 2003 Plan and the 2004 Plan (as amended) as of December 31, 2006 was RMB11.24 and RMBnil, respectively. At December 31, 2006, both the aggregate intrinsic value of options outstanding and options exercisable were approximately RMB19,295.

14. SHARE OPTION PLANS – continued

The following table summarizes share options outstanding on December 31, 2006:

	Options outstanding			Options exercisable		
	Number <u>outstanding</u>	Weighted average remaining contractual <u>life</u>	Fair value per share at grant date	Weighted average exercise price (RMB)	Number <u>exercisable</u>	Weighted average exercise price (RMB)
Ordinary shares						
RMB26 (HK\$25)	1,716,653	7.875	RMB0.297 (HK\$0.286)	26	1,716,653	26
RMB71 (US\$8.6)	784,294	8.167	RMB40.42 (US\$4.896)	71	203,713	71
	<u>2,500,947</u>	<u>7.967</u>		<u>40</u>	<u>1,920,366</u>	<u>31</u>

15. COMMITMENTS AND CONTINGENCIES

Commitments

The Company has operating lease agreements principally for its office properties in the PRC. Such leases have remaining terms ranging from 12 to 24 months and are renewable subject to negotiation. Rental expense was RMB4,439, RMB6,581 and RMB7,552, for the years ended December 31, 2004, 2005 and 2006, respectively.

Future minimum lease payments under non-cancellable operating lease agreements at December 31, 2006 were as follows:

	RMB
Year ending December 31:	
2007	1,959
2008	<u>155</u>
Total	<u>2,114</u>

15. COMMITMENTS AND CONTINGENCIES – continued

Contingencies

On March 16, 2007, the PRC National People's Congress adopted the 2008 PRC Enterprise Income Tax Law, which will become effective on January 1, 2008. The 2008 PRC Enterprise Income Tax Law imposes a tax rate of 25% on all enterprises, including foreign-invested enterprises, and terminates most of the tax exemptions, reductions, and preferential treatments available under current tax laws and regulations. However, under the 2008 PRC Enterprise Income Tax Law, enterprises that were established before March 16, 2007 and are already enjoying preferential tax treatments will continue to enjoy them (i) for a period of five years from January 1, 2008, in the case of preferential tax rates, or (ii) until the expiration of such term, in the case of preferential tax exemption or reduction for a specified period.

Under the 2008 PRC Enterprise Income Tax Law, companies recognized as "high and new technology enterprises strongly supported by the State" will be entitled to a preferential tax rate of 15%, but the 2008 PRC Enterprise Income Tax Law does not define "high and new technology enterprises strongly supported by the State." Under the 2008 PRC Enterprise Income Tax Law, each of Ninetowns' subsidiaries will continue to be entitled to the tax preferential treatment they currently enjoy until such treatment expires. However, because the PRC State Council has not promulgated the detailed rules for the 2008 PRC Tax Law, Ninetowns' subsidiaries may not qualify as "high and new technology enterprises strongly supported by the State" and therefore may not be entitled to a preferential enterprise income tax rate after the current preferential tax treatment expires.

16. SEGMENT INFORMATION

As of December 31, 2006, 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 the research and development of new enterprise software. The software development services segment is responsible for the development and integration of software in accordance with the customers' specifications and requirements. The computer hardware sales segment is engaged in the sale of computer hardware and accessories.

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

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

16. SEGMENT INFORMATION – continued

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

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

	Year ended December 31, 2005			
	<u>Enterprise software</u> RMB	<u>Software development services</u> RMB	<u>Computer hardware sales</u> RMB	<u>Total</u> RMB
Net revenues from external customers	109,022	7,600	678	117,300
Net revenues from related parties	39,081	28,100	-	67,181
Gross profit	147,278	17,838	196	165,312

	Year ended December 31, 2006			
	<u>Enterprise software</u> RMB	<u>Software development services</u> RMB	<u>Computer hardware sales</u> RMB	<u>Total</u> RMB
Net revenues from external customers	73,123	23,084	398	96,605
Net revenues from related parties	11,450	12,933	-	24,383
Gross profit	84,573	20,251	264	105,088

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

16. SEGMENT INFORMATION – continued

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

	<u>Years ended December 31,</u>		
	<u>2004</u> RMB	<u>2005</u> RMB	<u>2006</u> RMB
Net revenues from external customers under PRC GAAP	139,119	117,300	96,605
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	(1,838)	21,232	11,455
PRC value added tax refund	12,588	12,280	7,549
Total net revenues from external customers under US GAAP	149,869	150,812	115,609
Net revenues from related parties under PRC GAAP	61,870	67,181	24,383
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	(14,986)	14,387	10,304
PRC value added tax refund	4,794	7,486	2,952
Total net revenues from related parties under US GAAP	51,678	89,054	37,639
Gross profit under PRC GAAP	196,482	165,312	105,088
U.S. GAAP adjustments:			
Differences in the timing of revenue recognition	(16,824)	35,619	21,759
PRC value added tax refund	17,382	19,766	10,501
Share-based compensation expenses	-	-	(1,039)
Gross profit under US GAAP	197,040	220,697	136,309
Operating expenses	(57,368)	(86,539)	(109,357)
Government subsidies	1,340	447	705
Income from operations	141,012	134,605	27,657
Interest income	3,768	17,625	19,302
Income before income tax expenses	144,780	152,230	46,959

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

17. MAJOR CUSTOMERS

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

Customer	Years ended December 31,		
	2004	2005	2006
A	20%	18%	9%
B	-	10%	11%
C	12%	*	-
D	14%	20%	14%
E	15%	12%	*

* Represents less than 10% of total net revenue.

Trade receivable from one customer totaled 39% and 45% of total trade receivables at December 31, 2005 and 2006, respectively.

18. EMPLOYEE BENEFIT PLANS

Employees of the Company located in the PRC other than Hong Kong are covered by the retirement schemes defined by local practice and regulations, which are essentially defined contribution schemes. The calculation of contributions for the eligible employees is based on 20% of the applicable payroll costs. Certain employees of the Company who are located in Hong Kong have joined the Mandatory Provident Fund ("MPF") Scheme which is also a defined contribution scheme. The contribution to the MPF Scheme is calculated based on the rules set out in the MPF Ordinance in Hong Kong which is 5% on the relevant income of the employee with a specific ceiling. The expenses paid by the Company to these defined contribution schemes were RMB863, RMB2,566, and RMB4,587 for the years ended December 31, 2004, 2005, and 2006, 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 RMB487, RMB1,523, and RMB2,889 for the years ended December 31, 2004, 2005, and 2006, respectively.

19. STATUTORY RESERVES

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprises, Ninetown's 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 profit after tax as determined under PRC GAAP. The staff welfare and bonus reserve is determined by the board of directors.

19. STATUTORY RESERVES – continued

The general reserve is used to offset future extraordinary losses. The subsidiaries may, upon a resolution of the shareholders, convert the general reserve into capital. The staff welfare and bonus reserve is used for the collective welfare of the employees of the subsidiaries. The enterprise expansion reserve is used for the expansion of the subsidiaries' operations and can be converted to capital subject to approval by the relevant authorities. These reserves represent appropriations of retained earnings determined according to PRC laws and may not be distributed. There were no appropriations to these statutory reserves by Ninetown's subsidiaries in the PRC during 2004 and 2006. RMB28,553 was appropriated to the reserves by Beijing Ninetowns Ports during the year ended December 31, 2005.

20. RESTRICTED NET ASSETS

Relevant PRC Statutory laws and regulations permit payments of dividends by Ninetown's PRC subsidiaries and VIE from their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, the general reserve (Note 19), which requires annual appropriations of 10% of after-tax profit should be set aside prior to the payment of dividends. As a result of these PRC laws and regulations, the Company's PRC subsidiary and variable interest entity are restricted in their abilities to transfer a portion of their net assets to the Company. As of December 31, 2006, the amount of restricted net assets was approximately RMB522,535

21. SUBSEQUENT EVENTS

In April, 2007, the Company entered into a definitive agreement to acquire 70% of the equity interest in Ample Spring Holdings Limited ("Ample Spring") through the purchase of Ample Spring's ordinary shares for approximately RMB209 million (US\$27 million) payable in cash. Ample Spring provides B2B search services. The Company expects to accelerate the development of its B2B business through this acquisition.

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

Fork, Tommy
Chief Financial Officer

Wang, John
Senior Vice President
Business Development

Ren, Xiaoguang
President

Wu, Bolin
Chief Technology Officer

Dong, Min
Senior Vice President
Legal Affairs and Human Resources

OTHER CORPORATE INFORMATION

Corporate Information

Corporate Headquarter

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Internet Technology Group Company Limited
5th Floor, Union Plaza
20 Chaowai Street
Chaoyang District
Beijing, PRC 100020

Stock Exchange Listing

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

Independent Auditor

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

ADR Depositary Bank

JPMorgan Chase Bank
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Investor Relations

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Website: www.ninetowns.com/english

Annual General Meeting

The annual meeting of
shareholders will be held

on Friday, November 30, 2007 at 2:00pm at:
Plaza Conference Centre
5/F, China Life Tower
No.16 Chaowai Street
Chaoyang District, Beijing

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