

ChinaNet Online Holdings, Inc.  
Form 10-Q  
November 15, 2010

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

FORM 10-Q

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

For the quarterly period ended September 30, 2010

or

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

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

Commission File Number: 000-52672

ChinaNet Online Holdings, Inc.  
(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of incorporation or organization)

90-0617940  
(I.R.S. Employer Identification No.)

No.3 Min Zhuang Road, Building 6  
Yu Quan Hui Gu Tuspark, Haidian District, Beijing, PRC 100195

(Address of principal executive offices) (Zip Code)

+86-10-51600828  
(Registrant's telephone number, including area code)

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

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

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

\*The registrant has not yet been phased into the Interactive Data requirements.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer (Do not check if a smaller reporting company)  
 Smaller reporting company

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

As of November 12, 2010 the registrant had 17,078,720 shares of common stock outstanding.

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

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

|                                     | September 30,<br>2010<br>(US \$)<br>(Unaudited) | December 31,<br>2009<br>(US \$) |
|-------------------------------------|---|---------------------------------|
| <b>Assets</b>                       |   |                                 |
| Current assets:                     |   |                                 |
| Cash and cash equivalents           | \$ 22,241                                       | \$ 13,917                       |
| Accounts receivable, net            | 4,455   | 3,173                           |
| Other receivables                   | 2,856   | 2,636                           |
| Prepayment and deposit to suppliers | 4,221   | 4,111                           |
| Due from related parties            | 214   | 492                             |
| Inventories                         | 2   | 2                               |
| Other current assets                | 174   | 30                              |
| Total current assets                | 34,163  | 24,361                          |
| Property and equipment, net         | 1,518   | 1,355                           |
| Intangible assets, net              | 59  | -                               |
| Other long-term assets              | 31  | 48                              |
| <b>TOTAL ASSETS</b>                 | <b>\$ 35,771</b>                                | <b>\$ 25,764</b>                |
| <b>Liabilities and Equity</b>       |   |                                 |
| Current liabilities:                |   |                                 |
| Accounts payable                    | \$ 374  | \$ 290                          |
| Advances from customers             | 1,009   | 914                             |
| Other payables                      | 22  | 27                              |
| Accrued payroll and other accruals  | 298   | 191                             |
| Due to related parties              | -   | 24                              |
| Due to Control Group                | 416   | 1,142                           |
| Due to director                     | 389   | -                               |
| Taxes payable                       | 2,010   | 1,978                           |
| Dividends payable                   | 380   | 373                             |
| Total current liabilities           | 4,898   | 4,939                           |
| Long-term borrowing from director   | 131   | 128                             |
| Warrant liabilities                 | -   | 9,564                           |
| Commitments and contingencies       | -   | -                               |

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

|  | September 30,<br>2010<br>(US \$)<br>(Unaudited) | December 31,<br>2009<br>(US \$) |
|--|---|---------------------------------|
| <b>Equity:</b>   |   |                                 |
| Series A convertible preferred stock (US\$0.001 par value; authorized-8,000,000 shares; issued and outstanding-2,918,600 and 4,121,600 shares at September 30, 2010 and December 31, 2009 respectively; aggregate liquidation preference amount: \$7,677 and \$10,677, accrued but unpaid dividends of \$380 and \$373, at September 30, 2010 and December 31, 2009, respectively. | 3   | 4                               |
| Common stock (US\$0.001 par value; authorized-50,000,000 shares; issued and outstanding-17,061,320 shares and 15,828,320 shares at September 30, 2010 and December 31, 2009 respectively)  | 17  | 16                              |
| Additional paid-in capital   | 18,454  | 10,574                          |
| Statutory reserves   | 372   | 372                             |
| Retained earnings  | 11,320  | 50                              |
| Accumulated other comprehensive income   | 559   | 117                             |
| Total ChinaNet's Online Holdings, Inc.'s stockholders' equity  | 30,725  | 11,133                          |
| Noncontrolling interest  | 17  | -                               |
| Total equity   | 30,742  | 11,133                          |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$ 35,771</b>                                | <b>\$ 25,764</b>                |

See notes to the consolidated financial statements

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

|  | For the nine months<br>ended September 30, |                                | For the three months<br>ended September 30, |                                |
|--|--|--------------------------------|---|--------------------------------|
|  | 2010<br>(US \$)<br>(Unaudited)             | 2009<br>(US \$)<br>(Unaudited) | 2010<br>(US \$)<br>(Unaudited)              | 2009<br>(US \$)<br>(Unaudited) |
| <b>Sales</b>   |  |                                |   |                                |
| To unrelated parties   | \$ 30,304                                  | \$ 25,320                      | \$ 8,631                                    | \$ 7,604                       |
| To related parties   | 872  | 1,985                          | 265   | 522                            |
|  | 31,176                                     | 27,305                         | 8,896                                       | 8,126                          |
| Cost of sales  | 15,791                                     | 15,918                         | 3,110                                       | 4,029                          |
| Gross margin   | 15,385                                     | 11,387                         | 5,786                                       | 4,097                          |
| <b>Operating expenses</b>                                    |  |                                |   |                                |
| Selling expenses   | 2,187                                      | 3,253                          | 851   | 624                            |
| General and administrative expenses                          | 2,410                                      | 1,530                          | 815   | 614                            |
| Research and development expenses                            | 605  | 347                            | 276   | 133                            |
|  | 5,202                                      | 5,130                          | 1,942                                       | 1,371                          |
| Income from operations                                       | 10,183                                     | 6,257                          | 3,844                                       | 2,726                          |
| <b>Other income (expenses):</b>                              |  |                                |   |                                |
| Changes in fair value of warrants                            | 1,861                                      | (1,289)                        | -   | (1,289)                        |
| Interest income  | 8  | 9                              | 4   | 4                              |
| Other income   | 8  | 8                              | 4   | 2                              |
| Other expenses   | (1)  | (100)                          | 0   | (99)                           |
|  | 1,876                                      | (1,372)                        | 8   | (1,382)                        |
| Income before income tax expense and noncontrolling interest | 12,059                                     | 4,885                          | 3,852                                       | 1,344                          |
| Income tax expense   | 304  | 1,653                          | 25  | 696                            |
| Net income   | 11,755                                     | 3,232                          | 3,827                                       | 648                            |
| Net loss attributable to noncontrolling interest             | 127  | -                              | 50  | -                              |
| Net income attributable to ChinaNet Online Holdings, Inc.    | 11,882                                     | 3,232                          | 3,877                                       | 648                            |
| <b>Other comprehensive income</b>                            |  |                                |   |                                |
| Foreign currency translation gain                            | 442  | 13                             | 365   | 8                              |
| Comprehensive income   | \$ 12,197                                  | \$ 3,245                       | \$ 4,192                                    | \$ 656                         |

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

|  | For the nine months<br>ended September 30, |                                | For the three months<br>ended September 30, |                                |
|--|--|--------------------------------|---|--------------------------------|
|  | 2010<br>(US \$)<br>(Unaudited)             | 2009<br>(US \$)<br>(Unaudited) | 2010<br>(US \$)<br>(Unaudited)              | 2009<br>(US \$)<br>(Unaudited) |
| Net income attributable to ChinaNet Online Holdings, Inc.                        | \$ 11,882                                  | \$ 3,232                       | \$ 3,877                                    | \$ 648                         |
| Beneficial conversion feature of Series A convertible preferred stock            | -  | (5,898)                        | -   | (5,898)                        |
| Dividend of Series A convertible preferred stock                                 | (612)                                      | -                              | (190)                                       | -                              |
| Net income attributable to common shareholders of ChinaNet Online Holdings, Inc. | \$ 11,270                                  | \$ (2,666)                     | \$ 3,687                                    | \$ (5,250)                     |
| Earnings per share   |  |                                |   |                                |
| Earnings per common share  |  |                                |   |                                |
| Basic  | \$ 0.68                                    | \$ (0.18)                      | \$ 0.22                                     | \$ (0.33)                      |
| Diluted  | \$ 0.57                                    | \$ (0.18)                      | \$ 0.19                                     | \$ (0.33)                      |
| Weighted average number of common shares outstanding:                            |  |                                |   |                                |
| Basic  | 16,676,752                                 | 14,495,560                     | 16,939,961                                  | 15,774,300                     |
| Diluted  | 20,905,796                                 | 14,495,560                     | 20,916,463                                  | 15,774,300                     |
| Comprehensive Income   |  |                                |   |                                |
| Net income   | 11,755                                     | 3,232                          | 3,827                                       | 648                            |
| Foreign currency translation gain  | 442  | 13                             | 365   | 8                              |
|  | 12,197                                     | 3,245                          | 4,192                                       | 656                            |
| Comprehensive Income   |  |                                |   |                                |
| Comprehensive income / (loss) attributable to noncontrolling interest            | (127)                                      | -                              | (50)  | -                              |
| Comprehensive income attributable to ChinaNet's Online Holdings, Inc.            | 12,324                                     | 3,245                          | 4,242                                       | 656                            |
|  | 12,197                                     | 3,245                          | 4,192                                       | 656                            |

See notes to the consolidated financial statements

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

|   | For the nine months ended<br>September 30, |                                |
|---|--|--------------------------------|
|   | 2010<br>(US \$)<br>(Unaudited)             | 2009<br>(US \$)<br>(Unaudited) |
| <b>Cash flows from operating activities</b>   |  |                                |
| Net income  | \$ 11,755                                  | \$ 3,232                       |
| <b>Adjustments to reconcile net income to net cash provided by operating activities</b> |  |                                |
| Depreciation and amortization   | 275  | 134                            |
| Share-based compensation expenses   | 177  | 190                            |
| Changes in fair value of warrants   | (1,861)                                    | 1,289                          |
| Disposal of fixed assets  | -  | 19                             |
| <b>Changes in operating assets and liabilities</b>                                      |  |                                |
| Accounts receivable   | (1,195)                                    | (1,445)                        |
| Other receivables   | 2,095                                      | (166)                          |
| Prepayments and deposit to suppliers  | (24)                                       | 9                              |
| Due from related parties  | 283  | (154)                          |
| Other current assets  | (141)                                      | 33                             |
| Accounts payable  | 77   | 117                            |
| Advances from customers   | 76   | 361                            |
| Accrued payroll and other accruals  | 104  | 134                            |
| Due to related parties  | (24)                                       | (327)                          |
| Due to director   | 389  | -                              |
| Due to Control Group  | (738)                                      | 33                             |
| Other payables  | (5)  | -                              |
| Taxes payable   | (8)  | 1,275                          |
| Net cash provided by operating activities   | 11,235                                     | 4,734                          |
| <b>Cash flows from investing activities</b>   |  |                                |
| Purchases of vehicles and office equipment  | (385)                                      | (310)                          |
| Purchases of intangible assets  | (59)                                       | -                              |
| Purchases of other long-term assets   | (4)  | (38)                           |
| Net cash used in investing activities   | (448)                                      | (348)                          |



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

|  | For the nine months ended<br>September 30, |                                |
|--|--|--------------------------------|
|  | 2010<br>(US \$)<br>(Unaudited)             | 2009<br>(US \$)<br>(Unaudited) |
| <b>Cash flows from financing activities</b>  |  |                                |
| Cash investment contributed by noncontrolling interest   | 144  | -                              |
| Dividend paid to convertible preferred stockholders  | (605)                                      | -                              |
| Increase of short-term loan to third parties   | (2,257)                                    | (2,024)                        |
| Decrease of short-term loan from directors   | -  | (13)                           |
| Cancellation and retirement of common stock  | -  | (300)                          |
| Proceeds from issuance of Series A convertible preferred stock and warrants (net of issuance cost of US\$ 1,142) | -  | 9,162                          |
| Net cash (used in)/provided by financing activities  | (2,718)                                    | 6,825                          |
| Effect of exchange rate fluctuation on cash and cash equivalents   | 255  | 10                             |
| Net increase in cash and cash equivalents  | 8,324                                      | 11,221                         |
| Cash and cash equivalents at beginning of year   | 13,917                                     | 2,679                          |
| Cash and cash equivalents at end of period   | \$ 22,241                                  | \$ 13,900                      |
| <b>Supplemental disclosure of cash flow information</b>  |  |                                |
| Interest paid  | \$ -                                       | \$ -                           |
| Income tax paid  | \$ 1,242                                   | \$ 900                         |
| <b>Non-cash transactions:</b>  |  |                                |
| Warrant liability reclassify to additional paid in capital   | \$ 7,703                                   | \$ -                           |

See notes to the consolidated financial statements

CHINANET ONLINE HOLDINGS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and principal activities

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

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

The Company’s wholly owned subsidiary, China Net BVI was incorporated in the British Virgin Islands on August 13, 2007. On April 11, 2008, China Net BVI became the parent holding company of a group of companies comprised of CNET Online Technology Limited, a Hong Kong company (“China Net HK”), which established and is the parent company of Rise King Century Technology Development (Beijing) Co., Ltd., a wholly foreign-owned enterprise (“WFOE”) established in the PRC (“Rise King WFOE”). The Company refers to the transactions that resulted in China Net BVI becoming an indirect parent company of Rise King WFOE as the “Offshore Restructuring.” Through a series of contractual agreements, the Company operates its business in China primarily through Business Opportunity Online (Beijing) Network Technology Co., Ltd. (“Business Opportunity Online”), Beijing CNET Online Advertising Co., Ltd. (“Beijing CNET Online”). Beijing CNET Online owns 51% of Shanghai Borongdingsi Computer Technology Co., Ltd. (“Shanghai Borongdingsi”). Business Opportunity Online, Beijing CNET Online and Shanghai Borongdingsi, were incorporated on December 8, 2004, January 27, 2003 and August 3, 2005, respectively. From time to time, we refer to them collectively as the “PRC Operating Entities.”

CHINANET ONLINE HOLDINGS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

On June 24, 2010, one of the Company's subsidiaries, Business Opportunity Online (Beijing) Network Technology Co., Ltd. ("Business Opportunity Online"), together with three other individuals, who were not affiliated with the Company or any of its subsidiaries or Variable Interest Entities ("VIEs"), established a new company, Shenzhen City Mingshan Network Technology Co., Ltd. ("Shenzhen Mingshan"). Shenzhen Mingshan is 51% owned by Business Opportunity Online and 49% owned by the other three individuals. Shenzhen Mingshan is located in Shenzhen City, Guangdong province of PRC and is primarily engaged in designing, developing and selling internet based software, developing online games, designing and developing the related websites and providing the related internet and information technology services necessary to operate such games and websites. As of September 30, 2010, Business Opportunity Online has invested approximately RMB 4,000,000 (approximately US\$587,000) in Shenzhen Mingshan. Shenzhen Mingshan is currently in the start-up stage.

2. Summary of significant accounting policies

a) Change of reporting entity and basis of presentation

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

The accompanying unaudited interim consolidated financial statements include the accounts of the Company, and its subsidiaries and VIEs, China Net BVI, China Net HK, Rise King WFOE, Beijing CNET Online and Business Opportunity Online and Shenzhen Mingshan. According to the agreements between Beijing CNET Online and Shanghai Borongdingsi, although Beijing CNET Online legally owns 51% of Shanghai Borongdingsi's interests, Beijing CNET Online only controls the assets and liabilities related to the bank kiosk business, which has been

included in the financial statements of Beijing CNET Online, but does not control the other assets of Shanghai Borongdingsi, thus, Shanghai Borongdingsi's financial statements were not consolidated by the Company.

CHINANET ONLINE HOLDINGS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, as promulgated by the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by US GAAP for annual financial statements. However, management believes that the disclosures are adequate to ensure the information presented is not misleading.

In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring entries, which are necessary for a fair presentation of the results for the interim periods presented. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Form 10-K for the fiscal year ended December 31, 2009 filed with the SEC on March 31, 2010. The results of operations for the interim periods presented are not indicative of the operating results to be expected for the Company’s fiscal year ending December 31, 2010.

b) Principles of Consolidation

The consolidated financial statements include the financial statements of all the subsidiaries and VIEs of the Company. All transactions and balances between the Company and its subsidiaries and VIEs have been eliminated upon consolidation.

c) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the related disclosure of contingent assets and liabilities at the date of these consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases these estimates on historical experiences and the best information available at the time the estimates are made; however, actual results could differ from those estimates. US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, contingencies and results of operations. While management has based their assumptions and estimates on the facts and circumstances existing as of September 30, 2010, final amounts may differ from these estimates.

d) Foreign currency translation and transactions

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

CHINANET ONLINE HOLDINGS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For financial reporting purposes, the financial statements of the Company's PRC operating entities, which are prepared using the RMB, are translated into the Company's reporting currency, the US\$. Assets and liabilities are translated using the exchange rate at each balance sheet date. Revenue and expenses are translated using average rates prevailing during each reporting period, and stockholders' equity is translated at historical exchange rates. Adjustments resulting from the translation are recorded as a separate component of accumulated other comprehensive income in stockholders' equity.

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

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

|  | September 30,<br>2010              |        | December 31,<br>2009                |        |
|--|------------------------------------|--------|-------------------------------------|--------|
| Balance sheet items, except for equity accounts  | 6.6981                             |        | 6.8372                              |        |
|  | Nine months ended<br>September 30, |        | Three months ended<br>September 30, |        |
|  | 2010                               | 2009   | 2010                                | 2009   |
| Items in the statements of income and comprehensive income, and the statements of cash flows | 6.8164                             | 6.8425 | 6.7803                              | 6.8411 |

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

e) Cash and cash equivalents

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

CHINANET ONLINE HOLDINGS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

f) Accounts receivable, net

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

g) Inventories

Inventories, consisting mainly of low value consumable articles are stated at the lower of cost or market value. Inventories are charged to expense when being withdrawn.

h) Property and equipment, net

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

|                    |            |
|--------------------|------------|
| Vehicles           | 5 years    |
| Office equipment   | 3-10 years |
| Electronic devices | 5 years    |

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

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

i) Intangible assets, net

Purchased software is initially recorded at costs and amortized on a straight-line basis over the estimated useful economic life of 3 years.

j) Impairment of long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment loss is recognized for the difference between the carrying amount of the asset and its fair value. There were no impairment losses incurred for the nine and three months ended September 30, 2010 and 2009.





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## k) Fair Value

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

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

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

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

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

The carrying values of cash and cash equivalents, trade and other receivables, prepayments, payables and other liabilities approximate fair values due to their short maturities.

Assets and liabilities measured at fair value on a non-recurring basis are summarized as follows:

| Financial instruments | Fair value measurement using inputs |                       |                       | Carrying amount as of<br>December 31, 2009<br>US\$('000) |
|-----------------------|-------------------------------------|-----------------------|-----------------------|--|
|                       | Level 1<br>US\$('000)               | Level 2<br>US\$('000) | Level 3<br>US\$('000) |  |
| Warrant liabilities   | -                                   | 9,564                 | -                     |  |