

NINETOWNS INTERNET TECHNOLOGY GROUP CO LTD  
Form 20-F/A  
July 17, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 20-F/A  
UNDER  
THE SECURITIES ACT OF 1933**

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

OR

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

For the fiscal year ended **December 31, 2006**.

Commission file number: **000-51025**

OR

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

OR

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

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

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

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

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

**Cayman Islands**  
*(Jurisdiction of incorporation or organization)*

**5th Floor, Union Plaza**  
**20 Chaowai Street, Chaoyang District**  
**Beijing 100020, The People's Republic of China**  
**telephone: (86 10) 6588-7788**  
**facsimile: (86 10) 6588-2290**  
**e-mail: ir@ninetowns.com**  
*(Address of principal executive offices)*

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SEC **Persons who respond to the collection of information contained in this form are not required to respond**  
1852 **unless the form displays a currently valid OMB control number.**  
(12-05)

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

American Depositary Shares,  
each representing one ordinary share, par value HK\$0.025 per share

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Indicate the number of outstanding shares of each of the Issuer's class of capital or common stock as of the close of the period covered by this Annual Report: 34,991,834 ordinary shares, par value HK\$0.025 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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

Yes  No

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 20-F/A, or Amendment No. 1, amends our annual report on Form 20-F for the year ended December 31, 2006, which was filed with the Securities and Exchange Commission on July 16, 2007. This Amendment No. 1 is being filed to correct certain clerical errors appearing in our 20-F.

Except as described above and reflected in this Amendment No.1, no part of the Registrant's 20-F filed on July 16, 2007 is being amended, and no part of the Form 20-F/A as re-filed in this Amendment No.1 reflects any event occurring after the filing of the Form 20-F and should not be viewed as updating any information contained therein.

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**Item 1. Identity of Directors, Senior Management and Advisors.**

Not applicable.

**Item 2. Offer Statistics and Expected Timetable.**

Not applicable.

**Item 3. Key Information.****A. Selected financial information and other data**

The following table shows selected consolidated financial information and other data for our business. You should read the following information in conjunction with Item 5 of this annual report, "Operating and Financial Review and Prospects." The statement of operations data and cash flow data for the years ended December 31, 2004, 2005 and 2006, and the balance sheet data as of December 31, 2005 and 2006, are derived from our audited consolidated financial statements and related notes thereto, which are included in this annual report beginning on page F-1. These audited consolidated financial statements and the related notes thereto have been prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP.

The statement of operations data for 2002 and 2003, and the balance sheet data as of December 31, 2002 and 2003, are derived from our audited consolidated financial statements which have not been included in this annual report.

**In thousands, except  
per share, per ADS  
and  
operating data and  
percentages**

**For the year ended December 31,**

	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2006<sup>(1)</sup></b>
<b>Statement of operations data</b>						
Total net revenues:						
Enterprise software	RMB 93,375	RMB 113,791	RMB 188,720	RMB 203,488	RMB 116,833	US\$ 14,971
Software development services	14,400	19,045	12,723	35,700	36,017	4,615
Computer hardware sales	258	72	104	678	398	51
	108,033	132,908	201,547	239,866	153,248	19,637
Cost of revenues:						
Enterprise software	(1,115)	(1,532)	(1,528)	(495)	-	-
Software development services	(3,534)	(4,939)	(2,970)	(18,192)	(16,805)	(2,153)
Computer hardware sales	(216)	(48)	(9)	(482)	(134)	(17)

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	(4,865)	(6,519)	(4,507)	(19,169)	(16,939)	(2,170)
Gross profit	103,168	126,389	197,040	220,697	136,309	17,467
Operating expenses:						
Selling expenses	(13,604)	(13,674)	(15,977)	(25,752)	(13,604)	(1,743)
General and administrative expenses	(12,195)	(56,911)	(36,572)	(49,538)	(65,928)	(8,448)
Research and development expenses	(4,108)	(2,691)	(4,819)	(11,249)	(29,825)	(3,822)
Total operating expenses	(29,907)	(73,276)	(57,368)	(86,539)	(109,357)	(14,013)
Government subsidies	458	211	1,340	447	705	90
Income from operations	73,719	53,324	141,012	134,605	27,657	3,544
Interest income	619	1,220	3,768	17,625	19,302	2,473

**In thousands, except per share, per ADS and operating data and percentages**

**For the years ended December 31,**

	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2006<sup>(1)</sup></b>
Income before provision for income taxes minority interests and equity in earnings of an affiliate	RMB 74,338	RMB 54,544	RMB 144,780	RMB 152,230	RMB 46,959	US\$ 6,017
Provision for income taxes	(2,061)	(4,116)	(1,823)	(626)	(1,031)	(132)
Income before minority interest and equity in earnings of an affiliate	72,277	50,428	142,957	151,604	45,928	5,885
Minority interest	(7,299)	(9,239)	(9,006)	—	-	-
Equity in earnings of an affiliate	79	—	—	—	-	-
Net income	65,057	41,189	133,951	151,604	45,928	5,885
Net income per share and ADS <sup>(2)</sup> :						
Basic	2.96	1.82	4.96	4.39	1.32	0.17
Diluted	2.96	1.82	4.74	4.25	1.30	0.17
<b>Cash flow data:</b>						
Net cash provided by operating activities	56,984	87,244	143,270	146,372	40,832	5,232
Depreciation and amortization	1,126	874	2,120	5,293	9,137	1,171
Net cash provided by (used in) investing activities	15,613	(39,629)	(179,405)	(110,851)	(176,483)	(22,614)
Net cash provided by (used in) financing activities	(30,531)	70,250	565,597	2,044	6,328	811

	<b>2002</b>	<b>2003</b>	<b>As of December 31, 2004</b>	<b>2005</b>	<b>2006</b>	<b>2006<sup>(1)</sup></b>
<b>Balance sheet data:</b>						
Cash and cash equivalents	RMB 49,666	RMB167,531	RMB696,993	RMB731,474	RMB598,648	US\$76,709
Trade receivables, net of allowance for doubtful debts, from:						
external customers	28,179	31,096	43,913	45,996	43,142	5,528
related parties	9,000	31,885	30,940	29,752	3,963	508
Term deposits	24,832	65,664	150,913	207,000	307,209	39,365
Total assets	133,287	323,975	1,222,182	1,345,773	1,365,289	174,945
Deferred revenue	44,420	70,608	97,230	67,886	26,383	3,381
Total liabilities	56,581	94,234	131,130	98,808	60,309	7,728
Mezzanine equity	—	46,937	—	—	-	-
Total shareholders' equity	68,671	165,530	1,090,452	1,246,365	1,304,980	167,217
Number of ordinary shares outstanding	—	22,780,000	34,391,834	34,991,834	34,991,834	34,991,834

- (1) For the convenience of the reader, the RMB amounts are expressed in U.S. dollars at the rate of RMB7.8041 to US\$1.00, the noon buying rate in effect on December 29, 2006 as quoted by the Federal Reserve Bank of New York.
- (2) On November 9, 2004, our shareholders approved a 4-for-1 share split. All shares and per share data have been restated to give retroactive effect to this share split. One ADS represents one ordinary share.

### **Exchange rate information**

Our business is primarily conducted in China and denominated in Renminbi. This annual report contains translations of Renminbi amounts into U.S. dollars at a specific rate solely for the convenience of the reader. The conversion of Renminbi into U.S. dollars in this annual report 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. Unless otherwise noted, all translations from Renminbi to U.S. dollars and from U.S. dollars to Renminbi in this annual report were made at a rate of RMB7.8041 to US\$1.00, the noon buying rate in effect as of December 29, 2006. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all. In addition, such translations should not be construed to be the amounts that would have been reported under U.S. GAAP. The PRC government imposes controls over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade.

The following table sets forth information concerning exchange rates between Renminbi and U.S. dollars for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this annual report or will use in the preparation of our periodic reports or any other information to be provided to you. The source of these rates is the Federal Reserve Bank of New York.

eGrid and iTowNet have been our two largest customers for software development services. Our net revenues from the provision of software development and other services to eGrid were RMB24.2 million and RMB16.4 million (US\$2.1 million) or 10.0% and 10.7% of our total net revenues in 2005 and 2006, respectively. We did not recognize any net revenues from the provision of software development and other services to eGrid in 2004. Our net revenues from the provision of software development services to iTowNet were RMB9.6 million, RMB4.1million and nil, or 4.8%, 1.7% and nil of our total net revenues, in 2004, 2005 and 2006, respectively. To our knowledge, iTowNet and eGrid are not PRC government agencies, but iTowNet is 51.0% owned by the PRC Inspections Administration.

In the event one or more of our customers discussed above discontinues their businesses or their dealings with us, and we are unable to find an adequate replacement for such customer in a timely manner, we would suffer a decline in total net revenues and in turn would need to significantly increase our sales and marketing expenditures.

***Our billed receivables, which include trade receivables from related parties, are significant and if customers fail to pay amounts owed, our profitability and financial position could decline.***

As of December 31, 2006, our billed receivables amounted to approximately RMB21.9 million (US\$2.8 million), of which our trade receivables from related parties amounted to RMB4.0 million (US\$0.5 million). Our trade receivables as of December 31, 2006 represented approximately 2.2% of our total current assets and our billed receivables from related parties represented approximately 0.4% of our total current assets. As of December 31, 2006, we had an allowance for doubtful debts of approximately RMB1.1 million (US\$0.1 million). If any of our franchisees or any of our other customers fails to pay, or delays payment on, all or part of these receivables, we would be required to make additional allowances for doubtful debts and our profitability and financial position could decline.

***Our existing major shareholders have substantial control over us and could delay or prevent a change in corporate control, which could in turn reduce the market price of your ADSs.***

Our executive officers, directors and shareholders with 5.0% or more shareholding of our company and their affiliates beneficially own approximately 46.35% of our outstanding ordinary shares. Such concentration of ownership might have the effect of delaying or preventing a change in control of our company which could in turn reduce the market price of our ADSs and the voting and other rights of our other shareholders.

***Our failure to market our customer maintenance services to our existing users could impair our planned revenue growth.***

We offer one year of customer maintenance services with our iDeclare.CIQ basic package, and charge a fee of RMB1,500 per licensee for customer maintenance services each year thereafter. However, until September 2003, we did not emphasize the marketing of customer maintenance services because we were focused on building our relationships with our users and we believed that not all of our users and potential users were accustomed to being charged for this type of service. In 2006, we offered customer maintenance service contracts to approximately 29,000 users, so that approximately 23.8% of the total number of users due for a maintenance contract renewal in 2006 paid for the renewal. In 2006, we recognized approximately RMB41.5 million (US\$5.3 million) from provision of customer maintenance services.

Our success in marketing customer maintenance services to our users depends in part on whether users require software updates. Software updates can implement modifications to forms, programs and information systems necessary to address changes imposed by the PRC Inspections Administration.



***Any reduction of our preferential tax treatment as a PRC high and new technology enterprise could materially reduce our net income.***

All of our principal PRC operating subsidiaries enjoy or are entitled to enjoy preferential tax treatment in the form of reduced tax rates or tax holidays provided by the PRC government or its local agencies or bureaus. Beijing New Take Electronic Commerce Limited, or Beijing New Take; Beijing Ninetowns Times Electronic Commerce Limited, or Ninetowns Times; Ninetowns Digital Technology Limited, or Ninetowns Digital, currently benefit from a 15.0% preferential enterprise income tax, or EIT, rate. Beijing Ninetowns Ports Software and Technology Co., Ltd., or Ninetowns Ports, currently benefit from a 7.5% preferential EIT rate. Shanghai New Take Digital Technology Co., Ltd., or Shanghai New Take, currently benefit from a 16.5% preferential EIT rate. Beijing Ninetowns Network and Software Co., Ltd., or Ninetowns Network, and Guangdong Ninetowns Technology Co., Ltd., or Guangdong Ninetowns Technology, are currently entitled to an exemption from EIT. Beijing Ronghe Tongshang Network Technology Limited, or Ronghe Tongshang, which is our variable interest entity, is currently entitled to a 15.0% preferential EIT rate. As a result of these preferential tax treatments and the recognition of deferred tax assets for deductible temporary differences, our effective income tax rate for 2006 was 2.2%. In addition, we also receive from the PRC government a 14.0% value added tax, or VAT, refund on sales of certain registered software. We cannot assure you that we will continue to enjoy this preferential tax treatment in the future, either due to a change in the PRC government's tax policies or because a subsidiary or variable interest entity fails to satisfy the financial and operational criteria necessary to maintain its eligibility for such preferential tax treatment. Any reduction in our preferential tax treatment could materially reduce our net income.

On March 16, 2007, the 2008 PRC Enterprise Income Tax Law was enacted. Under the new law, effective on January 1, 2008, the PRC government will adopt an uniform EIT rate of 25.0% for all enterprises (including foreign-invested enterprises) and revoke the current tax exemption, reduction and preferential treatments applicable to foreign-invested enterprises. However, the preferential EIT rate of 15.0% for "high and new technology enterprises" was strongly supported by the State and current preferential tax treatments for foreign-invested high and new technology enterprises are expected to be grandfathered for a period of five years following the effective date of the new law. We believe that our PRC operating subsidiaries and variable interest entity will continue to qualify as high and new technology enterprises entitled to the 15.0% preferential EIT rate, and therefore we will not be adversely affected by the new law. However, we cannot assure you that we will continue to enjoy this preferential tax treatment in the future, either due to a change in the PRC government's tax policies or because a subsidiary or variable interest entity fails to satisfy the financial and operational criteria necessary to maintain its eligibility for such preferential tax treatment. Any reduction in our preferential tax treatment could materially reduce our net income. Additionally, because the PRC State Council has not promulgated detailed rules for the 2008 PRC Tax Law, our subsidiaries and variable interest entities may not qualify as "high and new technology enterprises" and thus may not be entitled to a preferential EIT rate of 15.0%. Instead, our subsidiaries and variable interest entities may be subject to the standard EIT rate of 25.0% after the current preferential tax treatment they enjoy expires. We will seek to apply for "high and new technology enterprise" status for our subsidiaries and variable interest entities once the detailed rules are made available to us. In addition, under the 2008 PRC Enterprise Income Tax Law, enterprises established under the laws of foreign countries or regions whose "de facto management bodies" are located within the PRC are considered resident enterprises and will generally be subject to the EIT at the rate of 25.0% on its global income. However, the 2008 PRC Enterprise Income Tax Law does not define the term "de facto management bodies." Substantially all of our management is currently located in the PRC and if they remain located in the PRC after the effective date of the PRC Enterprise Income Tax Law, we may be considered to be a resident enterprise and therefore may be subject to the EIT at the rate of 25.0% on our global income in the PRC.



### ***Restricted net assets***

Relevant PRC laws and regulations permit payments of dividends by our PRC subsidiaries only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, the statutory general reserve fund, which requires annual appropriations of 10% of net after-tax income should be set aside prior to payment of any dividends. As a result of these and other restrictions under PRC laws and regulations, our PRC subsidiary and affiliate are restricted in their ability to transfer a portion of their net assets to us either in the form of dividends, loans or advances, restricted portion amounted to approximately RMB522.5 million (US\$67.0 million), or 40.0% of our total consolidated net assets as of December 31, 2006.

Even though we currently do not require any such dividends, loans or advances from our PRC subsidiaries, we may in the future require additional cash resources from our PRC subsidiaries due to changes in business conditions, to fund future acquisitions or developments, or merely to declare and pay dividends or distributions to our shareholders, although we currently have no intention to do so.

### **Regulation of the import/export industry**

#### **The State Administration for Quality Supervision and Inspection and Quarantine of the PRC**

In April 2001, the PRC Inspections Administration was established by combining the former State Import and Export Commodity Inspection Quarantine Bureau of the PRC and the State Quality and Technique Supervision Bureau of the PRC, which oversees the inspection work of import and export commodities for the PRC in accordance with the institutional reform plan of the State Council. The PRC Inspections Administration, which is primarily an administrative and law enforcement institution governing, among others, the health quarantine of imported and exported animals and plants, the inspection, appraisal, certification and supervision of imported and exported commodities, has the following responsibilities, among others:

- executing the inspection and quarantine, appraising and supervising of import and export commodities;
- implementing the quarantine and supervision for the import and export of animals and plants and the inspection, supervision and administration of the sanitary and food quality;
- administering health registrations of import and export food products and their production units and external registration for export enterprises; administering the import and export inspection and quarantine marks, import safety licenses, and export quality licenses; and implementing the import and export-related quality authentication and accreditation;
- administering the issuance of Origin Certificates for commodities and the general certificates of origin;
- formulating the development plan of technologies for commodity inspection and quarantine; and
- developing international cooperation and technology exchanges related to commodity inspection and quarantine and carrying out the implementation work relating to technological barriers to trade, as stipulated.

**C. *Organizational structure***

We conduct substantially all of our business through seven PRC subsidiaries and two variable interest entities in China. The following diagram illustrates our subsidiaries, their country of incorporation and the proportion of our ownership of each as of May 31, 2007.

For details of the above subsidiaries and variable interest entities, see “— History and development of the company.”

**D. Property and equipment**

Our principal executive offices occupy a total of approximately 3,170 square meters on the 5th, 12th, 14th and 17th floors of Union Plaza, 20 Chaowai Street and the 20th floor of the Fan Li Building, 22 Chowai Street, Chaoyang District, Beijing 100020 PRC. In addition, we occupy a representative office of approximately 200 square meters at Suites 1705-6, 17/F, Two Chinachem Exchange Square, 338 King's Road, North Point, Hong Kong. As of May 31, 2007, we have one premise which we own and we have also leased 9 premises in the following cities and municipalities to serve as technical support centers and quarters for our technical support staff:

<b>Location</b>	<b>Office space (in square meters)</b>	<b>Number of employees</b>
Guangdong Province		
Dongguan	921.69	44
Guangzhou	120.85	60
Beijing	551.65	37
Shanghai	139.00	12
<b>Total</b>	<b>1,733.19</b>	<b>153</b>

During 2005, we transferred a number of technical support centers to our franchisees in an effort to reduce the number of technical support centers that we operate on our own. We currently support our existing users jointly with our four franchisees through four technical support centers operated and maintained by us and 43 technical support centers operated and maintained by our four franchisees located in most of the major import/export cities in China.

Ninetowns Ports acquired, subject to the receipt of the necessary title certificates, four residential units in the Sing Sun Building in Guangzhou, with aggregate space of approximately 355 square meters and uses such premises as employee housing for our employees in Guangzhou. During 2006, Ninetowns Ports acquired two commercial units as offices with aggregate space of approximately 340.61 square meters.

Ninetowns Times owns two commercial units in the Qingdao Bai Sing Building in Qingdao, with aggregate space of approximately 384 square meters and uses such commercial units as offices. Ninetowns Times also acquired, subject to the receipt of the necessary title certificates, an eight-storey building in Fengtai, with aggregate space of approximately 2,206.59 square meters and uses such building as a call center for our technical support services and also as a research and development center.

Ninetowns Ports also acquired four floors and the naming right of a building in Beijing. See Item 7 of this annual report, "Major Shareholders and Related Party Transactions — Related party transactions — Transaction with Mr. Ko Jin Heng."

**Insurance**

The insurance industry in China is still at an early stage of development. We are not required to maintain business liability insurance, and, to our knowledge, other software companies in China do not maintain such insurance. As a result, we do not have business liability insurance coverage, but we do maintain vehicle liability insurance. Moreover, while business disruption insurance is available, we have determined that the risks of disruption and the cost of insurance are such that we do not require it at this time. Any business disruption, litigation or natural disaster might therefore result in substantial costs and diversion of our resources.

We do not maintain key-man life insurance for any member of senior management. We maintain directors and officers insurance for our directors and members of senior management.

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 products 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 man-hours incurred and estimated total project hours. We expect our cost of revenues related to software development services to increase as a percentage of our net revenues from software development services as a result of the requirement for more advanced technologies in new projects. As such, we expect our overall cost of revenues from software development services to increase as we perform more software development services.



*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 and variable interest entities 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, Ninetowns Times and Ninetowns Digital are afforded favorable tax treatment and are only subject to a 15.0% EIT, Shanghai New Take and 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 is entitled to an exemption from EIT from January 1, 2006 to December 31, 2007. Ninetowns Network is entitled to an exemption from EIT from January 1, 2006 to December 31, 2008. Ronghe Tongshang is currently subject to a 15.0% EIT.

Ninetowns Digital, Beijing New Take, Ninetowns Times, Ninetowns Ports, Ninetowns Network and Ronghe Tongshang 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.

Baichman is currently subject to a 33.0% EIT.

*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 and variable interest entities 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 and amounts unbilled 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.

### **Critical 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 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 allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make the required payments and use the specific identification method to record such allowances. We typically write-off billed 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 billed receivables from Ninetowns Enke, iTowNet and eGrid, which are our customers that are related to us, were approximately 18.1% of our total billed receivables as of December 31, 2006. The billed receivables from our customers and franchisees, which are unrelated to us, were approximately 81.9% of our total billed receivables as of December 31, 2006. Since our billed 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 billed 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.

### **A. *Operating results***

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

	<b>Year ended December 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Total net revenues:			
Enterprise software	93.6%	84.8%	76.2%
Software development services	6.3	14.9	23.5
Computer hardware sales	0.1	0.3	0.3

Cost of revenues:			
Enterprise software	0.7	0.2	-
Software development services	1.5	7.6	11.0
Computer hardware sales	-	0.2	0.1
Gross profit	97.8	92.0	88.9

	<b>Year Ended December 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Operating expenses:</b>			
Selling expenses	7.9	10.7	8.9
General and administrative expenses	18.2	20.6	43.0
Research and development expenses	2.4	4.7	19.5
Total operating expenses	28.5	36	71.4
Government subsidies	0.6	0.2	0.5
Income from operations	69.9	56.2	18.0
Interest income	1.9	7.3	12.6
Income before provision for income taxes and minority interest	71.8	63.5	30.6
Provision for income taxes	0.9	0.3	0.6
Income before minority interests	70.9	63.2	30.0
Minority interests	4.4	–	
Net income	66.5%	63.2%	30.0%

## **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 RMB43.4 million (US\$5.6 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.



*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 by 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.

**Inflation**

Inflation and deflation in China did not have a material impact on our results of operations in the past three years. According to the National Bureau of Statistics of China, China's overall national inflation rate, as represented by the change in the Consumer Price Index in China, was 3.9%, 1.8% and 1.5% in 2004, 2005 and 2006, respectively.

### **Control over Baichuan**

In April 2007, in connection with our acquisition through our wholly-owned subsidiary, Ixworth, of a 70% interest in Ample Spring, we entered into a series of contractual agreements with Baichuan, Mr. Wang and Mr. Ren, previously shareholders of Baichuan, which provide us with effective control over Baichuan.

### **Related party trade receivables**

In connection with the transactions described above, we had trade receivables from related parties amounting to RMB4.0 million (US\$0.5 million) or 18.1% of our billed receivables as of December 31, 2006. These receivables consisted primarily of proceeds from sales of enterprise software and fees from software development services.

### **Board memberships**

Mr. Wang and Mr. Ren are two of the five directors of iTowNet. iTowNet is 51.0% owned by the PRC Inspections Administration and 49.0% owned by Import & Export. Import & Export is in turn 100.0% beneficially owned by Mr. Wang and Ms. Dong. Mr. Wu is the sole supervisor of iTowNet.

### **Stock option grants**

Please refer to Item 6, "Directors, Senior Management and Employees — Compensation of directors and executive officers."

#### **C. *Interests of experts and counsel***

Not applicable.

### **Item 8. Financial Information.**

#### **A. *Consolidated statements and other financial information***

Please see our consolidated financial statements which are filed as part of this annual report.

### **Legal proceedings**

We are not currently involved in any material litigation and we are not aware of any pending or threatened litigation or similar proceedings which could reasonably be expected, if such litigation or proceeding is decided adversely to us, to have a material adverse effect on our financial condition or results of operations.

### **Dividend policy**

Since our inception, we have not declared or paid a dividend on our ordinary shares. We do not anticipate paying any cash dividend in the foreseeable future. We currently intend to retain future earnings, if any, to finance our operations and the expansion of our business. Payments of dividends by our subsidiaries in China to us are subject to restrictions including the restriction that foreign-invested enterprises may only buy, sell and/or remit foreign currencies at banks authorized to conduct foreign exchange business after providing valid commercial documents. We do not expect any of these restrictions to have a material and adverse effect on our ability to receive payments of dividends from our subsidiaries in China. There are no such similar foreign exchange restrictions in the Hong Kong, the Cayman Islands or the British Virgin Islands.



**Item 16A. Audit Committee Financial Expert.**

See Item 6 of this annual report, "Directors, Senior Management and Employees — Board practices."

**Item 16B. Code of Ethics.**

Our board of directors has adopted a code of ethics for our chief executive officer and senior financial officers and a code of business conduct and ethics, which is applicable to all of our directors, officers and employees. Our code of ethics and code of business conduct and ethics are publicly available on our website at <http://www.ninetowns.com/english>, and such codes are filed as exhibits to this annual report.

**Item 16C. Principal Accountant Fees and Services.**

The following table sets forth the aggregate fees in connection with certain professional services rendered by Deloitte Touche Tohmatsu, an independent registered public accounting firm, for the periods indicated. We did not pay any tax related or other fees to our principal accountants during the periods indicated.

	<b>For the year ended December 31</b>		
	<b>2005</b>	<b>2006</b>	<b>2006</b>
Audit fees <sup>(1)</sup>	RMB2,463,000	RMB3,789,000	US\$486,000
Audit related fees	372,000	526,000	67,000
<b>Total</b>	<b>RMB2,835,000</b>	<b>RMB4,315,000</b>	<b>US\$553,000</b>

<sup>(1)</sup> Audit fees are the aggregate fees billed for each of the fiscal years for professional services rendered by our principal accountants for their audit and review of our annual financial statements and interim financial statements in connection with the statutory requirement and our initial public offering in 2004.

**Audit Committee Pre-Approval Policy and Procedures**

Our audit committee will pre-approve all audit and non-audit services provided by our independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services, as described above. On an annual basis, our audit committee will review and approve the audit services to be rendered by our independent registered public accounting firm prior to the engagement of the service. Audit services not covered by the annual engagement letter, audit-related services and tax services are estimated to result in an amount of more than US\$10,000 require the express approval of our audit committee prior to engagement. Our audit committee may delegate pre-approval authority to one or more members of our audit committee. The decisions of any audit committee member to whom authority is delegated to pre-approve a service shall be presented to the full audit committee at its next scheduled meeting. Our Chief Financial Officer, Tommy Siu Lun Fork is required to report to our audit committee on a quarterly basis regarding the extent of services actually provided and the fees for the services performed.

**Item 16D. Exemptions from the Listing Standards for Audit Committee.**

None.

**Exhibit Description**

**Number**

- |      |   |
|------|---|
| 12.1 | Certification of Chief Executive Officer pursuant to SEC Rule 13a-14(a) |
| 12.2 | Certification of Chief Financial Officer pursuant to SEC Rule 13a-14(a) |
| 13.1 | Certification of Chief Executive Officer pursuant to SEC Rule 13a-14(b) |
| 13.2 | Certification of Chief Financial Officer pursuant to SEC Rule 13a-14(b) |
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**Signatures**

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this annual report on its behalf on this 17 day of July, 2007.

**NINETOWNS INTERNET  
TECHNOLOGY GROUP COMPANY  
LIMITED**

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

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