

ASPEN TECHNOLOGY INC /DE/  
Form 10-Q/A  
March 15, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1  
to

## FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

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: 000-24786

### Aspen Technology, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**Ten Canal Park**

**Cambridge, Massachusetts**

(Address of Principal Executive Offices)

**04-2739697**

(I.R.S. Employer  
Identification No.)

**02141**

(Zip Code)

**(617) 949-1000**

(Registrant's telephone number, including area code)

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 twelve 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

Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

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 March 9, 2007, there were 87,749,130 shares of the registrant's common stock (par value \$0.10 per share) outstanding.

---

**TABLE OF CONTENTS**

	<b>Page</b>
Explanatory Notes	
<u>PART I. FINANCIAL INFORMATION</u>	
<u>FINANCIAL INFORMATION</u>	
<u>Item 1. Condensed Consolidated Financial Statements</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 4. Controls and Procedures</u>	33
<u>PART II. OTHER INFORMATION</u>	
<u>OTHER INFORMATION</u>	
<u>Item 6. Exhibits</u>	38
<u>SIGNATURES</u>	39
<u>CERTIFICATIONS</u>	

**Purpose of this Form 10-Q/A**

Subsequent to our issuance of condensed consolidated financial statements for the three months ended September 30, 2006, and in the course of preparing the condensed consolidated financial statements for the three and six months ended December 31, 2006, we identified errors in the accounting for foreign currency denominated transactions. We incorrectly accounted for transaction gains and losses on intercompany balances denominated in currencies other than the functional currency as if such balances were of a long term investment nature and included the impact as a component of accumulated other comprehensive income (loss) rather than earnings. These transaction gains and losses should have been included in earnings as the conditions for accounting for these intercompany balances as a long term investment were not met. In addition, we identified errors in the recording of purchase accounting in other than the functional currency of the acquired entity. These purchase accounting adjustments should have been denominated in the currency of the applicable subsidiary and translated to United States Dollars and were incorrectly recorded as United States Dollar denominated net assets in the consolidated financial statements. Accordingly, translation of the balance sheet position related to the purchase accounting allocations and translation impact of the amortization of intangible assets was not recorded.

In addition, we identified other errors in the course of preparing the condensed consolidated financial statements for the three and six months ended December 31, 2006. These errors related to the timing of recognition of service revenue, facility leasing costs, and professional fees. We also recognized the tax effects of these corrections and added disclosure relative to reseller relationships in footnote 8.

In total, the above adjustments are reflected in the Third Restatement described in Amendment No. 2 to our Form 10-K for the fiscal year ended June 30, 2006, and in this Amendment No. 1 on Form 10-Q, which we refer to as this Form 10-Q/A. In order to correct the errors with respect to the three months ended September 30, 2005 and 2006, we are restating our condensed consolidated financial statements for these periods, in order to reflect (a) foreign currency transaction losses of \$3.1 million and gains of \$0.3 million, respectively, (b) additional amortization of technology related intangible assets of \$0.3 million and \$0.4 million, respectively, (c) income tax provision decrease of \$1.0 million and \$0.1 million, respectively, (d) additional facility lease costs of less than \$0.1 million in each period, and (e) for the three months ended September 30, 2006, an increase in service revenues of \$0.4 million and a decrease in legal costs of \$0.1 million and related balance sheet adjustments.

See Note 12 to the condensed consolidated financial statements for a discussion of the restatement. This Form 10-Q/A updates the information provided in Part I, Items 1, 2, and 4 of the original Form 10-Q for the effects of the restatement. This Form 10-Q/A has not been updated for events occurring after the filing of the original Form 10-Q, except to reflect the restatement.

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**ASPEN TECHNOLOGY, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Unaudited and dollars in thousands)

	September 30, 2006 (As restated, see Note 12)	June 30, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 88,866	\$ 86,272
Accounts receivable, net	50,576	49,163
Unbilled services	8,544	8,518
Current portion of long-term installments receivable, net	5,699	12,123
Prepaid expenses and other current assets	8,438	9,179
Total current assets	162,123	165,255
Long-term installments receivable, net	10,447	35,681
Retained interest in sold receivables.	28,067	19,010
Property and leasehold improvements, at cost	45,327	44,771
Accumulated depreciation and amortization	(36,916 )	(36,097 )
Property and leaseholds, net.	8,411	8,674
Computer software development costs, net	16,242	15,456
Purchased intellectual property, net	24	165
Other intangible assets, net	4,805	6,711
Goodwill	18,031	18,035
Deferred tax assets	3,098	3,097
Other assets	2,466	2,552
	\$ 253,714	\$ 274,636
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
Current liabilities:		
Current portion of long-term debt	\$ 249	\$ 247
Accounts payable	3,143	4,613
Accrued expenses	67,165	77,716
Deferred revenue	52,895	57,936
Total current liabilities	123,452	140,512
Long-term debt and obligations, less current maturities	97	149
Deferred revenue, less current portion	2,851	2,609
Other liabilities	19,080	20,446
Redeemable Preferred Stock:		
Outstanding 333,364 shares as of September 30, 2006 and June 30, 2006	129,211	125,475
Stockholders' equity (deficit):		
Common stock:		
Outstanding 53,461,512 as of September 30, 2006 and 48,857,035 as of June 30, 2006	5,370	4,909
Additional paid-in capital	433,120	430,811
Accumulated deficit	(467,130 )	(457,977 )
Accumulated other comprehensive income (loss)	8,176	8,215
Treasury stock, at cost	(513 )	(513 )
Total stockholders' equity (deficit)	(20,977 )	(14,555 )
	\$ 253,714	\$ 274,636

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ASPEN TECHNOLOGY, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited and in thousands, except per share data)

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(As restated, see Note 12)</b>	<b>(As restated see Note 12)</b>
Software licenses	\$ 28,076	\$ 24,037
Service and other	36,246	35,797
Total revenues	64,322	59,834
Cost of software licenses	3,149	3,875
Cost of service and other	17,481	17,343
Amortization of technology related intangible assets	1,902	2,106
Total cost of revenues	22,532	23,324
Gross profit	41,790	36,510
Operating costs:		
Selling and marketing	21,210	18,758
Research and development	8,490	10,183
General and administrative	10,084	10,469
Restructuring charges	1,446	2,199
Loss on sales and disposals of assets	5,769	61
Total operating costs	46,999	41,670
Income (loss) from operations	(5,209 )	(5,160 )
Foreign currency exchange loss	(94 )	(3,297 )
Interest income	1,248	1,047
Interest expense	(481 )	(231 )
Income (loss) before provision for income taxes	(4,536 )	(7,641 )
(Provision for) benefit from income taxes	(881 )	309
Net income (loss)	(5,417 )	(7,332 )
Accretion of preferred stock discount and dividend	(3,736 )	(3,778 )
Income (loss) applicable to common shareholders	\$ (9,153 )	\$ (11,110 )
Basic and diluted income (loss) per share applicable to common shareholders	\$ (0.17 )	\$ (0.26 )
Weighted average shares outstanding basic and diluted	52,801	43,237

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ASPEN TECHNOLOGY, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited and in thousands)

	<b>Three Months Ended September 30, 2006 (As restated, see Note 12)</b>	<b>2005 (As restated see Note 12)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$(5,417 )	\$(7,332 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,271	6,337
Transaction (gain) loss on intercompany accounts	(321 )	3,093
Stock-based compensation.	1,741	1,808
Loss on securitization of installments receivable	5,672	
Loss on sales and disposals of assets	97	61
Accretion of discount on retained interest in sold receivables	(766 )	(757 )
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	(1,426 )	7,421
Decrease (increase) in unbilled services	10	(1,479 )
Decrease (increase) in installments receivable, including proceeds from securitization	18,587	(3,382 )
Decrease (increase) in prepaid expenses and other current assets	771	(1,078 )
Decrease in accounts payable and accrued expenses	(12,745 )	(19,657 )
Decrease in deferred revenue	(4,783 )	(4,345 )
Increase (decrease) in other liabilities	(1,366 )	24
Net cash provided by (used in) operating activities	5,325	(19,286 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and leasehold improvements	(957 )	(395 )
Decrease in other long-term assets	86	55
Capitalized computer software development costs	(2,744 )	(2,105 )
Net cash used in investing activities	(3,615 )	(2,445 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock under employee stock purchase plans	423	445
Exercise of stock options	551	1,194
Payments of long-term debt	(50 )	(311 )
Net cash provided by financing activities	924	1,328
<b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH</b>	<b>(40 )</b>	<b>(46 )</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>2,594</b>	<b>(20,449 )</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>86,272</b>	<b>68,149</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$ 88,866</b>	<b>\$ 47,700</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.

**ASPEN TECHNOLOGY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**1. Interim Condensed and Consolidated Financial Statements**

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC) for reporting on Form 10-Q. Accordingly, certain information and footnote disclosures required for complete financial statements are not included herein. It is suggested that these unaudited interim condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements for the year ended June 30, 2006, which are contained in the Annual Report on Form 10-K, as amended, of Aspen Technology, Inc. (the Company), as previously filed with the SEC. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, considered necessary for a fair presentation of the financial position, results of operations, and cash flows at the dates and for the periods presented have been included. The results of operations for the three-month period ended September 30, 2006 are not necessarily indicative of the results to be expected for the full fiscal year.

**2. Sale of Installments Receivable**

*(a) Traditional Activities*

Installments receivable represent the present value of future payments related to the financing by the Company of noncancelable term and perpetual license agreements with its customers which provide for payment in installments over a one to five-year period. A portion of each installment agreement is recognized as interest income in the accompanying consolidated condensed statements of operations. The interest rate utilized for the three months ended September 30, 2006 and 2005 was 8.0%.

The Company has arrangements to sell certain of its installments receivable to three financial institutions. The Company sold certain of its installment contracts for aggregate proceeds of approximately \$9.0 million and \$8.5 million during the three months ended September 30, 2006 and 2005, respectively. Generally, no gain or loss is recognized on the sale of the receivables due to the consistency of the discount rates used by the Company and the financial institutions.

The financial institutions have certain recourse to the Company upon nonpayment by the customer under the installments receivable. The amount of recourse is determined pursuant to the provisions of the Company's contracts with the financial institutions. Collections of these receivables reduce the Company's recourse obligations, as defined in the contracts. The Company's potential recourse obligation related to these contracts is within the range of \$0.1 million to \$1.2 million. In addition, the Company is obligated to pay additional costs to the financial institutions in the event of default by the customer.

*(b) Securitization of Installments Receivable*

On September 29, 2006, the Company entered into a \$75.0 million three year revolving securitization facility and securitized certain outstanding installment software license receivables (which receivables were not sold in the traditional sales described above) with a net carrying value of \$32.1 million. The structure of the facility was such that the securitization qualified as a sale. The Company received \$19.4 million of cash and retained an interest in the sold receivables valued at \$8.3 million. It also retained certain limited recourse obligations relative to the receivables valued at approximately \$0.5 million. Overall, the



transaction resulted in a loss of \$5.7 million in the quarter ended September 30, 2006 and was recorded as a loss on sales and disposals of assets in the accompanying consolidated statement of operations.

The amount of the loss was based on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer, as well as transaction costs.

As noted above, the retained interest in the sold receivables was recorded at its fair value of \$8.3 million at the time of the transaction and is classified as a long-term asset on the Company's consolidated balance sheet. The Company estimates fair value based on the present value of future expected cash flows based on using management's best estimates of key assumptions, principally credit losses, and discount rates commensurate with the risks involved.

Key economic assumptions used in subsequently measuring the carrying value of the Company's retained interests in the license receivables sold during the quarter ended September 30, 2006 and the effect on the fair value of those interests from adverse changes in those assumptions are as follows (in thousands):

Balance sheet carrying value of retained interest in sold receivables	\$	8,291	
Expected credit losses (annual rate):		0.82	%
Impact on fair value of 10% adverse change	\$	(23)	)
Impact on fair value of 20% adverse change	\$	(45)	)
Residual cash flow discount rate (annual rate):		13.0	%
Impact on fair value of 10% adverse change	\$	(397)	)
Impact on fair value of 20% adverse change	\$	(773)	)

These sensitivities are hypothetical and presented for illustrative purposes only. Changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption is calculated without changing any other assumption; in reality, changes in one assumption may result in changes in another, which may magnify or counteract the sensitivities.

The Company is recognizing the accretion of its retained interest to the estimated cash flow that will be received in interest income. Total interest income from accretion was \$0.8 million for the three months ended September 30, 2006 and 2005. The Company recognizes an impairment of the carrying value of its retained interest if a decline in the fair value of the retained interest is determined to be other-than-temporary. No such impairments have been recognized through September 30, 2006.

The Company retained the servicing rights relative to the receivables and receives annual servicing fees of \$0.3 million per year. The benefits of the servicing rights approximate the costs estimated to be incurred by the Company, and thus no servicing asset or liability has been recorded.

In connection with the above transaction, the Company incurred an obligation to guarantee that the proceeds from all installments receivable denominated in currencies other than the U.S. dollar included in the securitized pool will be equal to the U.S. dollar value on the initial contract date. The Company has entered into forward foreign exchange contracts intended to mitigate the financial exposure due to changes in currency exchange rates which are further described below. The fair value of this obligation was not material and has thus been accorded no value.

### 3. Derivative Instruments and Hedging

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS), No. 133 Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133, as amended by SFAS No. 138, requires that all derivatives, including foreign currency exchange contracts, be recognized on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is to be immediately recognized in earnings.

Forward foreign exchange contracts are used primarily by the Company to hedge certain balance sheet exposures resulting from changes in foreign currency exchange rates. Such exposures primarily result from portions of the Company's installment receivables that are denominated in currencies other than the U.S. dollar, primarily the Euro, the Japanese Yen, Canadian dollar and the British Pound Sterling. In addition, the Company incurred exposures as part of the June 2005 and September 2006 securitizations of installments receivable, in that the Company is obligated, in the form of a guarantee, to cover the exposure in the installments receivable that were transferred to its subsidiaries, resulting from changes in foreign currency exchange rates.

The foreign exchange contracts are entered into to hedge recorded installments receivable, both held and securitized, made in the normal course of business, and accordingly, are not speculative in nature. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, the Company hedges the majority of its installments receivable denominated in foreign currencies.

The Company's guarantee to cover the exposure in the securitized installments receivable represents an embedded derivative. The Company calculates the value of this guarantee at each balance sheet date, and if the value of the guarantee represents an obligation, the fair value is recorded as a liability. As of September 30, 2006, the value of this embedded derivative represented an asset to the Company, and as such, no entry was recorded.

At September 30, 2006, the Company had effectively hedged \$29.3 million of installments receivable, either held or securitized, and accounts receivable denominated in foreign currency. The Company does not hold or transact in financial instruments for purposes other than to hedge foreign currency risk. The gross value of the installments receivable that were denominated in foreign currency was \$33.3 million and \$40.3 million at September 30, 2006 and June 30, 2006, respectively. The installments receivable held as of September 30, 2006 mature at various times through September 2011. There have been no material gains or losses recorded relating to hedge contracts for the periods presented.

The Company records its foreign currency exchange contracts at fair value in its consolidated balance sheet and the related gains or losses on these hedge contracts are recognized in earnings. During the three months ended September 30, 2006 and 2005 the net gain recognized in the consolidated statements of operations was not material.

The following table provides information about the Company's foreign currency derivative financial instruments outstanding as of September 30, 2006. The information is provided in U.S. dollar amounts (in thousands), as presented in the Company's consolidated financial statements. The table presents the notional amount (at contract exchange rates) and the weighted average contractual foreign currency rates:

	Notional Amount	Estimated Fair Value(1)	Average Contract Rate
Euro	\$ 19,329	\$ 19,676	1.26
British Pound Sterling	4,987	5,118	1.83
Canadian Dollar	2,434	2,483	1.14
Japanese Yen	2,154	2,004	112.38
Swiss Franc	394	388	1.21
	\$ 29,298	\$ 29,669	

(1) The estimated fair value is based on the estimated amount at which the contracts could be settled based on the spot rates as of September 30, 2006. The market risk associated with these instruments resulting from currency exchange rate movements is expected to offset the market risk of the underlying installments being hedged. The credit risk is that the Company's banking counterparties may be unable to meet the terms of the agreements. The Company minimizes such risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any loss as a result of default by other parties. However, there can be no assurances that the Company will be able to mitigate market and credit risks described above.

#### 4. Stock-Based Compensation Plans

The Company issues stock options to its employees and outside directors and provides employees the right to purchase stock pursuant to stockholder approved stock option and employee stock purchase programs. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of the grant; those options generally vest over four years and have 7 and 10-year contractual terms.

Effective July 1, 2005, the Company adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), using the Statement's modified prospective application method. Prior to July 1, 2005, the Company followed Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its stock-based compensation. Under the provisions of SFAS No. 123R, the Company recognizes the fair value of stock-based compensation in net income, over the requisite service period of the individual grantees, which generally equals the vesting period. All of the Company's stock-based compensation is accounted for as equity instruments and there have been no liability awards granted.

The Company elected the modified prospective transition method for adopting SFAS 123R, and consequently prior periods have not been modified. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. The unrecognized expense of awards not yet vested at the date of adoption shall be recognized in net income in the periods after the date of adoption using the same valuation method (*i.e.*, Black-Scholes) and assumptions determined under the original provisions of SFAS 123, *Accounting for Stock-Based Compensation*, (SFAS 123) as disclosed in previous filings. Under the provisions of SFAS 123R, the Company recorded \$1.8 million of stock-based compensation for the three months ended September 30, 2006 and 2005, included in the following categories (in thousands):

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Recorded as expense:		
Cost of service and other	\$ 310	\$ 299
Selling and marketing	621	509
Research and development	199	208
General and administrative	611	792
	1,741	1,808
Capitalized computer software development costs	55	39
Total stock-based compensation.	\$ 1,796	\$ 1,847

The Company utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted after the adoption of SFAS 123R. The weighted-average fair values of the options granted under the stock option plans were \$8.91 and \$3.88 and of the shares subject to purchase under the employee stock purchase plan were \$2.60 and \$1.99 for the three months ended September 30, 2006 and 2005, respectively, using the following assumptions:

	<b>Three Months Ended September 30, 2006</b>				<b>Three Months Ended September 30, 2005</b>			
	<b>Stock Option Plans</b>		<b>Purchase Plan</b>		<b>Stock Option Plans</b>		<b>Purchase Plan</b>	
Average risk-free interest rate	4.84	%	5.10	%	4.06	%	3.79	%
Expected dividend yield	None		None		None		None	
Expected life	6.0 Years		0.5 Years		6.0 Years		0.5 Years	
Expected volatility	85	%	53	%	85	%	42	%

The dividend yield of zero is based on the Company's history of not having paid cash dividends and on its present intention not to pay cash dividends. Expected volatility is based on the historical volatility of the Company's common stock over the period commensurate with or longer than the expected life of the options. The risk-free interest rate is the U.S. Treasury STRIPS rate on the date of grant. The expected life was calculated using the method outlined in SEC Staff Accounting Bulletin Topic 14.D.2, *Expected Term*, as the Company's historical experience does not provide a reasonable basis for the expected term of the option.

## 5. Net Income (Loss) Per Common Share

Basic earnings per share was determined by dividing income (loss) attributable to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings per share was determined by dividing income (loss) attributable to common shareholders by diluted weighted average shares outstanding. Diluted weighted average shares reflects the dilutive effect, if any, of potential common shares. To the extent their effect is dilutive, potential common shares include common stock

options and warrants, based on the treasury stock method, preferred stock, based on the if-converted method, and other commitments to be settled in common stock. The calculations of basic and diluted income (loss) attributable to common shareholders per share and basic and diluted weighted average shares outstanding are as follows (in thousands, except per share data):

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Income (loss) applicable to common shareholders	\$ (9,153 )	\$ (11,110 )
Basic weighted average common shares outstanding	52,801	43,237
Weighted average potential common shares		
Diluted weighted average shares outstanding	52,801	43,237
Basic and diluted income (loss) per share applicable to common shareholders	\$ (0.17 )	\$ (0.26 )

The following potential common shares were excluded from the calculation of diluted weighted average shares outstanding as their effect would be anti-dilutive (in thousands):

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Convertible preferred stock	33,336	36,336
Preferred stock dividend, to be settled in common stock	2,864	3,554
Options and warrants	12,213	21,911
Total	48,413	61,801

#### 6. Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The components of comprehensive income (loss) for the three months ended September 30, 2006 and 2005 are as follows (in thousands):

	<b>Three Months Ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Net income (loss)	\$ (5,147 )	\$ (7,332 )
Foreign currency translation adjustments	(39 )	3,396
Comprehensive income (loss)	\$ (5,186 )	\$ (3,936 )

**7. Restructuring Charges**

During the three months ended September 30, 2006, the Company recorded \$1.4 million in restructuring charges primarily related to severance and relocation expenses under the May 2005 restructuring plan which are recognized in the period in which the affected employees were notified or the relocation expenses were incurred.

**(a) Restructuring charges originally arising in Q4 FY05.**

In May 2005, the Company initiated a plan to consolidate several corporate functions and to reduce its operating expenses. The plan to reduce operating expenses primarily resulted in headcount reductions, and also included the termination of a contract and the consolidation of facilities. These actions resulted in an aggregate restructuring charge of \$3.8 million, recorded in the fourth quarter of fiscal 2005. During the year ended June 30, 2006, the Company recorded an additional \$1.8 million related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that are recognized in the period in which the affected employees were notified, the relocation expenses were incurred, or the Company ceased use of the affected facilities. During the quarter ended September 30, 2006, the Company recorded an additional \$1.4 million in severance and relocation expenses for employees that were notified or relocation expenses that were incurred during the period.

As of September 30, 2006, there was \$1.3 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the three months ended September 30, 2006, the following activity was recorded (in thousands):

Fiscal 2005 Restructuring Plan	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Total
Accrued expenses, June 30, 2006	\$ 99	\$ 513	\$ 612
Restructuring charge	26	1,369	1,395
Restructuring charge Accretion	1		1
Payments	(64 )	(680 )	(744 )
Accrued expenses, September 30, 2006	\$ 62	\$ 1,202	\$ 1,264
Expected final payment date	May 2007	March 2007	

**(b) Restructuring charges originally arising in Q4 FY04**

During fiscal 2004, the Company recorded \$15.2 million in net restructuring charges. Of this amount, \$23.5 million is associated with a June 2004 restructuring plan, which is offset by \$8.3 million in adjustments to prior restructuring accruals and deferred rent balances.

In June 2004, the Company initiated a plan to reduce its operating expenses in order to better align its operating cost structure with the current economic environment and to improve operating margins. The plan to reduce operating expenses resulted in the consolidation of facilities, headcount reductions, and the termination of operating contracts. These actions resulted in an aggregate restructuring charge of \$23.5 million, recorded in the fourth quarter of fiscal 2004. During the year ended June 30, 2005, the Company recorded \$14.4 million related to headcount reductions and facility consolidations associated with the June 2004 restructuring plan, that are recognized in the period in which the affected employees were notified or the Company ceased use of the affected facilities. In addition, the Company recorded \$0.4 million in restructuring charges related to the accretion of the discounted restructuring accrual and a \$0.8 million decrease to the accrual related to changes in estimates of severance benefits and sublease terms. During the year ended June 30, 2006 the Company recorded a \$0.7 million increase to the accrual primarily due to a change in the estimate of future operating costs and sublease assumptions associated with the facilities.

As of September 30, 2006, there was \$6.5 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. During the three months ended September 30, 2006, the following activity was recorded (in thousands):

<b>Fiscal 2004 Restructuring Plan</b>	<b>Closure/ Consolidation of Facilities and Contract exit costs</b>	<b>Employee Severance, Benefits, and Related Costs</b>	<b>Total</b>
Accrued expenses, June 30, 2006	\$ 6,855	\$ 192	\$ 7,047
Change in estimate Revised assumptions	21		21
Restructuring charge Accretion	65		65
Payments	(583	) (79	) (662 )
Accrued expenses, September 30, 2006	\$ 6,358	\$ 113	\$ 6,471
Expected final payment date	September 2012	December 2006	

**(c) Restructuring charges originally arising in Q2 FY03**

In October 2002, management initiated a plan to further reduce operating expenses in response to first quarter revenue results that were below expectations and to general economic uncertainties. The plan to reduce operating expenses resulted in headcount reductions, consolidation of facilities, and discontinuation of development and support for certain non-critical products. These actions resulted in an aggregate restructuring charge of \$28.7 million. During fiscal 2004, the Company recorded a \$4.9 million decrease to the accrual related to revised assumptions associated with lease exit costs, particularly the buyout of a remaining lease obligation, and severance benefit obligations. During fiscal 2005 and fiscal 2006, the Company recorded \$7.0 million and \$1.0 million increases, respectively to the accrual primarily due to a change in the estimate of the facility vacancy term, extending to the term of the lease.

As of September 30, 2006, there was \$9.5 million remaining in accrued expenses relating to the remaining lease payments. The components of the restructuring plan are as follows (in thousands):

<b>Fiscal 2003 Restructuring Plan</b>	<b>Closure/ Consolidation of Facilities</b>
Accrued expenses, June 30, 2006	\$ 9,966
Change in estimate Revised assumptions.	(38 )
Payments.	(387 )
Accrued expenses, September 30, 2006	\$ 9,541
Expected final payment date	September 2012

**8. Commitments and Contingencies**

***U.S. Attorney s Office Investigation and Wells Notice***

In October 2004, the audit committee of the Company s board of directors commenced a detailed investigation of the accounting for certain software license and service agreement transactions entered into with certain alliance partners and other customers during fiscal years 2000 through 2002 (and later, fiscal 2000 to 2004), which investigation concluded in March 2005. In October 2004, the Company announced that it had received a subpoena from the U.S. Attorney s Office for the Southern District of New York requesting documents relating to transactions to which the Company was a party during the 2000 to 2002 time frame, associated documents dating from January 1, 1999, and additional materials.

In June 2006, the Company received a Wells Notice letter from the SEC of possible civil enforcement action regarding the Company s originally filed financial statements for fiscal years 2000 through 2004, which the Company restated in March 2005 following the conclusion of the audit

committee's review. In addition, the Company has been advised that Lawrence Evans, its former Chairman of the Board and Chief Executive Officer, David McQuillin, its former Chief Executive Officer, and Lisa Zappala, its former Chief Financial Officer, received separate Wells Notice letters in July 2006 regarding the same matter. Lawrence Evans is a current employee of the Company pursuant to an employment agreement entered into in June 2003, although he is no longer an executive officer.

The Company has cooperated fully with the subpoena requests and in the investigation by the U.S. Attorney's Office and the SEC. The investigation by the U.S. Attorney's Office is ongoing in coordination with the SEC, to which the audit committee had initially reported the initiation of the audit committee's investigation. The Company is currently unable to determine whether resolution of these matters will have a material adverse impact on its financial position or results of operations, or reasonably estimate the amount of the loss, if any, that may result from resolution of these matters. However, the ultimate outcome could have a material adverse effect on the Company's financial position and results of operations.

#### ***Class Action and Opt Out Suits***

In November 2004, two putative class action lawsuits were filed against the Company in the United States District Court for the District of Massachusetts, captioned, respectively, *Fener v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12375 (D. Mass.) (filed Nov. 9, 2004) and *Stockmaster v. Aspen Technology, Inc., et. al.*, Civil Action No. 04-12387 (D. Mass.) (filed Nov. 10, 2004), (the "Class Actions"). The Class Actions allege, among other things, that the Company violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in connection with various statements about its financial condition for fiscal years 2000 through 2004. On February 2, 2005, the Court consolidated the cases under the caption *Aspen Technology, Inc. Securities Litigation*, Civil Action No. 04-12375 (D. Mass.), and appointed The Operating Engineers and Construction Industry and Miscellaneous Pension Fund (Local 66) and City of Roseville Employees' Retirement System as lead plaintiff, purporting to represent a putative class of persons who purchased Aspen Technology, Inc. common stock between January 25, 2000 and October 29, 2004. On August 26, 2005, the plaintiffs filed a consolidated amended complaint containing allegations materially similar to the prior complaints and expanding the class action period.

Following mediation, on November 16, 2005, the Company and the plaintiffs on behalf of putative class members, defined to include all persons who purchased our common stock between October 29, 1999 and March 15, 2005, inclusive, (the "Class"), entered into a Stipulation and Agreement of Compromise, Settlement and Release of Securities Action, which (the "Stipulation"). The Stipulation was filed with the Court on the same date and provided, among other things, for settlement and release of all direct and indirect claims of the Class concerning matters covered by the Stipulation. On December 12, 2005, the Court granted preliminary approval of the settlement provided for in the Stipulation. After notice to the Class and after the hearing, on March 6, 2006, the Court granted final approval of the settlement, and the class action lawsuit was dismissed with prejudice. The Company entered into the Stipulation to resolve the matter and without acknowledging any fault, liability or wrongdoing of any kind. There has been no adverse determination by the Court against the Company or any of the other defendants in the case.

Members of the Class who opted out of the settlement (representing 1,457,969 shares of common stock, or less than 1% of the shares putatively purchased during the Class Action period) may bring their own individual actions, ("Opt Out Claims"). To date, state law Opt Out Claims, including claims of fraud, statutory treble damages, deceptive practices, and/or rescissory damages liability, based on the restated results of one or more fiscal periods included in the restated financial statements referenced in the Class Action, have been filed in Massachusetts Superior Court. The Company has responded by motion to dismiss on the grounds that the claims fail properly to state a claim. If not dismissed or settled on terms acceptable to us, the Company plans to defend the Opt Out Claims vigorously.



Pursuant to the terms of the Class Action settlement, the Company paid \$1.9 million and its insurance carrier paid \$3.7 million into a settlement fund for a total of \$5.6 million. The Company's \$1.9 million payment was recorded in general and administrative expenses in the quarter ended September 30, 2005. All costs of preparing and distributing notices to members of the Class and administration of the settlement, together with all fees and expenses awarded to plaintiffs' counsel and certain other expenses, will be paid out of the settlement fund, which will be maintained by an escrow agent under the Court's supervision.

On September 6, 2006, the Company also announced that, in connection with the preparation of financial statements for the fiscal year ended June 30, 2006, a subcommittee of independent directors was appointed to review the Company's accounting treatment for stock option grants for prior years. Following that announcement, the Company and certain of its officers and directors were named defendants in a purported federal securities class action lawsuits filed in Massachusetts federal district court, alleging violations of the Exchange Act and claiming material misstatements concerning its financial condition and results. In response to the Company's motion to dismiss the complaint, the parties stipulated to voluntary dismissal of the plaintiff's claims with prejudice on September 26, 2006 without any payment by the Company.

#### *Derivative Suits*

On December 1, 2004, a putative derivative action lawsuit was filed as a related action to the first filed of the Class Actions (described above) in the United States District Court for the District of Massachusetts, captioned *Caviness v. Evans, et al.*, Civil Action No. 04-12524 (D. Mass.), (the Derivative Action). The complaint, as subsequently amended, alleged, among other things, that the former and current director and officer defendants caused the Company to issue false and misleading financial statements, and brought derivative claims for the following: breach of fiduciary duty for insider trading; breach of fiduciary duty; abuse of control; gross mismanagement; waste of corporate assets; and unjust enrichment.

On August 18, 2005, the Court granted defendants' motion to dismiss the Derivative Action for failure of the plaintiff to make a pre-suit demand on the Company's board of directors to take the actions referenced in the Derivative Action complaint.

On April 12, 2005, the Company received a letter on behalf of another shareholder, demanding that the board of directors of the Company take actions substantially similar to those referenced in the Derivative Action. On February 28, 2006, the Company received a letter on behalf of Mr. Caviness, demanding that the Company take actions referenced in the Derivative Action complaint. The board of directors responded to both of the foregoing letters that the board has taken the letters under advisement pending further regulatory investigation developments, which the board continues to monitor and with which the Company continues to cooperate. In its responses, the board also requested confirmation of each person's status as a stockholder of Aspen Technology, Inc., and, with respect to the most recent letter, also referred the purported stockholder to the March 6, 2006 final approval of the settlement of direct and indirect claims of the Class in the Class Actions.

On September 27, 2006, a purported derivative action was filed in Massachusetts state court against the Company and certain present and former officers and directors captioned *Rapine v. AspenTech* (Civ. No. 06-3455). The complaint alleged that the Company breached its fiduciary duty in connection with the Company's restatement of financial statements stemming from its review of past stock option grants. On October 16, 2006, the Company removed the case to federal court and moved to dismiss it on the grounds that the plaintiff had failed to make the requisite pre-suit demand on the Company's board of directors, and because the Company was advised that the claims are largely also barred by the March 6, 2006 Class

Action settlement. The court has not ruled on the motion to dismiss. The Company cannot estimate the ultimate outcome of the case at this preliminary stage.

#### *Other*

From time to time, the Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. The outcome of these matters is currently not determinable, and there can be no assurance that such matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

The Company maintains strategic alliance relationships with third parties, including resellers, agents and systems integrators (collectively Agents or Agent) that market, sell and/or integrate the Company's products and services. The cessation or termination of certain relationships, by us the Company or an Agent, may subject the Company to material liability and/or expense. This material liability and/or expense includes potential payments due upon the termination or cessation of the relationship by us the Company or an Agent, costs related to the establishment of a direct sales presence or development of a new Agent in the territory.

No such events of termination or cessation have occurred. The Company is not able to reasonably estimate the amount of any such liability and/or expense if such event were to occur, given the range of factors that could affect the ultimate determination of the liability. Actual payments could be in the range of zero to twenty million dollars. If the Company reacquires the territorial rights for an applicable sales territory and establishes a direct sales presence, future commissions otherwise payable to an Agent for existing customer maintenance contracts and other intangible assets may be assumed from the Agent. If any of the foregoing were to occur, the Company may be subject to litigation and liability such that its operating results, cash flows and financial condition could be materially and adversely affected.

## 9. Preferred Stock Financing

In August 2003, the Company issued and sold 300,300 shares of Series D-1 convertible preferred stock (Series D-1 Preferred), along with warrants to purchase up to 6,006,006 shares of common stock at a price of \$3.33 per share, in a private placement to several investment partnerships managed by Advent International Corporation for an aggregate purchase price of \$100.0 million and incurred issuance costs of \$10.7 million. Concurrently, the Company paid cash of \$30.0 million and issued 63,064 shares of Series D-2 convertible preferred stock (Series D-2 Preferred), along with warrants to purchase up to 1,261,280 shares of common stock at a price of \$3.33 per share, to repurchase all of the outstanding Series B-I and B-II convertible preferred stock. In addition the Company exchanged existing warrants to purchase 791,044 shares of common stock at an exercise price ranging from \$20.64 to \$23.99 held by the Series B Preferred holders, for new warrants to purchase 791,044 shares of common stock at an exercise price of \$4.08.

In May 2006, holders of the Series D-1 Preferred converted 30,000 shares into 3,000,000 shares of common stock so that as of September 30, 2006 the Series D Preferred is convertible into 33,336,400 shares of common stock. In July 2006, 6,006,006 warrants were exercised in a cashless exercise, resulting in the issuance of 4,369,336 shares of the Company's common stock.

In the accompanying consolidated condensed statements of operations, the accretion of preferred stock discount and dividend consist of the following (in thousands):

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
Accrual of dividend on Series D preferred stock	\$ (2,812 )	\$ (2,808 )
Accretion of discount on Series D preferred stock	(924 )	(970 )
<b>Total</b>	<b>\$ (3,736 )</b>	<b>\$ (3,778 )</b>

**10. Segment Information**

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for reporting information about operating segments in companies' financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is the Chief Executive Officer of the Company.

The Company is organized geographically and by line of business. The Company has three major lines of business operating segments: license, consulting services and maintenance and training. The Company also evaluates certain subsets of business segments by vertical industries as well as by product categories. While the Executive Management Committee evaluates results in a number of different ways, the line of business management structure is the primary basis for which it assesses financial performance and allocates resources.

The accounting policies of the line of business operating segments are the same as those described in the Company's Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2006. The Company does not track assets or capital expenditures by operating segments. Consequently, it is not practical to show assets, capital expenditures, depreciation or amortization by operating segments. The following table presents a summary of operating segments (in thousands):

	License	Consulting Services	Maintenance and Training	Total
<b>Three Months Ended September 30, 2006</b>				
Revenues from external customers	\$ 28,076	\$ 16,544	\$ 19,702	\$ 64,322
Controllable expenses	12,698	10,767	3,784	27,249
Controllable margin(1)	\$ 15,378	\$ 5,777	\$ 15,918	\$ 37,073
<b>Three Months Ended September 30, 2005</b>				
Revenues from external customers	\$ 24,037	\$ 16,946	\$ 18,851	\$ 59,834
Controllable expenses	14,927	11,273	3,441	29,641
Controllable margin(1)	\$ 9,110	\$ 5,673	\$ 15,410	\$ 30,193

(1) The controllable margins reported reflect only the expenses of the line of business and do not represent the actual margins for each operating segment since they do not contain an allocation for selling and marketing, general and administrative, development and other corporate expenses incurred in support of the line of business.

**Profit Reconciliation (in thousands):**

	Three Months Ended September 30,	
	2006	2005
Total controllable margin for reportable segments	\$ 37,073	\$ 30,193
Selling and marketing	(17,629 )	(15,335 )
General and administrative and overhead	(17,438 )	(17,758 )
Restructuring charges	(1,446 )	(2,199 )
Loss on sales and disposals of assets	(5,769 )	(61 )
Interest and other income and expense, net	673	(2,481 )
Income (loss) before provision for from income taxes	\$ (4,536 )	\$ (7,641 )

### **11. Recent Accounting Pronouncements**

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertain Tax Positions, an Interpretation of FAS 109 (FIN 48), which clarifies the criteria for recognition and measurement of benefits from uncertain tax positions. Under FIN 48, an entity should recognize a tax benefit when it is more-likely-than-not, based on the technical merits, that the position would be sustained upon examination by a taxing authority. The amount to be recognized should be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Furthermore, any change in the recognition, derecognition or measurement of a tax position should be recognized in the interim period in which the change occurs. The Company expects to adopt FIN 48 as of July 1, 2007, and any change in net assets as a result of applying the Interpretation will be recognized as an adjustment to retained earnings on that date. The Company is in the process of evaluating its uncertain tax positions in accordance with FIN 48.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of materiality. SAB 108 is effective for fiscal years beginning after November 15, 2006. The Company believes that the initial adoption of SAB 108 will not have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Standard No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company has not yet determined the effect, if any, that the application of SFAS No. 157 will have on its consolidated financial statements.

### **12. Restatement of Condensed Consolidated Financial Statements**

Subsequent to the issuance of condensed consolidated financial statements for the three months ended September 30, 2006, and in the course of preparing the condensed consolidated financial statements for the three and six months ended December 31, 2006, the Company identified errors in the accounting for foreign currency denominated transactions. The Company incorrectly accounted for transaction gains and losses on intercompany balances denominated in currencies other than the functional currency as if such balances were of a long term investment nature and included the impact as a component of accumulated other comprehensive income (loss) rather than earnings. These transaction gains and losses should have been included in earnings as the conditions for accounting for these intercompany balances as a long term investment were not met. In addition, the Company identified errors in the recording of purchase accounting in other than the functional currency of the acquired entity. These purchase accounting adjustments should have been denominated in the currency of the applicable subsidiary and translated to United States Dollars and were incorrectly recorded as United States Dollar denominated net assets in the consolidated financial statements. Accordingly, translation of the balance sheet position related to the purchase accounting allocations and translation impact of the amortization of intangible assets was not recorded.

In addition, the Company identified other errors in the course of preparing the condensed consolidated financial statements for the three and six months ended December 31, 2006. These errors related to the timing of recognition of service revenue, facility leasing costs, and professional fees in the three months ended September 30, 2006. The tax effect of correcting all of the above errors required further adjustments. The Company also added disclosure related to reseller relationships in Note 8.

In order to correct these errors, the Company has restated its financial statements for the three months ended September 30, 2005 and 2006, in order to reflect (a) foreign currency transaction losses of \$3.1 million and gains of \$0.3 million, respectively, (b) additional amortization of technology related intangible assets of \$0.3 million and \$0.4 million, respectively, (c) income tax provision decrease of \$1.0 million and \$0.1 million, respectively, (d) additional facility lease costs of less than \$0.1 million in each period, and (e) for the three months ended September 30, 2006, an increase in service revenues of \$0.4 million and a decrease in legal costs of \$0.1 million, and related balance sheet adjustments.

In connection with the preparation of the consolidated financial statements for the fiscal year ended June 30, 2006, a subcommittee of independent members of the board of directors reviewed the Company's accounting treatment for all stock options granted since the Company completed its initial public offering in fiscal 1995. Based upon the subcommittee's review, the Audit Committee and Company management determined that certain option grants during fiscal years 1995 through 2004 were accounted for improperly, and concluded that stock-based compensation associated with certain grants was misstated in fiscal years 1995 through 2005, and in the nine months ended March 31, 2006. The subcommittee identified errors related to the determination of the measurement dates for grants of options allocated among a pool of employees when the specific number of options to be awarded to specific employees had not been finalized, and other measurement date errors. As a result of the errors in determining measurement dates, the Company also recorded payroll withholding tax-related adjustments for certain options formerly classified as Incentive Stock Option (ISO) grants under Internal Revenue Service regulations. These options were determined to have been granted with an exercise price below the fair market value of the Company's stock on the actual grant date, so do not qualify for ISO tax treatment. The disqualification of ISO classification and the resulting conversion to non-qualified status results in additional withholding taxes on exercise of those options. The Company recorded estimated payroll withholding tax charges of \$0.5 million, \$0.2 million, and \$1.2 million for the years ended June 30, 2004, 2005, and 2006, respectively, in connection with the disqualification of such ISO tax treatment. The stock-based compensation charges, including the aforementioned withholding tax adjustments, increased the net loss by \$0.2 million for the three months ended September 30, 2005 relative to amounts previously reported for that quarter.

In addition, as a result of the errors in determining measurement dates, certain options were determined to have been granted with an exercise price below the fair market value of the Company's stock on the actual grant date. These discounted options vesting subsequent to December 2004 result in nonqualified deferred compensation for purposes of Section 409A of the Internal Revenue Code, and holders are subject to an excise tax on the value of the options in the year in which they vest. Management has concluded that it is probable the Company will either implement a plan to assist the affected employees for the amount of this tax, or adjust the terms of the original option grant which would also have financial statement ramifications. As such, the Company recorded an estimated liability of approximately \$1.0 million in June 2006 in connection with this contingency.

In the course of preparing the condensed consolidated financial statements for the three months ended September 30, 2006, the Company identified errors in the accounting for stock-based compensation and certain revenue transactions in the fiscal year ended June 30, 2006. The stock-based compensation error was due to a calculation error associated with forfeiture rates upon the adoption of SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123R), as of July 1, 2005. The effect of correcting this error increased the net loss by \$0.3 million during the three months ended September 30, 2005 relative to amounts previously reported for that quarter.

The restatement of the condensed consolidated financial statements for the quarter ended September 30, 2005 also included adjustments for other errors identified after that quarter had originally been reported. These errors primarily related to the timing of revenue recognition, interest income, and the calculation of foreign currency gains and losses.

**Effects of the Restatements**

As a result of the foregoing, the Company has restated its condensed consolidated financial statements for the three months ended September 30, 2005 and 2006.

**Impact of the Financial Statement Adjustments on the Condensed Consolidated Statement of Operations**

The following table presents the impact of the financial statement adjustments on the Company's previously reported condensed consolidated statement of operations (in thousands, except per share data).

**Condensed Consolidated Statement of Operations**

	Three Months Ended September 30, 2006			Three Months Ended September 30, 2005		
	As Previously Reported	Restatement Adjustments	As Restated	As Previously Reported	Restatement Adjustments	As Restated
Software licenses	\$ 28,076	\$	\$ 28,076	\$ 24,317	\$ (280 )	\$ 24,037
Service and other	35,878	368	36,246	35,736	61	35,797
Total revenues	63,954	368	64,322	60,053	(219 )	59,834
Cost of software licenses	3,149		3,149	3,782	93	3,875
Cost of service and other	17,481		17,481	17,244	99	17,343
Amortization of technology related intangible assets	1,472	430	1,902	1,782	324	2,106
Total cost of revenues	22,102	430	22,532	22,808	516	23,324
Gross profit	41,852	(62 )	41,790	37,245	(735 )	36,510
Operating costs:						
Selling and marketing	21,210		21,210	18,647	111	18,758
Research and development	8,490		8,490	10,134	49	10,183
General and administrative	10,145	(61 )	10,084	10,185	284	10,469
Restructuring charges	1,446		1,446	2,199		2,199
Loss on sales and disposals of assets	5,769		5,769	61		61
Total operating costs	47,060	(61 )	46,999	41,226	444	41,670
Income (loss) from operations	(5,208 )	(1 )	(5,209 )	(3,981 )	(1,179 )	(5,160 )
Foreign currency exchange gain (loss)	(415 )	321	(94 )	(663 )	(2,364 )	(3,297 )
Interest income, net	767		767	151	665	816
Income before provision for income taxes	(4,856 )	320	(4,536 )	(4,493 )	(3,148 )	(7,641 )
Provision for income taxes	(932 )	51	(881 )	(640 )	949	309
Net income (loss)	(5,788 )	371	(5,417 )	(5,133 )	(2,199 )	(7,332 )
Accretion of preferred stock discount and dividend	(3,736 )		(3,736 )	(3,778 )		(3,778 )
Income applicable to common shareholders	\$ (9,524 )	\$ 371	\$ (9,153 )	\$ (8,911 )	\$ (2,199 )	\$ (11,110 )
Basic and diluted income (loss) per share applicable to common shareholders	\$ (0.18 )	\$ 0.01	\$ (0.17 )	\$ (0.21 )	\$ (0.05 )	\$ (0.26 )
Weighted average shares outstanding basic and diluted	52,801		52,801	43,237		43,237

*Impact of the Financial Statement Adjustments on the Condensed Consolidated Balance Sheet*

The following table presents the impact of the financial statement adjustments on the Company's previously reported condensed consolidated balance sheet as of September 30, 2006 (in thousands).

	<b>As Previously Reported</b>	<b>Restatement Adjustments</b>	<b>As Restated</b>
Prepaid expenses and other current assets	\$ 8,439	\$ (1 )	\$ 8,438
Total current assets	162,124	(1 )	162,123
Property and leasehold improvements, net	8,093	318	8,411
Other intangible assets, net	3,658	1,147	4,805
Goodwill	14,901	3,130	18,031
Deferred tax assets	1,595	1,503	3,098
Total assets	247,617	6,097	253,714
Accrued expenses	66,961	204	67,165
Deferred revenue	52,824	71	52,895
Current liabilities	123,177	275	123,452
Deferred tax liability	1,309	(1,309 )	
Accumulated deficit	(466,032 )	(1,098 )	(467,130 )
Accumulated other comprehensive income (loss)	(53 )	8,229	8,176
Total stockholders' equity (deficit)	(28,108 )	7,131	(20,977 )
Total liabilities and stockholders' equity (deficit)	247,617	6,097	253,714

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes appearing elsewhere in this Form 10-Q/A and in our annual report on Form 10-K, as amended, for the fiscal year ended June 30, 2006. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in Item 1A. Risk Factors in Part II of this Form 10-Q.

The following discussion gives effect to the restatements discussed in Note 12 to the consolidated financial statements included in this Form 10-Q/A. Our fiscal year ends on June 30, and references in this Form 10-Q/A to a specific fiscal year are the twelve months ended June 30 of such year (for example, fiscal 2006 refers to the year ended June 30, 2006).

**Overview**

We are a leading supplier of integrated software and services to the process industries, which consist of oil and gas, petroleum, chemicals, pharmaceuticals and other industries that manufacture and produce products from a chemical process. We provide a comprehensive, integrated suite of software applications that utilize proprietary empirical models of chemical manufacturing processes to improve plant and process design, economic evaluation, production, production planning and scheduling, and operational performance, and an array of services designed to optimize the utilization of these products by our customers.

**Critical Accounting Estimates and Judgments**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- revenue recognition for both software licenses and fixed-fee consulting services;
- impairment of long-lived assets, goodwill and intangible assets;
- accrual of legal fees associated with outstanding litigation;
- accounting for income taxes;
- allowance for doubtful accounts;
- accounting for securitization of installments receivable and subsequent valuation;
- restructuring accruals; and
- accounting for stock-based compensation.

**Revenue Recognition Software Licenses**

We recognize software license revenue in accordance with SOP No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-4 and SOP No. 98-9, as well as the various interpretations and clarifications of those statements. When we provide professional services considered not essential to the functionality of the software, and for which Vendor Specific Objective Evidence of fair value or VSOE, has been established, we recognize revenue for the delivered software when the basic criteria of SOP 97-2 are





met. VSOE has been established, in most instances, for Software Maintenance Services, Training and professional services rates. When we provide professional services that are considered essential to the functionality of the software, we recognize revenue when the basic criteria of SOP 97-2 are met and when the services have been completed. When we provide professional services, which involve significant production, modification or customization of the licensed software, we recognize such revenue and any related software licenses in accordance with SOP 81-1, Accounting for Performance of Construction Type and Certain Performance Type Contracts . These statements all require that four basic criteria must be satisfied before software license revenue can be recognized:

persuasive evidence of an arrangement between ourselves and a third party exists;

delivery of our product has occurred;

the sales price for the product is fixed or determinable; and

collection of the sales price is reasonably assured.

Our management uses its judgment concerning the satisfaction of these criteria, particularly the criteria relating to the determination of whether the fee is fixed and determinable and the criteria relating to the collectibility of the receivables, particularly the installments receivable, relating to such sales. These two criteria are particularly relevant to reseller transactions where, specifically, revenue is only recognized upon delivery to the end user, since the determination of whether the fee is fixed or determinable and whether collection is probable is more difficult. Should changes and conditions cause management to determine that these criteria are not met for certain future transactions, all or substantially all of the software license revenue recognized for such transactions could be deferred.

#### ***Revenue Recognition Fixed-Fee Consulting Services***

We recognize revenue associated with fixed-fee service contracts in accordance with the proportional performance method, measured by the percentage of costs (primarily labor) incurred to date as compared to the estimated total costs (primarily labor) for each contract. When a loss is anticipated on a contract, the full amount of the anticipated loss is provided currently. Our management uses its judgment concerning the estimation of the total costs to complete the contract, considering a number of factors including the experience of the personnel that are performing the services and the overall complexity of the project. We have a significant amount of experience in the estimation of the total costs to complete a contract and have not typically recorded material losses related to these estimates. We do not expect the accuracy of our estimates to change significantly in the future. Should changes and conditions cause actual results to differ significantly from management's estimates, revenue recognized in future periods could be adversely affected.

#### ***Impairment of Long-lived Assets, Goodwill and Intangible Assets***

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we review the carrying value of long-lived assets when circumstances dictate that they should be reevaluated, based upon the expected future operating cash flows of our business. These future cash flow estimates are based on historical results, adjusted to reflect our best estimate of future markets and operating conditions, and are continuously reviewed based on actual operating trends. Historically, actual results have occasionally differed from our estimated future cash flow estimates. In the future, actual results may differ materially from these estimates, and accordingly cause a full impairment of our long-lived assets.

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we conduct at least an annual assessment on January 1st of the carrying value of our goodwill assets, which is based on either estimates of future income from the reporting units or estimates of the market value of the units, based on comparable recent transactions. These estimates of future income are based upon historical results,

adjusted to reflect our best estimate of future markets and operating conditions, and are continuously reviewed based on actual operating trends. Historically, actual results have occasionally differed from our estimated future cash flow estimates. In the future, actual results may differ materially from these estimates. In addition, the relevancy of recent transactions used to establish market value for our reporting units is based on management's judgment.

The timing and size of any future impairment charges involves the application of management's judgment and estimates and could result in the impairment of all or substantially all of our long-lived assets, intangible assets and goodwill, which totaled \$47.5 million as of September 30, 2006.

#### ***Accrual of Legal Fees Associated with Outstanding Litigation***

We accrue estimated future legal fees associated with outstanding litigation for which management has determined that it is probable that a loss contingency exists. This requires management to estimate the amount of legal fees that will be incurred in the defense of the litigation. These estimates are based heavily on our expectations of the scope, length to complete and complexity of the claims. Historically, as these factors have changed after our original estimates, we have adjusted our estimates accordingly. In the future, additional adjustments may be recorded as the scope, length or complexity of outstanding litigation changes.

#### ***Accounting for Income Taxes***

We estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax liabilities together with the assessment of temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. Deferred tax assets also result from unused operating loss carryforwards, research and development tax credit carryforwards and foreign tax credit carryforwards. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, the impact will be included in the tax provision in our statement of operations.

Significant management judgment is required in determining any valuation allowance recorded against these deferred tax assets and liabilities. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods we may need to establish an additional valuation allowance which could result in a tax provision equal to the carrying value of our deferred tax assets. We have provided a full valuation allowance for all U.S. domiciled net deferred tax assets.

#### ***Allowance for Doubtful Accounts***

We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables for which collection is doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. In determining these provisions, we analyze our historical collection experience and current economic trends. If the historical data we use to calculate the allowance provided for doubtful accounts do not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be required for all or substantially all of certain receivable balances.

#### ***Accounting for Securitization of Installments Receivable***

We made judgments with respect to several variables associated with our June 2005 and September 2006 securitization transactions that had a significant impact on the valuation of our retained

interest in the sold receivables, as well as the calculation of the loss on the transactions. These judgments include the discount rate used to value the retained interest in the sold receivables, and estimates of rates of default. In determining these factors, we consulted third parties with respect to fair market discount rates, and analyzed our historical collection experience to default rates and collection timing. If the historical collection data do not reflect the future ability to collect outstanding receivables, the value of our retained interest may fluctuate.

***Accounting for Restructuring Accruals***

We follow SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities. In accounting for these obligations, we are required to make assumptions related to the amounts of employee severance, benefits, and related costs and to the time period over which facilities will remain vacant, sublease terms, sublease rates and discount rates. We base our estimates and assumptions on the best information available at the time the obligation has arisen. These estimates are reviewed and revised as facts and circumstances dictate; changes in these estimates could have a material effect on the amount accrued on the balance sheet.

***Accounting for Stock-Based Compensation***

We adopted SFAS No. 123(R), Share-Based Payment, effective July 1, 2005. Under the fair value provisions of this statement, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. SFAS 123(R) requires significant judgment and the use of estimates, particularly for assumptions such as stock price volatility and expected option lives to value stock-based compensation in net income. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could fluctuate significantly.

**Results of Operations**

Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

The following table sets forth the percentages of total revenues represented by certain condensed consolidated statement of operations data for the periods indicated:

	Three Months Ended	
	September 30,	
	2006	2005
Software licenses	43.6 %	40.2 %
Service and other	56.4	59.8
Total revenues	100.0	100.0
Cost of software licenses	4.9	6.5
Cost of service and other	27.2	29.0
Amortization of technology related intangible assets	2.9	3.5
Total Cost of Revenues	35.0	39.0
Gross Profit	65.0	61.0
Operating costs:		
Selling and marketing	33.0	31.3
Research and development	13.2	17.0
General and administrative	15.7	17.5
Restructuring charges	2.2	3.7
Loss on sales and disposals of assets	9.0	0.1
Total operating costs	73.1	69.6
Income (loss) from operations	(8.1 )	(8.6 )
Foreign currency exchange loss	(0.1 )	(5.5 )
Interest income, net	1.1	1.3
Income (loss) before provision for income taxes	(7.1 )%	(12.8 )%

*Comparison of the Three Months Ended September 30, 2006 and 2005*

***Total Revenues***

Revenues are derived from software licenses, consulting services and maintenance and training. Total revenues for the three months ended September 30, 2006 increased 7.5% to \$64.3 million from \$59.8 million in the three months ended September 30, 2005. Total revenues from customers outside the United States were \$35.8 million or 55.7% of total revenues for the three months ended September 30, 2006 as compared to \$35.6 million or 59.5% of total revenues for the three months ended September 30, 2005. The geographical mix of revenues can vary from period to period.

***Software License Revenues***

Software license revenues represented 43.6% of total revenues for the three months ended September 30, 2006 compared to 40.2% for the three months ended September 30, 2005. Revenues from software licenses in the three months ended September 30, 2006 increased 16.8% to \$28.1 million from \$24.0 million in the three months ended September 30, 2005. Software license revenues are attributable to software license renewals covering existing users, the expansion of existing customer relationships through licenses covering additional users, licenses of additional software products, and, to a lesser extent, to the addition of new customers. The increase primarily reflected strength in our energy end-market, along with continued strength in our chemicals and engineering and construction end-markets.

***Service and Other Revenues***

Revenues from service and other consist of consulting services, post-contract support on software licenses, training and sales of documentation. Revenues from service and other for the three months ended September 30, 2006 were relatively unchanged at \$36.2 million compared to \$35.8 million for the three months ended September 30, 2005.

***Cost of Software Licenses***

Cost of software licenses consists primarily of royalties and amortization of previously capitalized software costs. Cost of software licenses for the three months ended September 30, 2006 declined 18.7% to \$3.1 million from \$3.9 million for the three months ended September 30, 2005. Cost of software licenses as a percentage of revenues from software licenses decreased to 11.2% for the three months ended September 30, 2006 from 16.1% for the three months ended September 30, 2005. The cost decrease is primarily due to a \$0.5 million decrease in royalty expense associated with the termination of a long-term fixed royalty contract.

***Cost of Service and Other***

Cost of service and other consists of the cost of execution of application consulting services, technical support expenses and the cost of training services. Cost of service and other for the three months ended September 30, 2006 increased 0.8% to \$17.5 million from \$17.3 million for the three months ended September 30, 2005. Cost of service and other, as a percentage of revenues from service and other for the three months ended September 30, 2006 decreased to 48.2% from 48.4% for the three months ended September 30, 2005.

***Amortization of Technology Related Intangibles***

Amortization of technology related intangibles for the three months ended September 30, 2006 was \$1.9 million and \$2.1 million for the three months ended September 30, 2005. As a percentage of total

revenues, amortization of technology related intangibles was 2.9% for the three months ended September 30, 2006, as compared to 3.5% for the three months ended September 30, 2005.

***Selling and Marketing Expenses***

Selling and marketing expenses for the three months ended September 30, 2006 increased 13.1% to \$21.2 million from \$18.8 million for the three months ended September 30, 2005, while increasing as a percentage of total revenues to 33.0% from 31.3%. The increase in dollars is primarily due to a \$0.6 million increase in payroll and stock-based compensation costs, \$1.2 million of sales conference expenses, and a \$0.3 million increase in external sales commission expense.

***Research and Development Expenses***

Research and development expenses consist of personnel and outside consultancy costs required to conduct our product development efforts. Research and development expenses for the three months ended September 30, 2006 decreased 16.6% to \$8.5 million from \$10.2 million for the three months ended September 30, 2005, and decreased as a percentage of total revenues to 13.2% from 17.0%. The decrease is primarily attributable to a \$0.7 million increase in capitalized software development costs and a \$0.5 million reduction in consulting expenses.

We capitalized software development costs that amounted to 24.4% of our total engineering costs during the three months ended September 30, 2006, as compared to 17.1% during the three months ended September 30, 2005. These percentages will vary from quarter to quarter and year to year, depending upon the stage of development for the various projects in a given period.

***General and Administrative Expenses***

General and administrative expenses consist primarily of salaries of administrative, executive, financial and legal personnel, and outside professional fees. General and administrative expenses for the three months ended September 30, 2006, were relatively unchanged, as they decreased 3.0% to \$10.1 million from \$10.5 million for the three months ended September 30, 2005, and declined as a percentage of total revenues to 15.7% from 17.5%.

***Restructuring Charges***

During the three months ended September 30, 2006, we recorded \$1.4 million in restructuring charges for severance and relocation expenses as part of the 2005 restructuring plan in the period in which the employees were notified or the relocation occurred.

***Loss on sales and disposals of assets***

Loss on the sale of assets during the three months ended September 30, 2006 was \$5.8 million as compared to \$0.1 million during the three months ended September 30, 2005. This increase is primarily due to the loss of \$5.7 million on the securitization of installments receivable in September 2006.

***Interest Income***

Interest income is generated from investment of excess cash in short-term and long-term investments, from the license of software pursuant to installment contracts and from the accretion to fair value of our retained interest in sold receivables. Under these installment contracts, we offer a customer the option to make annual payments for its term licenses instead of a single license fee payment at the beginning of the license term. Historically, a substantial majority of the asset optimization customers have elected to license these products through installment contracts. Included in the annual payments is an implicit interest rate

established by us at the time of the license. As we sell more perpetual licenses for value chain solutions, these sales are being paid for in forms that are generally not installment contracts. If the mix of sales moves away from installment contracts, interest income in future periods will be reduced.

We sell a portion of the installment contracts to unrelated financial institutions. The interest earned by us on the installment contract portfolio in any one year is the result of the implicit interest rate established by us on installment contracts and the size of the contract portfolio. Interest income for the three months ended September 30, 2006 increased 19.1% to \$1.2 million from \$1.0 million for the three months ended September 30, 2005. This increase primarily is due to higher interest rates received and higher average balances in our money market funds.

#### ***Interest Expense***

Interest expense is generated from notes payable and through the course of our accounts and installments receivable financing transactions. Interest expense was \$0.5 million for the three months ended September 30, 2006 and \$0.2 million for the three months ended September 30, 2005.

#### ***Foreign currency exchange gain (loss)***

***Foreign currency exchange gains and losses are primarily incurred as a result of the revaluation of intercompany accounts denominated in foreign currencies and reflect movement in period end exchange rates. The revaluation adjustments are primarily unrealized gains and losses as the related intercompany balances typically have not settled in cash. In the quarter ended September 30, 2006, we recorded a loss of \$0.1 million, compared to a \$3.3 million loss in the quarter ended September 30, 2005.***

#### ***Tax Provision***

The tax provision recorded during the three months ended September 30, 2006 primarily relates to income taxes incurred in foreign jurisdictions for which an offsetting benefit in the United States is currently unavailable. The inability to realize a benefit from those foreign taxes is caused principally by our excess United States net operating loss carryforward position. Our ability to realize a benefit from these net operating loss carryforwards is dependent upon our future profitability in the United States. We did not record a domestic income tax benefit for the three months ended September 30, 2006 and 2005 as we provided a full valuation allowance against the domestic tax net operating loss carryforwards that were generated during the period.

#### **Liquidity and Capital Resources**

##### ***Resources***

Historically, we have financed our operations principally through cash generated from operating activities, public and private offerings of securities, sales of installment contracts and borrowings under bank credit facilities. As of September 30, 2006, we had cash and cash equivalents totaling \$88.9 million. We believe our current cash and cash equivalents, cash available from sales of installment contracts, cash flow from operations and cash available under bank credit arrangements will be sufficient to meet our anticipated cash needs for at least the next twelve months. However, we may need to obtain additional financing thereafter or earlier, if our current plans and projections prove to be inaccurate or our expected cash flows prove to be insufficient to fund our operations because of lower-than-expected revenues, unanticipated expenses or other unforeseen difficulties, including those further described in Item 1A. Risk Factors. In addition, we may seek to take advantage of favorable market conditions by raising additional funds from time to time through public or private security offerings, debt financings, strategic alliances or other financing sources. Our ability to obtain additional financing will depend on a number of factors, including market conditions, our operating performance and investor interest. These factors may



make the timing, amount, terms and conditions of any financing unattractive. They may also result in our incurring additional indebtedness or accepting stockholder dilution. If adequate funds are not available or are not available on acceptable terms, we may have to forego strategic acquisitions or investments, reduce or defer our development activities, or delay our introduction of new products and services. Any of these actions may seriously harm our business and operating results.

#### *Operating Cash Flow*

During the three months ended September 30, 2006, operating activities provided \$5.3 million of cash primarily due to the securitization of installments receivable, offset by cash payments of accrued expenses and accounts payable.

#### *Financing Activities*

During the three months ended September 30, 2006, financing activities provided \$0.9 million of cash primarily due to the exercise of stock options and to the issuance of shares under our employee stock purchase plan.

In August 2003, we issued and sold 300,300 shares of Series D-1 preferred, along with WD warrants to purchase up to 6,006,006 shares of common stock, for an aggregate purchase price of \$100.0 million. Concurrently, we paid \$30.0 million and issued 63,064 shares of Series D-2 preferred, along with WB and WD warrants to purchase up to 1,261,280 shares of common stock, to repurchase all of the outstanding Series B preferred. The Series D preferred earns cumulative dividends at an annual rate of 8%, that are payable when and if declared by the board, in cash or, subject to certain conditions, common stock. Each share of Series D preferred currently is convertible into 100 shares of common stock, subject to anti-dilution and other adjustments. The shares of Series D preferred currently are convertible into an aggregate of 33,336,400 shares of common stock. The Series D preferred is subject to redemption at the option of the holders as follows: 50% on or after August 14, 2009 and 50% on or after August 14, 2010.

#### *Sales of Installment Contracts*

We historically have maintained arrangements to sell installments receivable to financial institutions, most recently General Electric Capital Corporation, Bank of America and Silicon Valley Bank. During the three months ended September 30, 2006 and 2005, we sold \$9.0 million and \$8.5 million of installments receivable under these arrangements, respectively. As of September 30, 2006, there was in excess of \$70 million in additional availability under the arrangements. We expect to continue to have the ability to sell receivables, as the collection of the sold receivables will reduce the outstanding balance, and the availability under the arrangements can be increased. At September 30, 2006, we had a partial recourse obligation that was within the range of \$0.1 million to \$1.2 million.

In September 2006, we entered into a \$75.0 million three year revolving securitization facility and securitized certain outstanding installment software license receivables (which receivables were not sold in the traditional sales described below) with a net carrying value of \$32.1 million. The structure of the facility was such that the securitization qualified as a sale. We received \$19.4 million of cash and retained an interest in the sold receivables valued at \$8.3 million. We also retained certain limited recourse obligations relative to the receivables valued at approximately \$0.5 million. Overall, the transaction resulted in a loss of \$5.7 million in the quarter ended September 30, 2006 and was recorded as a loss on sales and disposals of assets in the accompanying consolidated statement of operations. We expect that we would have received approximately \$5.4 million, \$8.6 million and \$9.0 million of cash flows from these installments receivable during fiscal years 2007, 2008 and 2009, if not for the securitization of the receivables.

*Credit Facility*

In January 2003, we executed a Loan Arrangement with Silicon Valley Bank. This arrangement provides a line of credit of up to the lesser of (i) \$15.0 million or (ii) 70% of eligible domestic receivables, and a line of credit of up to the lesser of (i) \$10.0 million or (ii) 80% of eligible foreign receivables. The lines of credit bear interest at the bank's prime rate (8.25% at September 30, 2006). We are required to maintain a \$4.0 million compensating cash balance with the bank, or be subject to an unused line fee and collateral handling fees. The lines of credit will initially be collateralized by nearly all of our assets, and upon achieving certain net income targets, the collateral will be reduced to a lien on our accounts receivable. We are required to meet certain financial covenants, including minimum tangible net worth, minimum cash balances and an adjusted quick ratio. As of September 30, 2006, there were \$8.5 million in letters of credit outstanding under the line of credit, and there was \$7.8 million available for future borrowing. As of September 30, 2006, we were in compliance with the tangible net worth covenant and adjusted quick ratio covenants. The loan agreement expires in January 2007. We are currently in negotiations to either: (1) extend this line of credit with our current lender and amend the terms of the facility; or (ii) obtain a facility from another lender.

*Requirements**Capital Expenditures*

During the three months ended September 30, 2006, investing activities used \$3.6 million of cash as a result of the purchase of \$0.9 million of property and equipment and the capitalization of \$2.7 million of computer software development costs. We expect to spend an additional \$7 million in capital expenditures in the last nine months of fiscal 2007, primarily for additional purchases of software and computer equipment. We are not currently party to any purchase contracts related to future capital expenditures.

*Contractual Obligations and Requirements*

Our commitments as of September 30, 2006 consisted of debt and lease obligations for our headquarters and other facilities. Other than these, there were no other commitments for capital or other expenditures. Our obligations related to these items at September 30, 2006 were as follows (in thousands):

	2007	2008	2009	2010	2011	Thereafter	Total
Operating leases	\$ 7,260	\$ 7,437	\$ 7,570	\$ 7,406	\$ 6,460	\$ 14,834	\$ 50,967
Debt obligations	249	97					346
Total commitments	\$ 7,509	\$ 7,534	\$ 7,570	\$ 7,406	\$ 6,460	\$ 14,834	\$51,313

*Dividends*

Each share of Series D preferred is entitled to a cumulative annual dividend of 8.0% of the stated value per share of such share, payable upon declaration by the board of directors, in its discretion, or upon conversion or redemption of the Series D preferred. As of September 30, 2006, there was \$31.3 million in accumulated but undeclared dividends on the Series D preferred. Accumulated dividends, when and if declared by our board, must be paid in cash, unless we elect to pay the dividends in common stock and we are able to satisfy specified conditions.

*Summary of Restructuring Accruals*

During the three months ended September 30, 2006, we recorded \$1.4 million in restructuring charges primarily related to severance and relocation expenses related to office consolidations under the May 2005 restructuring plan, which are recognized in the period in which the affected employees were notified or the relocation expenses were incurred.

**Restructuring charges originally arising in Q4 FY05.**

In May 2005, we initiated a plan to consolidate several corporate functions and to reduce our operating expenses. The plan to reduce operating expenses primarily resulted in headcount reductions, a termination of a contract and facilities consolidations. These actions resulted in an aggregate restructuring charge of \$3.8 million recorded in the fourth quarter of fiscal 2005. During the year ended June 30, 2006, we recorded an additional \$1.8 million related to headcount reductions, relocation costs and facility consolidations associated with the May 2005 plan that are recognized in the period in which the affected employees were notified, the relocation expenses were incurred, or we ceased use of the affected facilities. During the quarter ended September 30, 2006, we recorded an additional \$1.4 million in severance and relocation expenses for employees that were notified or relocation expenses that were incurred during the period.

As of September 30, 2006, there was \$1.3 million remaining in accrued expenses relating to the remaining severance obligations and lease payments. The activity for the three months ended September 30, 2006 was (in thousands):

	Closure/ Consolidation of Facilities	Employee Severance, Benefits, and Related Costs	Total
<b>Fiscal 2005 Restructuring Plan</b>			
Accrued expenses, June 30, 2006	\$ 99	\$ 513	\$ 612
Restructuring charge	26	1,369	1,395
Restructuring charge Accretion	1		1
Payments	(64 )	(680 )	(744 )
Accrued expenses, September 30, 2006	\$ 62	\$ 1,202	\$ 1,264
Expected final payment date	May 2007	March 2007	

**Restructuring charges originally arising in Q4 FY04**

As of September 30, 2006, there was \$6.5 million remaining in accrued expenses relating to the remaining severance obligations and lease payments for charges recorded in fiscal 2004. The activity for the three months ended September 30, 2006 was (in thousands):

	Closure/ Consolidation of Facilities and Contract exit costs	Employee Severance, Benefits, and Related Costs	Total
<b>Fiscal 2004 Restructuring Plan</b>			
Accrued expenses, June 30, 2006	\$ 6,855	\$ 192	\$ 7,047
Change in estimate Revised assumptions	21		21
Restructuring charge Accretion	65		65
Payments	(583 )	(79 )	(662 )
Accrued expenses, September 30, 2006	\$ 6,358	\$ 113	\$ 6,471
Expected final payment date	September 2012	December 2006	

**Restructuring charges originally arising in Q2 FY03**

As of September 30, 2006, there was \$9.5 million remaining in accrued expenses relating to the remaining lease payments for charges recorded in fiscal 2003. The activity for the three months ended September 30, 2006 was (in thousands):

<b>Fiscal 2003 Restructuring Plan</b>	<b>Closure/ Consolidation of Facilities</b>
Accrued expenses, June 30, 2006	\$ 9,966
Change in estimate Revised assumptions	(38 )
Payments	(387 )
Accrued expenses, September 30, 2006	\$ 9,541
Expected final payment date	September 2012

**Item 4. Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2006. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We previously reported four material weaknesses in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) as of June 30, 2006, which were described in Item 9A and Management's Report on Internal Control Over Financial Reporting in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

In November 2006, our current management, including our chief executive officer and chief financial officer, identified an additional material weakness in internal control over the calculation and review of forfeiture rates affecting stock-based compensation expense as of June 30, 2006. Specifically, we did not have effective operational and review controls in place to provide reasonable assurance that the calculation of stock-based compensation expense reflected accurate forfeiture rates under the provisions of SFAS No. 123R, which were adopted on July 1, 2005. This control deficiency resulted in the restatement of the consolidated financial statements for the year ended June 30, 2006 as described in Note 17 to the consolidated financial statements in our Annual Report on Form 10-K, as amended. This material weakness relating to the calculation and review of forfeiture rates affecting stock-based compensation expense as of June 30, 2006 is discussed further in Management's Report on Internal Control Over Financial Reporting (as revised) included in our Annual Report on Form 10-K, as amended.

In February 2007, our current management, including our chief executive officer and chief financial officer, identified an additional material weakness in internal control over the accounting for foreign currency transactions related to the consolidation of our foreign subsidiaries. Specifically, we did not have adequate controls and procedures to ensure that (a) transaction gains and losses on intercompany balances denominated in currencies other than the functional currency were properly accounted for in earnings

instead of accumulated other comprehensive income (loss) and (b) translation of all foreign denominated balances, including those generated from the application of purchase accounting, is accounted for in the functional currency of the applicable entity and translated at the appropriate current exchange rates. These adjustments, which are reflected in our financial statements as of and for the three months ended September 30, 2006, caused changes in foreign exchange gains and losses, amortization of technology related intangible assets, and changes to the translation of balance sheets at the appropriate exchange rates. Such weaknesses could continue to impact the balances in all of the accounts previously mentioned. This control deficiency resulted in the restatement of the consolidated financial statements for the years ended June 30, 2004, 2005 and 2006 as described in Note 17 to the consolidated financial statements in our Annual Report on Form 10-K, as amended. This material weakness relating to the accounting for foreign currency transactions related to the consolidation of our foreign subsidiaries for the years ended June 30, 2004, 2005 and 2006 is discussed further in Management's Report on Internal Control over Financial Reporting (as revised) included in our Annual Report on Form 10-K, as amended.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management's Report on Internal Control Over Financial Reporting (as revised) in our Annual Report on Form 10-K, as amended, for the fiscal year ended June 30, 2006 described certain remediation initiatives designed to address the six reported material weaknesses. During the quarter ended September 30, 2006, we continued to design enhancements to our controls and implemented a limited number of changes to our internal control environment. We have implemented or expect to implement the changes described below during our current fiscal year, and will design and implement additional changes as considered appropriate, which are intended to remediate the material weaknesses which existed as of June 30, 2006. We expect to test the effectiveness of such changes in connection with our annual testing of the effectiveness of internal controls. As a result of the six previously reported material weaknesses in our internal control over financial reporting, which were not remediated as of September 30, 2006, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective as of September 30, 2006.

The remedial measures implemented by us to date will not in and of themselves remediate the material weaknesses, and certain of these remedial measures will require some time to be fully implemented or to take full effect. Prior to the remediation of these material weaknesses, there remains risk that the transitional controls, described below, on which we currently rely will fail to be sufficiently effective, which could result in material misstatement of our financial position or results of operations and require a restatement. During the quarter ended September 30, 2006, we made the following changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to address our previously reported material weaknesses. These changes in our internal control over financial reporting have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

In order to improve controls over the periodic financial close process, we:

- Hired a Chief Financial Officer with expertise in internal controls and financial reporting;
- Initiated the planning phase of a long-term project to upgrade our existing financial applications, which is being designed to streamline the capturing of relevant data, improve the general ledger and entity account level reporting structures and enhance the information query and reporting capability for the consolidated books worldwide;

- Initiated detailed review procedures by finance management for all manual journal entries recorded at the consolidated level prior to posting;
- Required that all complex non-routine transactions during the quarter ended September 30, 2006 were researched, detailed in written memoranda and reviewed by senior management prior to recording; and,
- Hired additional billing, accounting and collections staff in finance to support the continued consolidation of worldwide transaction processing in the Company's headquarters in Cambridge, MA.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we:

- Began our assessment of the accounting applications deployed to service accounts receivable which have been sold in the planning phase of the system upgrade project discussed above. This assessment is expected to continue into future quarters.

In order to improve controls over the accrual of goods and services received, we:

- Increased the frequency and timing of communications from executive and finance management to purchase requestors, and implemented additional manual procedures, to ensure any known liabilities were communicated to finance for timely recording at September 30, 2006.

After the quarter ended September 30, 2006 and prior to the date of filing of this quarterly report on Form 10-Q, we made the following changes in our internal control over financial reporting to address our previously reported material weaknesses and to further strengthen our internal controls. These changes in our internal control over financial reporting have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

In order to improve controls over the periodic financial close process, we:

- Designed and implemented a new quarterly reconciliation of the subsidiary-level books to the consolidated books; and
- Initiated a new dual review procedure by finance management of all material balance sheet account reconciliations to ensure that all material reconciling items identified in balance sheet account reconciliations were accounted for properly and timely.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we:

- Initiated a new dual review procedure by finance management of all material balance sheet account reconciliations, including accounts receivable reconciliations, to ensure all cash receipts were timely applied to applicable accounts receivable balances and to ensure the appropriate liability was recorded in instances where the receivable had been sold to a financial institution; and
- Enhanced our review process by finance management of credit balances in accounts receivable to ensure proper classification as a liability or as a credit to accounts receivable.

In order to improve controls over the accounting for income taxes, we:

- Implemented a new review process by executive finance management of the quarterly tax accounts and calculations; and
- Improved internal reporting of financial account balances to the tax department.



In order to improve controls over the accrual of goods and services received, we:

- Designed and implemented a new process to review open purchase orders and subsequent payments for appropriate accounting treatment at September 30, 2006.

In order to improve controls over the calculation and review of forfeiture rates affecting stock-based compensation expense, we adjusted the calculation methodology for our stock-based compensation expense to include accurate forfeiture rates under the provisions of SFAS No. 123R.

In addition, we will continue to plan and enhance our infrastructure and related processes to strengthen our internal control over financial reporting and address our material weaknesses as follows:

In order to improve controls over the periodic financial close process, we intend to:

- Continue to upgrade our existing financial applications and supporting processes and organizational structure, which will allow management to streamline the capturing of relevant data, improve the general ledger and entity account level reporting structures and enhance the information query and reporting capability for our operations on a global basis;
- Take steps to simplify the legal entity structure;
- Continue to evaluate and assess the adequacy and expertise of the finance and accounting staff on a global basis.

In order to improve controls in the accounts receivable function over the process to record customer invoice payments timely and accurately, we intend to:

- Continue to require dual review by finance management of all material balance sheet account reconciliations, including accounts receivable reconciliations; and
- Continue our assessment of the adequacy of the financial applications and supporting processes and organizational structure deployed to service accounts receivable which have been sold.

In order to improve controls over the accounting for income taxes, we intend to:

- Further enhance our policies and procedures for determining and documenting income tax liabilities and deferred income tax assets and liabilities, as well as for preparing income tax provision calculations;
- Increase the number of personnel with specialized corporate and international tax expertise in the tax department.

In order to improve controls over the accrual of goods and services received, we intend to:

- Continue to automate the purchasing cycle including a system implementation and enhanced reporting that will allow for accurate and timely reports of purchases which require periodic accrual;
- Maintain ongoing reviews of open purchase and subsequent payments by finance and accounts payable management to ensure appropriate accounting treatment; and
- Continue frequent executive and finance management communications to purchase requestors to ensure communication of known liabilities to finance for timely recording.

In order to improve controls over the calculation and review of forfeiture rates affecting stock-based compensation expense, we intend to increase the level of management review of our stock-based compensation expense calculations to ensure forfeiture rates are accurately reflected



under the provisions of SFAS No. 123R.

36

---

In order to improve controls over the accounting for foreign currency transactions related to the consolidation of our foreign subsidiaries we intend to:

- Make changes to the financial closing process to ensure that translation and transaction gains and losses related to our foreign subsidiaries are prepared and reviewed in accordance with generally accepted accounting principles; and
- Review and document our intentions to settle balances between subsidiaries denominated in currencies other than the U.S. Dollar.

If the remedial measures described above are insufficient to address any of the six identified material weaknesses, or additional deficiencies that may arise in the future, material misstatements in our interim or annual financial statements may occur in the future. We are currently implementing an enhanced controls environment intended to address the material weaknesses in our internal control over financial reporting and to remedy the ineffectiveness of our disclosure controls and procedures. While this implementation phase is underway, we are relying on extensive manual procedures, including regular reviews, to assist us with meeting the objectives otherwise fulfilled by an effective controls environment. Among other things, any unremediated material weakness could result in material post-closing adjustments in future financial statements. Furthermore, any such unremediated material weakness could have the effects described in Item IA. Risk Factors . We have identified six material weaknesses in our internal control over financial reporting as of September 30, 2006 that, if not remedied effectively, could result in material misstatements in our financial statements for future periods.

The certifications of our principal executive officer and principal financial officer required in accordance with Section 302 of the Sarbanes-Oxley Act are attached as exhibits to this Form 10-Q/A. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in internal control over financial reporting, referred to in paragraph 4 of the certifications. This Item 4 should be read in conjunction with the officer certifications for a more complete understanding of the topics presented.

**Item 6. Exhibits**

Exhibit Number	Description	Filed with this	Incorporated by Reference		Exhibit Number
		Form 10-Q	Form	Filing Date with SEC	
10.1	Loan Agreement, dated as of September 27, 2006, among Aspen Technology Funding 2006-II LLC, Aspen Technology, Inc., Portfolio Financial Servicing Company, Inc., Key Equipment Finance Inc., Keybank National Association, and Relationship Funding Company, LLC	*			
10.2	Tenth Loan Modification Agreement, dated as of September 14, 2006, between Silicon Valley Bank and Aspen Technology, Inc.		10-K	September 28, 2006	10.84
10.3	Eleventh Loan Modification Agreement, dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc.	*			
10.4	Sixth Loan Modification Agreement (EXIM), dated as of September 14, 2006, between Silicon Valley Bank and Aspen Technology, Inc.		10-K	September 28, 2006	10.85
10.5	Seventh Loan Modification Agreement - EXIM dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc.	*			
10.6	Partial Release and Acknowledgement Agreement, dated as of September 27, 2006, by and among Silicon Valley Bank and Aspen Technology, Inc.	*			
10.7	Form of Terms and Conditions of Stock Option Agreement Granted Under 2001 Restated Stock Option Plan	*			
10.8	Form of Terms and Conditions of Stock Option Agreement Granted Under 2005 Stock Incentive Plan	*			
10.9	Form of Restricted Stock Unit Agreement Granted under 2005 Stock Incentive Plan.	*			
10.10	Form of Restricted Stock Unit Agreement-G Granted under 2005 Stock Incentive Plan.				
10.11	Form of Executive Retention Agreement entered into as of September 26, 2006, by Aspen Technology, Inc. and each of Frederic G. Hammond, Manolis E. Kotzabasakis, Bradley T. Miller, C. Steven Pringle and Blair F. Wheeler				
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			

---

\* Filed previously

Management contract or compensatory plan

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 14, 2007	ASPEN TECHNOLOGY, INC. By:	/s/ MARK E. FUSCO Mark E. Fusco <i>President and Chief Executive Officer</i>
Date: March 14, 2007	By:	/s/ BRADLEY T. MILLER Bradley T. Miller <i>Senior Vice President and Chief Financial Officer</i>

**EXHIBIT INDEX**

Exhibit Number	Description	Filed with this	Incorporated by Reference		Exhibit Number
		Form 10-Q	Form	Filing Date with SEC	
10.1	Loan Agreement, dated as of September 27, 2006, among Aspen Technology Funding 2006-II LLC, Aspen Technology, Inc., Portfolio Financial Servicing Company, Inc., Key Equipment Finance Inc., Keybank National Association, and Relationship Funding Company, LLC	*		September 28, 2006	10.84
10.2	Tenth Loan Modification Agreement, dated as of September 14, 2006, between Silicon Valley Bank and Aspen Technology, Inc.		10-K	September 28, 2006	10.85
10.3					

**29. Commitments**

The following table sets forth the Company's contractual obligations as of September 30, 2011:

	Office Rental	Server hosting and board-band lease	Purchase of TV advertisement time	Purchase of internet advertisement resources	Total
	US\$('000)	US\$('000)	US\$('000)	US\$('000)	US\$('000)
Three months ending December 31, -2011	99	74	1,055	65	1,293
For the year ending December 31, -2012	382	113	-	-	495
-2013	509	-	-	-	509
-2014	509	-	-	-	509
-2015	509	-	-	-	509
-2016	340	-	-	-	340
<b>Total</b>	<b>2,348</b>	<b>187</b>	<b>1,055</b>	<b>65</b>	<b>3,655</b>

**30. Segment reporting**

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

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

F-39

---

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

Nine Months Ended September 30, 2011 (Unaudited)

	Internet Ad. US\$ (‘000)	TV Ad. US\$ (‘000)	Bank kiosk US\$ (‘000)	Brand management and sales channel building US\$ (‘000)	Others US\$ (‘000)	Inter- segment and reconciling item US\$ (‘000)	Total US\$ (‘000)
Revenue	16,434	4,756	415	943	-	(14 )	22,534
Cost of sales	4,711	3,847	36	288	-	(14 )	8,868
Total operating expenses	3,645	394	155	523	1,307 *	-	6,024
Including: Depreciation and amortization expense	183	75	120	275	74	-	727
Operating income(loss)	8,078	515	224	132	(1,307 )	-	7,642
Gain on deconsolidation of subsidiary	-	-	-	-	232	-	232
Share of earnings (losses) in equity investment affiliates	-	26	-	-	(206 )	-	180
Expenditure for long-term assets	1,477	1	185	7	13	-	1,683
Net income (loss)	7,291	502	224	106	(1,276 )	-	6,847
Total assets	49,474	3,681	866	4,916	20,941	(30,210 )	49,668

\*Including approximately US\$237,000share-based compensation expenses.

Three Months Ended September 30, 2011 (Unaudited)

	Internet Ad. US\$ (‘000)	TV Ad. US\$ (‘000)	Bank kiosk US\$ (‘000)	Brand management and sales channel building US\$ (‘000)	Others US\$ (‘000)	Inter- segment and reconciling item US\$ (‘000)	Total US\$ (‘000)
Revenue	3,860	1,972	140	446	-	-	6,418
Cost of sales	1,605	1,669	12	132	-	-	3,418
Total operating expenses	1,102	76	24	234	376 *	-	1,812
Including: Depreciation and amortization expense	91	37	24	80	25	-	257
Operating income(loss)	1,153	227	104	80	(376 )	-	1,188
	-	-	-	-	-	-	-

Gain on deconsolidation of subsidiary							
Share of earnings (losses) in equity investment affiliates	-	(4 )	-	-	(71 )	-	(75 )
Expenditure for long-term assets	13	1	74	4	1	-	93
Net income (loss)	1,119	191	105	42	(446 )	-	1,011
Total assets	49,474	3,681	866	4,916	20,941	(30,210 )	49,668

\*Including approximately US\$65,000 share-based compensation expenses.

F-40

---



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

Nine Months Ended September 30, 2010 (Unaudited)

	Internet Ad. US\$ (‘000)	TV Ad. US\$ (‘000)	Bank kiosk US\$ (‘000)	Brand management and sales channel building US\$ (‘000)	Others US\$ (‘000)	Inter- segment and reconciling item US\$ (‘000)	Total US\$ (‘000)
Revenue	19,736	11,044	396	-	593	(593 )	31,176
Cost of sales	5,000	10,709	34	-	48	-	15,791
Total operating expenses	3,777	379	63	-	1,576 *	(593 )	5,202
Including: Depreciation and amortization expense	92	58	63	-	62	-	275
Operating income(loss)	10,959	(44 )	299	-	(1,031 )	-	10,183
Changes in fair value of warrants	-	-	-	-	1,861	-	1,861
Expenditure for long-term assets	264	-	-	-	184	-	448
Net income (loss)	10,661	(42 )	299	-	837	-	11,755
Total assets	24,080	6,642	276	-	13,211	(8,438 )	35,771

\*Including approximately US\$177,000 share-based compensation expenses.

Three Months Ended September 30, 2010 (Unaudited)

	Internet Ad. US\$ (‘000)	TV Ad. US\$ (‘000)	Bank kiosk US\$ (‘000)	Brand management and sales channel building US\$ (‘000)	Others US\$ (‘000)	Inter- segment and reconciling item US\$ (‘000)	Total US\$ (‘000)
Revenue	7,160	1,603	133	-	358	(358 )	8,896
Cost of sales	1,646	1,453	11	-	-	-	3,110
Total operating expenses	1,673	94	31	-	502 *	(358 )	1,942
Including: Depreciation and amortization expense	42	8	31	-	29	-	110
Operating income(loss)	3,841	56	91	-	(144 )	-	3,844
Changes in fair value of warrants	-	-	-	-	-	-	-
	193	-	-	-	142	-	335

Expenditure for long-term  
assets

Net income (loss)	3,821	57	90	-	(141 )	-	3,827
Total assets	24,080	6,642	276	-	13,211	(8,438 )	35,771

\*Including approximately US\$56,000 share-based compensation expenses.

31. Earnings per share

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

F-41

---

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

	Nine months ended September 30,		Three months ended September 30,	
	2011 \$ US('000)	2010 \$ US('000)	2011 \$ US('000)	2010 \$ US('000)
	(Unaudited)		(Unaudited)	
	(Amount in thousands except for the number of shares and per share data)		(Amount in thousands except for the number of shares and per share data)	
Net income attributable to ChinaNet Online Holdings, Inc.	\$6,943	\$ 11,882	\$1,111	\$ 3,877
Dividend on Series A convertible preferred stock	(407 )	(612 )	(85 )	(190 )
Net income attributable to common shareholders of ChinaNet Online Holdings, Inc.- Basic	6,536	11,270	1,026	3,687
Add: Dividend for Series A convertible preferred stock	407	612	-	(1) 190
Net income attributable to common shareholders of ChinaNet Online Holdings, Inc.-Diluted	6,943	11,882	1,026	3,877
Weighted average number of common shares outstanding - Basic	17,806,818	16,676,752	18,632,103	16,939,961
Effect of diluted securities:				
Series A Convertible preferred stock	2,173,322	3,274,981	-	(2) 3,015,339
Warrants	285,624 (1)	954,063 (3)	-	(2) 961,163 (3)
Weighted average number of common shares outstanding -Diluted	20,265,764	20,905,796	18,632,103	20,916,463
Earnings per share-Basic	\$0.37	\$ 0.68	\$0.06	\$ 0.22
Earnings per share-Diluted	\$0.34	\$ 0.57	\$0.06	\$ 0.19

All share and per share data have been retroactively adjusted to reflect the reverse acquisition on June 26, 2009 whereby the 13,790,800 shares of common stock issued by the Company (nominal acquirer) to the shareholders of China Net BVI (nominal acquiree) are deemed to be the number of shares outstanding for the period prior to the reverse acquisition. For the period after the reverse acquisition, the number of shares considered to be outstanding is the actual number of shares outstanding during that period.

- (1) The diluted earnings per share calculation for the nine months ended September 30, 2011 did not include the effect of the warrants and options to purchase up to 3,148,974 shares of common stock in the aggregate, because their effect was anti-dilutive.
- (2) The diluted earnings per share calculation for the three months ended September 30, 2011 did not include the effect of the 1,348,469 incremental shares resulted from assumed conversion of the convertible preferred stock and the warrants and options to purchase up to 4,835,056 shares of common stock in the aggregate, because their

effect was anti-dilutive.

- (3) The diluted earnings per share calculation for the nine and three months ended September 30, 2010 did not include the effect of the options to purchase up to 54,000 shares of common stock, because their effect was anti-dilutive.

32. Share-based compensation expenses

On July 12, 2010, the Company renewed the investor relations service contract with Hayden Communications International, Inc. ("HC") for an 18-month service contract commencing July 12, 2010. As additional compensation, the Company granted HC 60,000 restricted shares of the Company's common stock, which were issued on September 30, 2011. The shares were issued in accordance with the exemption from the registration provisions of the Securities Act of 1933, as amended, provided by Section 4(2) of such Act for issuances not involving any public offering. The 60,000 shares were valued at \$3.80 per share, the closing bid of the Company's common stock on the date of grant and the related compensation expense was amortized over the requisite service period. Total compensation expenses recorded for the nine and three months ended September 30, 2011 were US\$114,000 and US\$38,000, respectively. The Company did not recognize any compensation expenses for the three months ended September 31, 2010, due to the amount was immaterial.

F-42

---

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

On November 30, 2009, the Company granted 5-year options to each of its three independent directors, Mr. Douglas MacLellan, Mr. Mototaka Watanabe and Mr. Zhiqing Chen, to purchase in the aggregate 54,000 shares of the Company's common stock at a exercise price of US\$5.00 per share, in consideration of their services to the Company. These options vest quarterly at the end of each 3-month period, in equal installments over the 24-month period from the date of grant. However, upon a change of control, the option shall automatically become fully vested and exercisable as of the date of such changes of control. The company adopted Black-Scholes option pricing model to gauge the grant date fair value of these options. The related compensation expenses were amortized over its vesting period. Total compensation expenses recognized for the nine months ended September 30, 2011 and 2010 were US\$123,260 and US\$59,400, respectively. Total compensation expenses recognized for the three months ended September 30, 2011 and 2010 were US\$27,340 and US\$17,820, respectively.

The Company estimates the fair value of these options using the Black-Scholes option pricing model based on the following assumptions:

Underlying stock price	\$5
Expected term	3
Risk-free interest rate	1.10%
Dividend yield	-
Expected Volatility	150%
Exercise price of the option	\$5
Value per option	\$4.05

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

Options issued and outstanding at September 30, 2011 and their movements during the period are as follows:

	Option Outstanding			Option Exercisable		
	Number of underlying shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of underlying shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
Balance, January 1, 2011	54,000	3.92	\$5.00	27,000	3.92	\$5.00
Granted/Vested	-			20,250		\$5.00
Forfeited	-			-		
Exercised	-			-		
Balance, September 30, 2011	54,000	3.17	\$5.00	47,250	3.17	\$5.00

33. Subsequent events

The Company has performed an evaluation of subsequent events through the date the financial statements were issued, with no other material event or transaction needing recognition or disclosure found.

F-43

---

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward-Looking Statements

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this interim report. Our consolidated financial statements have been prepared in accordance with U.S. GAAP. In addition, our consolidated financial statements and the financial data included in this interim report reflect our reorganization and have been prepared as if our current corporate structure had been in place throughout the relevant periods. The following discussion and analysis contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words "expect," "anticipate," "intend," "believe," or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010. Readers are cautioned not to place undue reliance on these forward-looking statements.

### Overview

Our company (formerly known as Emazing Interactive, Inc.) 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 our company's incorporation until June 26, 2009, when our company consummated the Share Exchange (as defined below), our company's activities were primarily concentrated in web server access and company branding in hosting web based e-games.

On June 26, 2009, our 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, our principal stockholder at such time. Pursuant to the terms of the Exchange Agreement, the China Net BVI Shareholders transferred to us all of the China Net BVI Shares in exchange for the issuance of 13,790,800 shares (the "Exchange Shares") in the aggregate of our common stock (the "Share Exchange"). As a result of the Share Exchange, China Net BVI became our wholly owned subsidiary and we are now a holding company which engages in providing advertising, marketing and communication services to small and medium companies in China, through certain contractual arrangements with operating entities in the People's Republic of China (the "PRC"). Our multi-channel advertising and marketing platform consists of the websites [www.28.com](http://www.28.com) ("28.com"), [www.liansuo.com](http://www.liansuo.com) ("liansuo.com"), [www.chuangye.com](http://www.chuangye.com) ("chuangye.com"), our Internet advertising portals, ChinaNet TV, our TV production and advertising unit, bank kiosk advertising unit, which is primarily used as an advertising platform for clients in the financial services industry and will be further utilized as an additional value-added communication channel for SME clients, and our brand management and sales channel building services unit.

Our 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”). We refer to the transactions that resulted in China Net BVI becoming an indirect parent company of Rise King WFOE as the “Offshore Restructuring.”



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

At the time the above Contractual Agreements were signed, the controlling shareholder of China Net BVI was Rise King BVI, which holds 55% of China Net BVI’s common stock. At the time the Contractual Agreements were signed, the sole registered shareholder of Rise King BVI, Mr. Yang Li, entered into slow-walk agreements with each of the Control Group individuals, pursuant to which, upon the satisfaction of certain conditions, the Control Group individuals had the option to purchase the 10,000 shares of Rise King BVI, (4,600 by Mr. Handong Cheng, 3,600 by Mr. Xuanfu Liu and 1,800 by Ms. Li Sun, acting as a nominee for Mr. Zhige Zhang) owned by Mr. Yang Li, at a purchase price of US\$ 1 per share (the par value of Rise King BVI’s common stock). Under the terms of the slow-walk agreement, the Control Group had the right to purchase the shares as follows: (1) one-third of the shares when China Net BVI and its PRC subsidiary and VIEs (“ the Group”) generates at least RMB 100,000,000 of the gross revenue for twelve months commencing on January 1, 2009 and ending to December 31, 2009 (the “Performance Period I”); (2) one-third of the shares when the Group generates at least RMB 60,000,000 of the gross revenue for six months commencing on January 1, 2010 and ending to June 30, 2010 (the “Performance Period II); (3) one-third of the shares when the Group generates at least RMB 60,000,000 of the gross revenue for six months commencing on July 1, 2010 and ending to December 31, 2010 (the “Performance Period III”). In the event that the Group did not achieve the performance targets specified above, then the Control Group individuals would have been able to exercise the Option at the Alternative Exercise Price (which is US\$ 2 per share), on the date that the Acquisition has been completed or abandoned. Each Control Group individual had the option to purchase one-third of the total number of shares that he or she was eligible to purchase under the slow-walk agreement upon the satisfaction of each condition described above.

The Control Group individuals also entered an Entrustment Agreement with Rise King BVI, pursuant to which, based on the 55% equity interest held in the Group directly or indirectly, Rise King BVI entrusted the Control Group to manage the Group companies by irrevocably authoring the Control Group to act on behalf of Rise King BVI, as the exclusive agents and attorneys with respect to all matters concerning Rise King BVI’s Shareholding, during the validity period of this Agreement, including the rights of attending the shareholders’ meeting; exercising all the shareholder’s rights and shareholder’s voting rights enjoyed by Rise King BVI under the laws and the articles of associations of the Company and each Group Companies, (collectively “the Group”) including without limitation voting for and making decisions on the increase or decrease of the authorized capital/registered capital, issuing company bonds, merger, division, dissolution, liquidation of the Group or change of the Group’ type, amendment to the articles of association of the Group, designating and appointing the legal representatives (the chairman of the Board), directors, supervisors, general managers and other senior officers of the Group. The Control Group also agreed and confirmed that each of them shall act in concert with one another when exercising all of their rights (including but not

limited to the voting rights) authorized to them in this Agreement.

45

---

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

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

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

As of the date of the Share Exchange, through a series of contractual agreements, we operate our business in China primarily through Business Opportunity Online, Beijing CNET Online. Beijing CNET Online owns 51% of Shanghai Borongdingsi Computer Technology Co., Ltd. ("Shanghai Borongdingsi"). Business Opportunity Online, Beijing CNET Online and Shanghai Borongdingsi, were incorporated on December 8, 2004, January 27, 2003 and August 3, 2005, respectively.

Shanghai Borongdingsi is owned 51% by Beijing CNET Online. Beijing CNET Online and Shanghai Borongdingsi entered into a cooperation agreement in June 2008, followed up with a supplementary agreement in December 2008, to conduct bank kiosk advertisement business. The business is based on a bank kiosk cooperation agreement between Shanghai Borongdingsi and Henan provincial branch of China Construction Bank which allows Shanghai Borongdingsi or its designated party to conduct in-door advertisement business within the business outlets throughout Henan Province. The bank kiosk cooperation agreement has a term of eight years starting August 2008. However, Shanghai Borongdingsi was not able to conduct the advertisement business as a stand-alone business due to the lack of an advertisement business license and supporting financial resources. Pursuant to the aforementioned cooperation agreements, Beijing CNET Online committed to purchase equipment, and to provide working capital, technical and other related support to Shanghai Borongdingsi. Beijing CNET Online owns the equipment used in the kiosk business, is entitled to sign contracts in its name on behalf of the business, and holds the right to collect the advertisement revenue generated from the bank kiosk business exclusively until the recovery of the cost of purchase of the equipment. Thereafter, Beijing CNET Online 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, Business Opportunity Online, together with three other individuals, who were not affiliated with us, formed a new company, Shenzhen City Mingshan Network Technology Co., Ltd. ("Shenzhen Mingshan"). The registered capital and paid-in capital of Shenzhen Mingshan was RMB10,000,000 and RMB5,000,000, respectively. Shenzhen Mingshan is 51% owned by Business Opportunity Online and 49% owned collectively by the other three individuals. Shenzhen Mingshan is located in Shenzhen City, Guangdong Province of the PRC and is primarily engaged in developing and designing internet based software, online games and the related operating websites and providing related internet and information technology services necessary to operate such games and websites. On January 6, 2011, as approved by the shareholders of Shenzhen Mingshan, an independent third party investor, who was not affiliated with us, invested RMB15,000,000 (approximately US\$2,283,070) cash into Shenzhen Mingshan and Shenzhen Mingshan's registered capital and paid-in capital increased from RMB10,000,000 (approximately US\$1,466,000) and RMB5,000,000 (approximately US\$733,000) to RMB25,000,000 (approximately US\$3,786,000) and RMB20,000,000 (approximately US\$3,029,000), respectively. Therefore, beginning on January 6, 2011, the new investor became the majority shareholder of Shenzhen Mingshan. Our share of the equity interest in Shenzhen Mingshan decreased from 51% to 20.4% and we ceased to have a controlling financial interest in Shenzhen Mingshan but still retained an investment in, and significant influence over, Shenzhen Mingshan.

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

On December 8, 2010, we, through one of our VIEs, Shanghai Jing Yang, acquired a 49% interest in a newly established company, Beijing Yang Guang Media Investment Co., Ltd. (“Beijing Yang Guang”) for a cash consideration of RMB 7,350,000 (approximately US\$1,112,000), which represents 49% of Beijing Yang Guang’s paid-in capital and net assets of RMB15,000,000 (approximately US\$2,269,000). In August, 2011, Shanghai Jing Yang sold back its 49% equity interest in Beijing Yang Guang to the majority shareholder of Beijing Yang Guang for a cash consideration of RMB7,350,000, which equals to the purchase consideration paid when acquired the 49% equity interest in December 2010.

We, through one of our PRC VIEs, Beijing CNET Online, entered into an equity interest acquisition agreement with the shareholders of Quanzhou Zhi Yuan Marketing Planning Co., Ltd. (“Quanzhou Zhi Yuan”) and Quanzhou Tian Xi Sun He Advertisement Co., Ltd. (“Quanzhou Tian Xi Shun He”), (collectively “the acquirees”) on December 18, 2010 and December 22, 2010, to acquire 100% equity interest of Quanzhou Zhi Yuan and 51% equity interest of Quanzhou Tian Xi Shun He, respectively. These acquisitions were subsequently consummated on January 4, 2011 and February 23, 2011, respectively. Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He are both independent advertising companies based in Fujian province of the PRC, which provide comprehensive branding and marketing services to over fifty small to medium sized companies focused mainly in the sportswear and clothing industry. These acquisitions enable our company to enter the Fujian Province, which has a base of fast growing small and medium enterprises, we are able to capitalize on this base of enterprises through our complete suite of marketing and franchise promotion services which allows our company to expand its market opportunity from franchises, dealerships and merchants looking to expand their businesses domestically in China. In June 2011, Beijing CNET Online entered into an additional agreement with the noncontrolling interest of Quanzhou Tian Xi Shun He to purchase the remaining 49% equity interest of Quanzhou Tian Xi Shun He for a cash consideration of RMB7,200,000 (approximately US\$1,114,000). On June 27, 2011, this transaction was approved and registered with the relevant PRC government authorities of Quanzhou City, Fujian Province of PRC and on the same date, Quanzhou Tian Xi Shun He became a wholly owned subsidiary of Beijing CNET Online.

On January 28, 2011, we, through one of our VIEs, Business Opportunity Online, formed a new wholly owned subsidiary, Business Opportunity Online (Hubei) Network Technology Co., Ltd. (“Business Opportunity Online Hubei”). Business Opportunity Online Hubei is mainly engaged in internet advertisement design, production and promulgation.

On March 1, 2011, Business Opportunity Online, together with an individual, who was not affiliated with us, formed a new company, Beijing Chuang Fu Tian Xia Network Technology Co., Ltd. (“Beijing Chuang Fu Tian Xia”). The registered capital of Beijing Chuang Fu Tian Xia is RMB1,000,000 (approximately US\$152,000). Business Opportunity Online and the co-founding individual invested RMB510,000 (approximately US\$77,500) and RMB490,000 (approximately US\$74,500) cash in Beijing Chuang Fu Tian Xia, respectively, representing 51% and 49% of the equity interests of Beijing Chuang Fu Tian Xi, respectively. In addition to capital investment, the

co-founding individual is required to provide the controlled domain names, www.liansuo.com and www.chuangye.com to be registered under the established subsidiary. This subsidiary is mainly engaged in providing and operating internet advertising, marketing and communication services to small and medium companies through the websites associated with the above mentioned domain names. As of September 30, 2011, www.liansuo.com is currently in its first stage of operation, while www.chuangye.com is currently in its fourth round of testing on services and functionalities with the entrepreneurial communities.

47

---

On April 18, 2011, we, through one of our VIEs, Business Opportunity Online Hubei, formed a new wholly owned company, Hubei CNET Advertising Media Co., Ltd. (“Hubei CNET”). The registered capital and paid in capital of Hubei CNET is RMB1,000,000 (approximately US\$152,205). Hubei CNET is mainly engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

On April 18, 2011, one of our VIEs, Business Opportunity Online Hubei, together with an individual, who was not affiliated with us, formed a new company, Zhao Shang Ke Network Technology (Hubei) Co., Ltd. (“Zhao Shang Ke Hubei”). The registered capital of Zhao Shang Ke Hubei is RMB2,000,000 (approximately US\$306,000). Business Opportunity Online Hubei and the co-founding individual invested RMB1,020,000 (approximately US\$156,000) and RMB980,000 (approximately US\$150,000) cash in Zhao Shang Ke Hubei, respectively, and hence own 51% and 49% of the equity interests of Zhao Shang Ke Hubei, respectively. Zhao Shang Ke Hubei is mainly engaged in providing advertisement design, production, promulgation and most importantly sales channels expansion services.

On July 1, 2011, one of our VIEs, Quanzhou Zhi Yuan, formed a new wholly owned company, Xin Qi Yuan Advertisement Planning (Hubei) Co., Ltd. (“Xin Qi Yuan Hubei”). The registered capital and paid in capital of Xin Qi Yuan HuBei is RMB100,000 (approximately US\$15,470). Xin Qi Yuan Hubei is mainly engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

On July 1, 2011, one of our VIEs, Quanzhou Tian Xi Shun He, formed a new wholly owned company, Mu Lin Sen Advertisement (Hubei) Co., Ltd. (“Mu Lin Sen Hubei”). The registered capital and paid in capital of Mu Lin Sen HuBei is RMB100,000 (approximately US\$15,470). Mu Lin Sen Hubei is mainly engaged in advertisement design, production, promulgation and providing the related adverting and marketing consultancy services.

On July 1, 2011, one of our VIEs, Business Opportunity Online Hubei, together with an individual who is not affiliated with the Company formed a new company, Sheng Tian Network Technology (Hubei) Co., Ltd. (“Sheng Tian Hubei”). The registered capital and paid in capital of Sheng Tian Hubei is RMB2,000,000 (approximately US\$309,410). Business Opportunity Online Hubei and the co-founding individual invested RMB1,020,000 (approximately US\$157,800) and RMB980,000 (approximately US\$151,610) cash in Sheng Tian Hubei, respectively, and hence owned 51% and 49% of the equity interests of Sheng Tian Hubei, respectively. Sheng Tian Hubei is mainly engaged in computer system design, development and promotion, software development and promotion, and providing the related technical consultancy services.

On September 5, 2011, one of our VIEs, Business Opportunity Online Hubei, formed a new wholly owned company, Chongqing Business Opportunity Online Technology Co., Ltd. (“Business Opportunity Online Chongqing”). The registered capital and paid in capital of Business Opportunity Online Chongqing is RMB2,000,000 (approximately US\$312,285). Business Opportunity Online Chongqing is mainly engaged in internet advertisement design and production.

As of September 30, 2011, we operated our business primarily in China through the above mentioned PRC subsidiary and PRC operating entities or VIEs.

Through our PRC operating entities, we are one of China's leading B2B fully integrated internet service provider for expanding small and medium enterprises' (SMEs) sales networks in China. Our services are founded on proprietary internet and advertising technologies that include preparing and publishing rich media enabled advertising and marketing campaigns for clients on the Internet, mobile phone, television and other valued added communication channels, hosting mini-sites with online messaging and consulting functionalities, generating effective sales leads and providing online management tools to help SMEs manage the expansion of their sales networks. Our goal is to strengthen our position as the leading diversified one-stop internet service provider to SMEs for their sales network expansion in China.

#### Basis of presentation, critical accounting policies and management estimates

Our unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. 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 U.S. GAAP for annual financial statements. However, we believe 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 our Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC on March 31, 2011. The results of operations for the interim periods presented are not indicative of the operating results to be expected for our fiscal year ending December 31, 2012.

We prepare financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of revenues and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements.

#### Foreign currency translation

Our functional currency is United States dollars ("US\$"), and the functional currency of China Net HK is Hong Kong dollars ("HK\$"). The functional currency of our PRC operating subsidiary and VIEs is Renminbi ("RMB"), and PRC is the primary economic environment in which we operate.

For financial reporting purposes, the financial statements of our PRC operating subsidiary and VIEs, which are prepared using the RMB, are translated into our reporting currency, the United States Dollar ("U.S. dollar"). Assets and liabilities are translated using the exchange rate at each balance sheet date. Revenue and expenses are translated using average rates prevailing during each reporting period, and shareholders' equity is translated at historical exchange rates. Adjustments resulting from the translation are recorded as a separate component of accumulated other comprehensive income in shareholders' 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, 2011	December 31, 2010
Balance sheet items, except for equity accounts	6.4018	6.6118

	Nine months ended September 30,	
	2011	2010
Items in the statements of income and comprehensive income, and statements cash flows	6.5060	6.8164

  

	Three months ended September 30,	
	2011	2010
Items in the statements of income and comprehensive income, and statements cash flows	6.4231	6.7803

#### Investment in equity investment affiliates

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

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

#### Goodwill

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

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

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

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

50

---

We accounted for changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary in accordance with ASC Topic 805 Business Combination, subtopic 10, which requires the transaction be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent and reallocated the subsidiary's accumulated comprehensive income, if any, among the parent and the noncontrolling interest through an adjustment to the parent's equity.

## Revenue recognition

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

Sales include revenues from internet advertising generated from our portal website, reselling of internet advertising spaces and other internet advertisement related resources purchased from other portal websites, reselling of advertising time purchased from TV stations and brand management and sales channel expansion services. No revenue from advertising-for-advertising barter transactions was recognized because the transactions did not meet the criteria for recognition in ASC Topic 605, subtopic 20. Advertising contracts establish the fixed price and advertising services to be provided. Pursuant to advertising contracts, we provide advertisement placements in different formats, including but not limited to banners, links, logos, buttons, rich media and content integration. Revenue is recognized ratably over the period the advertising is provided and, as such, we consider the services to have been delivered. We treat all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Based upon our credit assessments of our customers prior to entering into contracts, we determine if collectability is reasonably assured. In situations where collectability is not deemed to be reasonably assured, we recognize revenue upon receipt of cash from customers, only after services have been provided and all other criteria for revenue recognition have been met.

## Taxation

### 1. Income tax

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

We adopted ASC Topic 740-10-25-5 through 740-10-25-7 and 740-10-25-13, which prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. For the nine and three months ended September 30, 2011 and 2010, we did not have any interest and penalties associated with tax positions and did not have any significant unrecognized uncertain tax positions.

i). We are incorporated in the State of Nevada. Under the current laws of Nevada we are not subject to state corporate income tax. Following the Share Exchange, we became a holding company and do not conduct any substantial operations of our own. No provision for federal corporate income tax has been made in our financial statements as no assessable profits for the nine and three months ended September 30, 2011 or prior periods. We do not provide for U.S. taxes or foreign withholding taxes on undistributed earnings from our non-U.S. subsidiaries because such earnings are intended to be reinvested indefinitely. If undistributed earnings were distributed, foreign tax credits could become available under current law to reduce the resulting U.S. income tax liability.

51

---

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

iii). China Net HK was incorporated in Hong Kong and does not conduct any substantial operations of its own. No provision for Hong Kong profits tax have been made in our financial statements as no assessable profits for the nine and three months ended September 30, 2011 or prior periods. Additionally, upon payments of dividends by China Net HK to its sole shareholder, China Net BVI, no Hong Kong withholding tax will be imposed.

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

1 Rise King WFOE is a software company qualified by the related PRC governmental authorities and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a two-year EIT exemption from its first profitable year and a 50% reduction of its applicable EIT rate, which is 25% to 12.5% of its taxable income for the exceeding three years. Rise King WFOE had a net loss for the year ended December 31, 2008 and its first profitable year is fiscal year 2009 which has been verified by the local tax bureau by accepting the application filed by us. Therefore, it was entitled to a two-year EIT exemption for fiscal year 2009 through fiscal year 2010 and a 50% reduction of its applicable EIT rate which is 25% for fiscal year 2011 through fiscal year 2013. After the fiscal year of 2013, the applicable income tax rate for Rise King WFOE will be 25% under the current EIT law of PRC. Therefore, for the nine month ended September 30, 2011 and 2010, the applicable income tax rate for Rise King WFOE was 12.5% and nil%, respectively. For the three months ended September 30, 2011 and 2010, the applicable income tax rate for Rise King WFOE was also 12.5% and nil%, respectively.

1 Business Opportunity Online was qualified as a High and New Technology Enterprise in Beijing High-Tech Zone in 2005 and was approved by the local tax authorities of Beijing, the PRC, to be entitled to a three-year EIT exemption for fiscal year 2005 through fiscal year 2007 and a 50% reduction of its applicable EIT rate, which is 15% to 7.5% for the following three years from the fiscal year of 2008 through the fiscal year of 2010. However, in March 2007, a new enterprise income tax law (the “New EIT”) in the PRC was enacted which was effective on January 1, 2008. Subsequently, on April 14, 2008, relevant governmental regulatory authorities released new qualification criteria, application procedures and assessment processes for “High and New Technology Enterprise” status under the New EIT which would entitle the re-qualified and approved entities to a favorable statutory tax rate of 15%. Business Opportunity Online re-applied its qualification for a High and New Technology Enterprise in 2008 to the related PRC regulatory authorities. With an effective date of September 4, 2009, Business Opportunity Online obtained the approval of its reassessment of the qualification as a “High and New Technology Enterprise” under the New EIT law and was entitled to a favorable statutory tax rate of 15%. Under the previous EIT laws and regulations, High and New Technology Enterprises enjoyed a favorable tax rate of 15% and were exempted from income tax for three years beginning with their first year of operations, and were entitled to a 50% tax reduction to 7.5% for the subsequent three years and 15% thereafter. The current EIT Law provides grandfathering treatment for enterprises that were (1) qualified as High and New Technology Enterprises under the previous EIT laws, and (2) established before March 16, 2007, if they continue to meet the criteria for High and New Technology Enterprises under the current EIT Law. The grandfathering provision allows Business Opportunity Online to continue enjoying their unexpired tax holidays provided by the previous EIT laws and regulations, as it was established in December 2004 and qualified as a High and New Technology Enterprises under the previous EIT laws in 2005. After the expiration of the current tax holiday as of December 31, 2010, the applicable income tax rate of Business Opportunity Online was increased to 15%, the standard preferential income tax rate for a High and New Technology Enterprise. Therefore, for the nine months ended September 30, 2011 and 2010, the applicable income tax rate for Business Opportunity Online was 15% and 7.5%, respectively. For the three months ended September 30, 2011 and 2010, the applicable income tax rate for Business Opportunity Online was also 15% and 7.5%, respectively.



1 Business Opportunity Online Hubei, Hubei CNET, Zhao Shang Ke Hubei, Xin Qi Yuan Hubei, Mu Lin Sen Hubei and Sheng Tian Hubei were incorporated in Xiaotian Industrial Park of Xiaogan Economic Development Zone in Xiaogan City, Hubei province of the PRC. These operating entities have been approved by the related local government authorities to apply the deemed income tax method for its computation of income tax expense. Under the deemed income tax method, the deemed profit is calculated based on 10% of the total revenue and the applicable income tax rate is 25%. Therefore, the income tax expenses under the deemed income tax method is calculated as 2.5% of the total revenue recognized in each of the reporting period.

1 The applicable income tax rate for the other PRC operating entities of our company is 25%.

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

All of the tax holidays enjoyed by our PRC subsidiary and VIEs were based on the current applicable laws and regulations of the PRC and approved by the related government regulatory authorities and local tax authorities where our respective PRC subsidiary and VIEs operate. Rise King WFOE, Business Opportunity Online and our operating entities incorporated in Xiaogan City, Hubei province of the PRC were most affected by these tax holidays within the structure of us. The tax holidays have expiration periods within three years and are subject to change in accordance with the PRC government economic development policies and regulations. These tax holidays are mainly determined by the regulation and policies of the PRC government in the context of the overall economic policy and strategy. As a result, the uncertainty of these tax holidays are subject to, but not limited to, the PRC government policy on supporting any specific industry's development under the outlook and strategy of overall macroeconomic development.

## 2. Business tax and relevant surcharges

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

## Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08, "Intangibles-Goodwill and Other" (Topic 350): Testing Goodwill for Impairment. This ASU is intended to simplify goodwill impairment testing by adding a qualitative review step to assess whether the required quantitative impairment analysis that exists today is necessary. Under the amendments in this ASU, an entity is permitted to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The amendments in this Update are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on our consolidated financial position and results of operations upon adoption.

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



position and results of operations upon adoption.

53

---

## A. RESULTS OF OPERATIONS FOR THE NINE AND THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

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

	Nine months ended September 30,		Three months ended September 30,	
	2011	2010	2011	2010
	(US \$)	(US \$)	(US \$)	(US \$)
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Sales</b>				
To unrelated parties	\$21,987	\$30,304	\$6,329	\$8,631
To related parties	547	872	89	265
	22,534	31,176	6,418	8,896
<b>Cost of sales</b>				
From unrelated parties	8,047	15,791	3,369	3,110
From related parties	821	-	49	
	8,868	15,791	3,418	3,110
<b>Gross margin</b>	13,666	15,385	3,000	5,786
<b>Operating expenses</b>				
Selling expenses	2,198	2,187	575	851
General and administrative expenses	2,726	2,410	861	815
Research and development expenses	1,100	605	376	276
	6,024	5,202	1,812	1,942
<b>Income from operations</b>	7,642	10,183	1,188	3,844
<b>Other income (expenses):</b>				
Changes in fair value of warrants	-	1,861	-	-
Share of losses in equity investment affiliates	(180 )	-	(75 )	-
Gain on deconsolidation of subsidiary	232	-	-	-
Interest income	9	8	5	4
Other income (expenses)	5	7	-	4
	66	1,876	-70	8
<b>Income before income tax expense</b>	7,708	12,059	1,118	3,852
Income tax expense	861	304	107	25
<b>Net income</b>	6,847	11,755	1,011	3,827
Net (income)/ loss attributable to noncontrolling interest	96	127	100	50
Net income attributable to ChinaNet Online Holdings, Inc.	6,943	11,882	1,111	3,877
<b>Dividend on Series A convertible preferred stock</b>	(407 )	(612 )	(85 )	(190 )
	\$6,536	\$11,270	\$1,026	\$3,687

Net income attributable to common stockholders of ChinaNet  
Online Holdings, Inc.

Earnings per share

54

---

## Earnings per common share

Basic	\$0.37	\$0.68	\$0.06	\$0.22
Diluted	\$0.34	\$0.57	\$0.06	\$0.19

## Weighted average number of common shares outstanding:

Basic	17,806,818	16,676,752	18,632,103	16,939,961
Diluted	20,265,764	20,905,796	18,632,103(1)	20,916,463

- (1) The diluted earnings per share calculation for the nine months ended September 30, 2011 did not include the effect of the warrants and options to purchase up to 3,148,974 shares of common stock in the aggregate, because their effect was anti-dilutive.
- (2) The diluted earnings per share calculation for the three months ended September 30, 2011 did not include the effect of the 1,348,469 incremental shares that resulted from assumed conversion of the convertible preferred stock and the warrants and options to purchase up to 4,835,056 shares of common stock in the aggregate, because their effect was anti-dilutive.
- (3) The diluted earnings per share calculation for the nine and three months ended September 30, 2010 did not include the effect of the options to purchase up to 54,000 shares of common stock, because their effect was anti-dilutive.

## NON-GAAP MEASURES

To supplement the unaudited consolidated statement of income and comprehensive income presented in accordance with GAAP, we are also providing non-GAAP measures of income before income tax expenses, net income, net income attributable to us and basic and diluted earnings per share for the nine months ended September 30, 2011 and 2010, which are adjusted from results based on GAAP to exclude the non-cash gain recorded, which related to the gain on deconsolidation of a subsidiary for the nine months ended September 30, 2011 and the fair value changes of the warrants we issued in our August 2009 financing for the nine months ended September 30, 2010. The non-GAAP financial measures are provided to enhance the investors' overall understanding of our current performance in on-going core operations as well as prospects for the future. These measures should be considered in addition to results prepared and presented in accordance with GAAP, but should not be considered a substitute for or superior to GAAP results. We use both GAAP and non-GAAP information in evaluating our operating business results internally and therefore deemed it important to provide all of this information to investors.

The following table presents a reconciliation of our non-GAAP financial measures to the unaudited consolidated statements of income and comprehensive income for the nine months ended September 30, 2011 and 2010, (all amounts in thousands of US dollars):

	Nine months ended September 30,			
	2011		2010	
	GAAP	NON	GAAP	NON
	(Unaudited)	GAAP	(Unaudited)	GAAP
		(Unaudited)		(Unaudited)
Income from operations	\$7,642	\$7,642	\$10,183	\$10,183
Other income (expenses):				
Changes in fair value of warrants	-	-	1,861	-

Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

Share of losses in equity investment affiliates	(180 )	(180 )	-	-
Gain on deconsolidation of subsidiary	232	-	-	-
Interest income	9	9	8	8
Other income (other expenses)	5	5	7	7
	66		1,876	

55

---

		(166)		15
Income before income tax expense	7,708		12,059	
Adjusted income before income tax expense		7,476		10,198
Income tax expense	861	861	304	304
Net income	6,847		11,755	
Adjusted net income		6,615		9,894
Net (income)/ loss attributable to noncontrolling interest	96	96	127	127
Net income attributable to ChinaNet Online Holdings, Inc.	\$6,943		\$11,882	
Adjusted net income attributable to ChinaNet Online Holdings, Inc.		\$6,711		\$10,021
Dividend on series A convertible preferred stock	(407)	(407)	(612)	(612)
Net income attributable to common stockholders of ChinaNet Online Holdings, Inc.	\$6,536		\$11,270	
Adjusted net income attributable to common stockholders of ChinaNet Online Holdings, Inc.		\$6,304		\$9,409
Earnings per common share-Basic	\$0.37		\$0.68	
Adjusted earnings per common share-Basic		\$0.35		\$0.56
Earnings per common share-Diluted	\$0.34		\$0.57	
Adjusted earnings per common share-Diluted		\$0.33		\$0.48
Weighted average number of common shares outstanding:				
Basic	17,806,818	17,806,818	16,676,752	16,676,752
Diluted	20,265,764	20,265,764	20,905,796	20,905,796

## REVENUE

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

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

Revenue type	Nine months ended September 30,					
	2011		2010			
(Amounts expressed in thousands of US dollars, except percentages)						
Internet advertisement	\$ 16,434	72.9	%	\$ 19,736	63.3	%
TV advertisement	4,742	21.1	%	11,044	35.4	%

Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

Bank kiosks	415	1.8	%	396	1.3	%
Brand management and sales channel building	943	4.2	%	-	-	
Total	\$ 22,534	100	%	\$ 31,176	100	%

56

---

Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

Revenue type	Three months ended September 30,					
	2011			2010		
(Amounts expressed in thousands of US dollars, except percentages)						
Internet advertisement	\$ 3,860	60.1	%	\$ 7,160	80.5	%
TV advertisement	1,972	30.7	%	1,603	18.0	%
Bank kiosks	140	2.2	%	133	1.5	%
Brand management and sales channel building	446	7.0	%	-	-	
Total	\$ 6,418	100	%	\$ 8,896	100	%

Revenue type	Nine months ended September 30,					
	2011			2010		
(Amounts expressed in thousands of US dollars, except percentages)						
Internet advertisement	\$ 16,434	100	%	\$ 19,736	100	%
--From unrelated parties	15,915	96.8	%	18,865	95.6	%
--From related parties	519	3.2	%	871	4.4	%
TV advertisement	4,742	100	%	11,044	100	%
--From unrelated parties	4,742	100	%	11,043	99.99	%
--From related parties	-	-		1	0.01	%
Bank kiosks	415	100	%	396	100	%
--From unrelated parties	415	100	%	396	100	%
--From related parties	-	-		-	-	
Brand management and sales channel building	943	100	%	-	-	
--From unrelated parties	915	97.0	%	-	-	
--From related parties	28	3.0	%	-	-	
Total	\$ 22,534	100	%	\$ 31,176	100	%
--From unrelated parties	\$ 21,987	97.6	%	\$ 30,304	97.2	%
--From related parties	\$ 547	2.4	%	\$ 872	2.8	%

Revenue type	Three months ended September 30,					
	2011			2010		
(Amounts expressed in thousands of US dollars, except percentages)						
Internet advertisement	\$ 3,860	100	%	\$ 7,160	100	%
--From unrelated parties	3,846	99.6	%	6,896	96.3	%
--From related parties	14	0.4	%	264	3.7	%
TV advertisement	1,972	100	%	1,603	100	%
--From unrelated parties	1,972	100	%	1,602	99.94	%
--From related parties	-	-		1	0.06	%
Bank kiosks	140	100	%	133	100	%
--From unrelated parties	140	100	%	133	100	%
--From related parties	-	-		-	-	
Brand management and sales channel building	446	100	%	-	-	
--From unrelated parties	371	83.2	%	-	-	
--From related parties	75	16.8	%	-	-	



Edgar Filing: ASPEN TECHNOLOGY INC /DE/ - Form 10-Q/A

Total	\$ 6,418	100	%	\$ 8,896	100	%
--From unrelated parties	\$ 6,329	98.6	%	\$ 8,631	97.0	%
--From related parties	\$ 89	1.4	%	\$ 265	3.0	%

57

---

Total Revenues: Our total revenues decreased to US\$22.5 million for the nine months ended September 30, 2011 from US\$31.2 million for the same period in 2010. For the three months ended September 30, 2011, our total revenue decreased to US\$6.4 million from US\$8.9 million for the same period in 2010. For the nine months ended September 30, 2011, the decrease in our total net revenue was primarily due to the significant decrease in the TV advertisement revenue as compared to the same period in 2010. For the three months ended September 30, 2011, the decrease in our total net revenue was mainly due to a decrease in our internet advertising revenue as compared to the same period in 2010.

We derive the majority of our advertising service revenues from the sale of advertising space with sales leads generated on our internet portals with provisions of related technical supports, internet marketing services and content management, and in addition, from the resale of advertising time purchased from different TV programs to unrelated third parties and to some of our related parties. We report our advertising revenue between related and unrelated parties on account of historical basis with which approximately 3% to 5% of our advertising service revenues came from clients related to some of the shareholders of our PRC operating entities. Our advertising services to related parties were provided in the ordinary course of business on an arm's-length basis on the same terms as those provided to our unrelated advertising clients.

During the nine months ended September 30, 2011, we continued to execute our strategy of focusing on internet advertisement services, including internet advertising and marketing, search engine marketing and optimization, internet information management (part of management tools) and others, which in total constituted approximately 73% of our total net revenue and achieved gross margins of 71% as compared to 63% of the total net revenue and 75% of the gross margin achieved for the same period of last year. We will continue to concentrate resources and capital on our advertising and marketing platform, including [www.28.com](http://www.28.com) and [www.liansuo.com](http://www.liansuo.com), our social networking service information platform, [www.chuangye.com](http://www.chuangye.com), and other procurements in order to yield more predictable and recurring revenue. [www.liansuo.com](http://www.liansuo.com) is currently in its first stage of operation, while [www.chuangye.com](http://www.chuangye.com) is currently in its fourth round of testing on services and functionalities with the entrepreneurial communities.

Our advertising service revenues are recorded net of any sales discount, including volume discounts and other customary incentives offered to our small to medium franchise and merchant clients, including additional advertising time for their advertisements on unused spots available on our website in the representation of the difference between our official list price and the amount we charge our clients. We typically sign service contracts with small to medium franchise and other small to medium enterprise clients who require us to advertise and market their franchise business, distribution business, dealership business, business opportunity business or other business ventures on our portal websites at specified places within or at specified periods; and/or place the advertisements onto our purchased advertisement time provided by specific TV programs for specified period of times. We recognize revenues as the advertisement airs over the term of the contract based on the schedule agreed upon with our clients.

1 For the nine months ended September 30, 2011 and 2010, our internet advertising revenue decreased to approximately US\$16.4 million from approximately US\$19.7 million for the same period in 2010. For the three months ended September 30, 2011, our internet advertising revenue decreased to approximately US\$3.9 million as compared to approximately US\$7.2 million for the same period of 2010. The decrease in our internet revenue for the nine and three months ended September 30, 2011 as compared with the same period in 2010 was primarily due to a decrease in our weighted average number of customers by approximately 8%-15% and the average revenue per client by approximately 10%-30%. Due to the Chinese government's monetary policy of increasing interest rates and tightening the money supply, and other economic difficulties that unexpectedly began in the second quarter of 2011, many of our clients, including our branded clients, who are mostly small and medium enterprises, cut their advertising expenditures significantly in response to the overall economic situation in China. In the meantime, we gradually gained some new clients as a result of the efforts we made in some new cities through our newly formed operating entities. However, their contribution to our revenue has been limited in 2011. We also have gradually gained new clients on [www.liansuo.com](http://www.liansuo.com) as presently there are approximately 4,000 clients listed on the site during

its three-month initial operating period, representing a 50% increase from the end of last quarter. However, the majority of the clients are on a free trial period, but it has further expanded the Company exposure to larger clients, providing a new array of income source.

1 For the nine months ended September 30, 2011, our TV advertising revenue decreased to US\$4.74 million from US\$11.04 million for the same period in 2010. We generated this US\$4.74 million of TV advertising revenue by selling approximately 4,700 minutes of advertising time that we purchased from seven provincial TV stations, which were partially purchased through Beijing Yang Guang, in comparison with approximately 13,650 minutes of advertising time purchased from seven TV stations that we sold in the same period in 2010. For the three months ended September 30, 2011, our TV advertising revenue increased to US\$1.97 million from US\$1.60 million for the same period in 2010. For the three months ended September 30, 2011 and 2010, we sold approximately 1,600 minutes and 1,650 minutes of advertising time purchased from TV stations, respectively. For the nine months ended September 30, 2011, the decrease in revenue from the TV advertisement segment was a direct result of the decrease of total minutes of TV advertising time sold during the period as compared to the same period of 2010. Beginning in the middle of the fiscal year 2010, due to the increase in the cost per minute charged by the TV stations, which cost was passed on to our end customers, our clients' demand for the TV advertising service decreased significantly as a result. We had to decrease our selling price to sell all the TV minutes purchased from the TV stations, which led to a low gross profit margin of approximately 3% of this segment for the nine months ended September 30, 2010. Therefore, in the beginning of fiscal year 2011, we reduced the business scope of the TV division, which was integrated into our advertising and marketing platform and provided to the existing Internet client base additional communication channels. For the nine months ended September 30, 2011, we only kept a limited quantity of TV time slots with relatively lower cost per minute, which led to more affordable prices for our customers. Therefore, the gross profit margin of this segment improved significantly for the nine months ended September 30, 2011 to approximately 19% as compared with 3% for the same period of last year. For the nine months ended September 30, 2011, our average selling price per minute improved to approximately US\$1,013 per minute as compared to approximately US\$809 per minute for the same period in 2010. Due to the improvement of the selling price per minute charged to our TV advertising clients in year 2011, for the three months ended September 30, 2011 and 2010, our revenue generated from the TV division increased to approximately US\$1.97 million, representing a 23% increase as compared to approximately US\$1.6 million for the same period in 2010. We will continue to monitor the demand from our customers for this segment in the second half of 2011, and purchase additional TV advertisement time, if necessary. The TV division is not going to expand internally in terms of its operational size and manpower, but it will continue to grow through external outsourcing and potential partnerships and/or joint ventures to secure the availability of TV minutes when needed.

1 For the nine months ended September 30, 2011, we achieved approximately US\$0.42 million of revenue from the bank kiosk business segment as compared to approximately US\$0.40 million for the same period in 2010. For the three months ended September 30, 2011 and 2010, we achieved approximately US\$0.14 million and US\$0.13 million of revenue from this segment, respectively. The bank kiosk advertising business is still in the development stage and many details still need to be further analyzed and finalized before we allocate more capital into this business unit. It was not a significant contributor to revenue for either the nine and three months ended September 30, 2011 and 2010. Management believes that at this moment, this business is unlikely to expand and some of the technology used in this business unit will be fully integrated into the overall advertising and marketing platform.

1 Upon the acquisition of Quanzhou ZhiYuan, Quanzhou Tian Xi Shun He and the incorporation of Zhao Shang Ke Hubei, we operated our business in an additional reportable business segment, which was Brand Management and Sales Channel Building segment. For the nine and three months ended September 30, 2011, we achieved approximately US\$0.94 million and US\$0.45 million of revenue from this segment, respectively. We anticipate that the revenue from this segment will continue grow in the last three months of 2011.

Costs of revenue



Our costs of revenue consist of costs directly related to the offering of our advertising services. The following tables set forth our costs of revenue, divided into four segments, by amount and gross profit ratio for the periods indicated, with inter-segment transactions eliminated:

	Nine months ended September 30,						
	2011			2010			
	(Amounts expressed in thousands of US dollars, except percentages)						
	Revenue	Cost	GP ratio		Revenue	Cost	GP ratio
Internet advertisement	\$16,434	\$4,711	71 %		\$19,736	\$5,000	75 %
TV advertisement	4,742	3,833	19 %		11,044	10,709	3 %
Bank kiosk	415	36	91 %		396	34	91 %
Brand management and sales channel building	943	288	69 %	-	-	-	N/A
Others	-	-	N/A		-	48	N/A
Total	\$22,534	\$8,868	61 %		\$31,176	\$15,791	49 %

	Three months ended September 30,						
	2011			2010			
	(Amounts expressed in thousands of US dollars, except percentages)						
	Revenue	Cost	GP ratio		Revenue	Cost	GP ratio
Internet advertisement	\$3,860	\$1,605	58 %		\$7,160	\$1,646	77 %
TV advertisement	1,972	1,669	15 %		1,603	1,453	9 %
Bank kiosk	140	12	91 %		133	11	92 %
Brand management and sales channel building	446	132	70 %	-	-	-	N/A
Total	\$6,418	\$3,418	47 %		\$8,896	\$3,110	65 %

Cost of revenues: Our total costs of revenue decreased to US\$8.87 million for the nine months ended September 30, 2011 from US\$15.79 million for the same period in 2010. For the three months ended September 30, 2011, our total cost of revenue increased to US\$3.42 million from US\$3.11 million for the same period in 2010. For the nine months ended September 30, 2011, the significant decrease of our total cost of revenue was mainly due to the significant decrease in costs of our TV advertisement business segment, which was in line with the decrease of our TV advertisement revenue for the period as discussed above. For the three months ended September 30, 2011, the increase of our total cost of revenue was primarily due to the increase in the costs of our TV advertisement business segment and the costs for the newly established business segment of brand management and sales channel building in year 2011, which was in-line with the increase of revenue in these two segments for the three months ended September 30, 2011 as compared with the same period in 2010. Our cost of revenues related to offering of our advertising services primarily consists of internet resources purchased from other portal websites and technical services providers related to lead generation, sponsored search, TV advertisement time costs purchased for reselling, and business taxes and surcharges.

1 Internet resources cost is the largest component of our cost of revenue for internet advertisement revenue. We purchased these resources from other well-known portal websites in China, such as: Baidu, Google and Tecent (QQ), to increase exposure of our internet advertisement clients on the overall internet community in China and to generate more visits to their advertisements, including, their mini-sites, hosted by our portal websites. We accomplish these objectives through sponsored searches, advanced tracking and advanced traffic generating

technologies, and search engine marketing technologies in connection with the well-known portal websites indicated above. For the nine months ended September 30, 2011 and 2010, our internet resources cost for internet advertising revenue was US\$4.71 million and US\$5.00 million, respectively. For the three months ended September 30, 2011 and 2010, our internet resources cost for internet advertising revenue was US\$1.61 million and US\$1.65 million, respectively. The decrease of the internet resources cost for the nine and three months ended September 30, 2011 as compared to the same period of 2010 was due to the decrease in the internet advertisement revenue, as discussed above. However, the decrease of cost of internet advertising revenue was relatively lower as compared to the decrease in internet advertising revenue, mainly due to: (1) the increase of per-click charge from our search engine marketing resource suppliers, such as Baidu. We use these resources to increase the exposure of our internet advertisement per client by either key word searching or price bidding; (2) as discussed above, our customers intended to cut their advertising spending due to current economic difficulties. In order to retain our current customers, we have enhanced the effectiveness of key word price bidding functionality through our resource providers to maintain customers' satisfaction of the internet advertisement placed on our website portals, and this in turn increased our internet advertising cost per client as compared with the same period of last year. Therefore, for the nine and three months ended September 30, 2011, the gross profit margin for this segment decreased to 71% and 58%, respectively, as compared with 75% and 77% for the same period of 2010, respectively.

1 TV advertisement time cost is the largest component of our cost of revenue for TV advertisement revenue. For the nine and three months ended September 30, 2011 and 2010, we purchased TV advertisement time from seven provincial TV stations, and resell it to our TV advertisement clients. Our TV advertisement time cost was US\$3.83 million and US\$10.71 million for the nine months ended September 30, 2011 and 2010, respectively. For the three months ended September 30, 2011 and 2010, our TV advertisement time cost was US\$1.67 million and US\$1.45 million, respectively. Our gross profit margin for this segment improved to 19% and 15% for the nine and three months ended September 30, 2011 as compared to 3% and 9% for the same period of 2010. This improvement was primarily due to the efficiency of purchasing TV time on a more cost effective basis while simultaneously matching our customers' needs. In addition, we only kept the TV advertising time from the stations that can be purchased on a more affordable cost basis as compared with the selling price that our customers can afford.

Gross Profit: As a result of the foregoing, our gross profit was US\$13.67 million for the nine months ended September 30, 2011 as compared to US\$15.39 million for the same period in 2010. For the three months ended September 30, 2011 and 2010, we achieved approximately US\$3.00 million and US\$5.79 million gross profit, respectively. The decrease in the gross profit for the nine and three months ended September 30, 2011 as compared with the same period in 2010 was mainly due to the decrease in internet revenue for these periods as compared with the same periods of last year, as discussed above. Along with the increase in the proportion of the high margin internet advertising revenue over the total revenue for the nine months ended September 30, 2011, which was 72.9% as compared to 63.3% for the same period in 2010, our overall gross margin increased to 61% for the nine months ended September 30, 2011, as compared with 49% for the same period in 2010. For the three months ended September 30, 2011, as the proportion of the high margin internet advertising revenue over the total revenue decreased to 60.1% from 80.5% for the same period of 2010, our overall gross margin decreased to 47% for the three months ended September 30, 2011 as compared to 65% for the same period of 2010.

#### Operating Expenses and Net Income

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

	Nine months ended September 30,		2011		2010	
	Amount	% of total revenue	Amount	% of total revenue	Amount	% of total revenue
Total Revenue	\$ 22,534	100 %	\$ 31,176	100 %		
Gross Profit	13,666	61 %	15,385	49 %		
Selling expenses	2,198	10 %	2,187	7 %		
General and administrative expenses	2,726	12 %	2,410	8 %		
Research and development expenses	1,100	5 %	605	2 %		
Total operating expenses	\$ 6,024	27 %	\$ 5,202	17 %		



	Three months ended September 30, 2011		2010	
	(Amounts expressed in thousands of US dollars, except percentages)			
	Amount	% of total revenue	Amount	% of total revenue
Total Revenue	\$ 6,418	100 %	\$ 8,896	100 %
Gross Profit	3,000	47 %	5,786	65 %
Selling expenses	575	9 %	851	10 %
General and administrative expenses	861	13 %	815	9 %
Research and development expenses	376	6 %	276	3 %
Total operating expenses	\$ 1,812	28 %	\$ 1,942	22 %

Operating Expenses: Our total operating expenses increased to US\$6.02 million for the nine months ended September 30, 2011 from US\$5.20 million for the same period in 2010. For the three months ended September 30, 2011, our total operating expenses decreased to US\$1.81 million as compared to US\$1.94 million for the same period in 2010.

1 Selling expenses: For the nine months ended September 30, 2011, our selling expenses increased slightly to US\$2.20 million from US\$2.19 million for the same period in 2010. For the three months ended September 30, 2011 and 2010, our selling expenses decreased to US\$0.58 million from US\$0.85 million for the same period in 2010. Our selling expenses primarily consist of advertising expenses for brand development that we pay to TV stations and other media outlets for the promotion and marketing of [www.28.com](http://www.28.com), other advertising and promotional expenses, staff and staff benefits, performance bonuses, website server hosting and broadband leasing expenses, and travel and communication expenses. For the nine months ended September 30, 2011: (1) our brand development advertising expenses on TV programs for [www.28.com](http://www.28.com) decreased by approximately US\$0.34 million; (2) staff salary, bonus and benefit expenses increased by approximately US\$0.26 million, which was mainly due to new operating entities formed and acquired during the nine months ended September 30, 2011; and (3) other selling expenses such as entertainment, traveling and communication expenses increased by approximately US\$0.09 million. For the three months ended September 30, 2011 and 2010, (1) our brand development advertising expenses on TV programs for [www.28.com](http://www.28.com) decreased by approximately US\$0.42 million; (2) staff salary, bonus and benefit expenses increased by approximately US\$0.16 million, which was primarily due to the formation and acquisition of new operating entities; and (3) other general selling expenses decreasing slightly by approximately US\$0.01 million.

1 General and administrative expenses: For the nine months ended September 30, 2011, general and administrative expenses increased to US\$2.73 million as compared to US\$2.41 million for the same period in 2010. For the three months ended September 30, 2011, general and administrative expenses increased to US\$0.86 million as compared to US\$0.82 million for the same period in 2010. Our general and administrative expenses primarily consist of salaries and benefits for management, accounting and administrative personnel, office rentals, depreciation of office equipment, amortization of intangible assets, professional service fees, maintenance, utilities and other office expenses. The increase in our general and administrative expenses for the nine months ended September 30, 2011 was mainly due to the following reasons: (1) increase in expenses incurred by Quanzhou Zhi Yuan, Quanzhou Tian Xi Shun He and Sheng Tian Hubei during the nine months ended September 30, 2011 of approximately US\$0.39 million, of which approximately US\$0.30 million was related to the amortization of the intangible assets (i.e. contract backlog, customer relationship, non-compete agreement and cloud-compute based software platforms) recognized over their respective estimated economic life; (2) at the same time, due to the deconsolidation of Shenzhen Mingshan which occurred in January 2011, general and administration expense for Shenzhen Mingshan was not included in our consolidated earnings for the nine months ended September 30, 2011, which was

approximately US\$0.21 for the same period in 2010; (3) depreciation expenses and maintenance expenses increased by approximately US\$0.13 million for the new office equipment purchased and improvements to our office space incurred during the nine months ended September 30, 2011; (4) other general office expenses, such as: communication, traveling, entertainment and other office supplies increased by approximately US\$0.09 million; and (5) professional service fees decreased by approximately US\$0.07 million as we gradually trained our own staff to handle more duties and decreased the expenses for outsourcing. For the three months ended September 30, 2011 and 2010, the increase of the general and administrative expenses was due to similar reasons as discussed for the nine months ended September 30, 2011.

1 Research and development expenses: For the nine months ended September 30, 2011, research and development expenses increased to US\$1.1 million from US\$0.61 million for the same period of 2010. For the three months ended September 30, 2011, research and development expenses increased to US\$0.38 million as compared to US\$0.28 million for the same period of 2010. Our research and development expenses primarily consist of salaries and benefits for the research and development staff, equipment depreciation expenses, and office utilities and supplies allocated to our research and development department. The increase of the research and development expenses for the nine and three months ended September 30, 2011 was mainly due to the expansion of our research and development function which resulted in an increase of the salary expenses and other general administrative expense and supplies. We expect that our research and development expenses will increase in future periods as we continue to expand, optimize and enhance the technology of our portal websites, upgrade our advertising and internet management software and develop other related cloud-based management tools. In the next three to five years, we expect research and development expenses to be within the range of six percent to ten percent of our total revenues.

Operating Profit: As a result of the foregoing, for the nine months ended September 30, 2011 and 2010, we achieved approximately US\$7.64 million and US\$10.18 million operating profit, respectively. For the three months ended September 30, 2011 and 2010, our operating profit was approximately US\$1.18 million and US\$3.84 million, respectively. The decrease in our operating profit for the nine and three months ended September 30, 2011 was primarily due to the decrease in net revenue and gross profit generated from our internet advertising business as discussed above.

Changes in Fair Value of Warrants: We originally accounted for our warrants issued to the investors and the placement agent in our August 2009 financing as derivative liabilities under ASC Topic 815 "Derivatives and Hedging", because it contains a "Down-round" protection that were applicable if we were to issue new shares of common stock or common stock equivalents at a price per share less than the exercise price of the Warrants. The "Down-round protection" provision is not considered to be an input to the fair value of a fixed-for-fixed option on equity shares which lead to the Warrants to fail to be qualified as indexed to the Company's own stock and then fail to meet the scope exceptions of ASC Topic 815. Therefore, we accounted for the Warrants as derivative liabilities under ASC Topic 815. Pursuant to ASC Topic 815, derivative should be measured at fair value and re-measured at fair value with changes in fair value recorded in earnings at each reporting period. On March 29, 2010, we and the holders of the Warrants entered into agreements to amend certain provisions of the Warrants. The amendment to the investor and placement agent warrants removes the "Down-round protection" rights. In addition, the amendment to the warrants added a provision to grant the holders of a majority of the warrants an approval right until December 31, 2010, over any new issuance of shares of common stock or common stock equivalents at a price per share less than the exercise price of the warrants. As a result of this amendment, the Warrants issued in the August 2009 financing were qualified as indexed to our own stock and then met the scope exceptions of ASC Topic 815, and were eligible to be reclassified as equity. In accordance with ASC Topic 815, the classification of a contract should be reassessed at each balance sheet date. If the classification required under this ASC changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification. If a contract is reclassified from an asset or a liability to equity, gains or losses recorded to account for the contract at fair value during the period that the contract was classified as an asset or a liability should not be reversed. Therefore, we re-measured the fair value of the Warrants as of March 29, 2010, the date of the event that caused the classification, which was approximately US\$ 7,703,000 and reclassified the amount to equity as additional paid-in capital. The gain of the changes in fair value during the period that the Warrants were classified as a derivative liability for the nine months ended September 30, 2010, which was approximately US\$ 1,861,000 was recorded in earnings. As the Warrants had been reclassified to equity on March 29, 2010, no gain or loss of changes in fair value of Warrants would be recognized thereafter.



Share of earnings (losses) in equity investment affiliates: For the nine and three months then ended September 30, 2011, we recognized our pro-rata share of earning or losses in Beijing Yang Guang, which was approximately US\$26,000 of earnings and US\$4,000 of losses, respectively, with a corresponding increase or decrease to the carrying value of the long term investment in Beijing Yang Guang. We acquired a 49% equity interest of Beijing Yang Guang in December 2010. In August 2011, we disposed our 49% equity interest of Beijing Yang Guang to its majority shareholder. Our pro-rata share of earnings recognized in the aggregate for the period that we held the 49% equity interest of Beijing Yang Guang was approximately US\$26,000 and was received in cash as distribution of earnings from Beijing Yang Guang in early November 2011. Shenzhen Mingshan used to be 51% owned by one of our operating VIEs and was a consolidated entity of our company from its date of incorporation through January 6, 2011. On January 6, 2011, an independent third party investor invested RMB15,000,000 (approximately US\$2,283,000) cash to Shenzhen Mingshan, and hence obtained 60% equity interest of Shenzhen Mingshan, and our company's share of equity interest then decreased from 51% to 20.4%. Accordingly, Shenzhen Mingshan then became an equity investment affiliate of our company. Therefore, we recognized our pro-rata share of losses in Shenzhen Mingshan, which was approximately US\$206,000 and US\$71,000 for the nine and three months ended September 30, 2011, respectively, with a corresponding decrease to the carrying value of long term investment in Shenzhen Mingshan. Therefore, net amount recognized as share of losses in equity investment affiliates recognized for the nine and three months ended September 30, 2011 was approximately US\$180,000 and US\$75,000 for these equity investment affiliates, respectively.

Gain on deconsolidation of subsidiary: The deconsolidation of Shenzhen Mingshan that occurred on January 6, 2011 was accounted for in accordance with ASC Topic 810 "Consolidation". We recognized a gain of approximately US\$232,000 upon deconsolidation of Shenzhen Mingshan in our consolidated statements of income and comprehensive income for the nine months ended September 30, 2011, with a corresponding increase to the carrying value of the investment in Shenzhen Mingshan in the consolidated balance sheet. This deconsolidation gain represents the excess of the fair value of our retained equity interest in Shenzhen Mingshan over its carrying value as of the date of deconsolidation.

Income Tax: We recognized an income tax expense of US\$0.86 million and US\$0.30 million for the nine months ended September 30, 2011 and 2010, respectively. For the three months ended September 30, 2011 and 2010, our income tax expense was US\$0.11 million and US\$0.03 million, respectively. The increase in income tax expenses was mainly due to the increase in the effective income tax rate of our PRC operating entities, Business Opportunity Online and Rise King WFOE for the nine and three months ended September 30, 2011, as compared to that for the same period of 2010. For fiscal year 2011, the applicable income tax rate for Business Opportunity Online and Rise King WFOE is 15% and 12.5%, respectively. For fiscal year 2010, the applicable income tax rate for these two operating subsidiaries was 7.5% and nil%, respectively.

Net Income: As a result of the foregoing, our net income amounted to US\$6.85 million for the nine months ended September 30, 2011 as compared to US\$11.76 million for the same period in 2010. Excluding the non-cash gain of US\$0.23 million recognized for deconsolidation of Shenzhen Mingshan and the US\$1.86 million gain recorded as changes in fair value of warrants for the nine months ended September 30, 2011 and 2010, respectively, we achieved adjusted net income amounted to US\$6.62 million and US\$9.89 million for the nine months ended September 30, 2011 and 2010, respectively. For the three months ended September 30, 2011 and 2010, our net income was US\$1.01 million and US\$3.83 million, respectively.

Net income/ losses attributable to noncontrolling interest: On February 23, 2011, Beijing CNET Online acquired a 51% equity interest in Quanzhou Tian Xi Shun He. On March 1, 2011, Business Opportunity Online together with an individual, who was not affiliated with us, formed a new company, Beijing Chuang Fu Tian Xia. Beijing Chuang Fu Tian Xia is 51% owned by Business Opportunity Online and 49% owned by the individual. On April 18, 2011, Business Opportunity Online Hubei together with an individual, who was not affiliated with us, formed a new company, Zhao Shang Ke Hubei. Zhao Shang Ke Hubei is 51% owned by Business Opportunity Online Hubei and

49% owned by the co-founder individual. On July 1, 2011, Business Opportunity Online Hubei together with an individual, who was not affiliated with us, formed a new company, Sheng Tian Hubei. Sheng Tian Hubei is 51% owned by Business Opportunity Online Hubei and 49% owned by the co-founder individual. Therefore, net income or losses of the above majority-owned subsidiaries of our PRC VIEs were allocated between their respective shareholders based on their respective percentage of the ownership in the entities for the nine and three months ended September 30, 2011. For the nine months ended September 30, 2011, net income allocated to the noncontrolling interest of Zhao Shang Ke Hubei was approximately US\$0.024 million, net losses in the aggregate allocated to the noncontrolling interest of the other majority-owned subsidiaries of our VIEs was approximately US\$0.120 million. Therefore, net losses attributable to the noncontrolling interest for these majority-owned subsidiaries of our VIEs in the aggregate for the nine months ended September 30, 2011 was approximately US\$0.096 million. For the three months ended September 30, 2011, all of these majority-owned subsidiaries of our VIEs incurred losses, and net losses in the aggregate allocated to the noncontrolling interest of these majority-owned subsidiaries of our VIEs was approximately US\$0.10 million.

Net income attributable to ChinaNet Online Holdings, Inc.: Total net income we achieved for the nine and three months ended September 30, 2011 plus the total net losses attributable to the noncontrolling interest shareholders as discussed above was the net income attributable to ChinaNet Online Holdings, Inc.

Dividend for Series A convertible preferred stock: Cash dividend to Series A convertible preferred stockholders was calculated at the per annum rate of 10% of the liquidation preference amount of the Series A preferred stock which was US\$2.5 per share and the actual number of days each share was outstanding within the reporting period. The cash dividend we accrued for the Series A convertible preferred stock was approximately US\$0.41 million and US\$0.61 million for the nine months ended September 30, 2011 and 2010, respectively. For the three months ended September 30, 2011 and 2010, preferred stock dividend accrued was approximately US\$0.09 million and US\$0.19 million, respectively. On August 21, 2011, all unconverted shares of our convertible preferred stock issued by us in our August 2009 Financing were mandatorily converted into our common stock in accordance with the Security Purchase Agreement entered between our company and the investors.

Net income attributable to ChinaNet's common shareholders: Net income attributable to ChinaNet's common shareholders represents the net income after the allocation to the noncontrolling interest shareholders minus the cash dividend accrued for Series A convertible preferred stockholders.

## B. LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents represent cash on hand and deposits held at call with banks. We consider all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents. As of September 30, 2011, we had cash and cash equivalents of approximately US\$21.3 million.

Our liquidity needs include (i) net cash used in operating activities that consists of (a) cash required to fund the initial build-out and continued expansion of our network and (b) our working capital needs, which include deposits and advanced payment to TV advertising time and internet resource providers, payment of our operating expenses and financing of our accounts receivable; (ii) net cash used in investing activities that consist of payments for acquisitions to further expand our business and client base, and investments in advanced technology based intangibles to provide more value-added services to our client and other office equipment; and (iii) net cash used in financing activities that mainly represented cash dividends we paid to our preferred stockholders. To date, we have financed our liquidity need primarily through proceeds from our operating activities.

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

	Nine months ended September 30,	
	2011	2010
	Amounts in thousands of US dollars	
Net cash provided by operating activities	\$ 8,443	\$ 11,235
Net cash used in investing activities	(3,116 )	(448 )
Net cash provided by (used in) financing activities	3	(2,718 )
Effect of foreign currency exchange rate changes on cash and cash equivalent	360	255
Net increase in cash and cash equivalents	\$ 5,690	\$ 8,324

Net cash provided by operating activities: Our net cash provided by operating activities was US\$8.4 million and US\$11.2 million for the nine months ended September 30, 2011 and 2010, respectively. For the nine months ended September 30, 2011, we earned approximately US\$7.7 million in net income (excluding the US\$0.23 million non-cash gain recognized for deconsolidation of Shenzhen Mingshan and the approximately US\$1.08 million of non-cash expenses of depreciation, amortization, share of losses in equity investment affiliates and the share-based compensation expenses etc). During the nine months ended September 30, 2011: (1) accounts receivable and trade receivables from related parties increased by approximately US\$1.8 million; (2) we collected approximately US\$3.8 million third party loans granted for the purpose of expanding of our potential value added communication channel resources; (3) advances from customers decreased by approximately US\$1.3 million; (4) due to related parties, due to Control Group and due to directors decreased by approximately US\$0.8 million due to our settling of these outstanding balances with our Control Group and director; and (5) taxes payable increased by approximately US\$0.9 million. These transactions in the aggregate adjusted our net income (excluding non-cash items) of approximately US\$7.7 million to the net cash inflow of approximately US\$8.4 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2010, we earned approximately US\$10.3 million in net income (excluding the US\$1.86 million of non-cash gain recorded as changes in fair value of the warrant liabilities and approximately US\$0.45 million non-cash expense of depreciation and share based compensation expenses). For the nine months ended September 30, 2010, (1) accounts receivable, trade receivables from related parties and other prepayments increased by approximately US\$1.1 million; (2) we collected approximately US\$2.1 million of third party loans; (3) due to Control Group and due to director decreased by approximately US\$0.4 million, and (4) accounts payable, other payables and accruals increased by US\$0.3 million. These transactions in the aggregate adjusted our net income of approximately US\$10.3 million to net cash inflow of approximately US\$11.2 million for the nine months ended September 30, 2010.

Net cash used in investing activities: Our net cash used in investing activities for the nine months ended September 30, 2011 was approximately US\$3.1 million, which mainly included the following transactions: (1) we spent approximately US\$0.2 million for purchasing of computers, office equipment and settling the outstanding payment for bank kiosks purchased; (2) we also spent approximately US\$1.4 million for the purchasing of software and the related technology from an individual not affiliated with us, with whom we incorporated a new majority-owned operating entity in July 2011. These purchased software platforms and the related technology will be further consolidated and integrated into our advertising and marketing platform and management tools platform and packed into different value-added services to be provided to our clients; (3) we received approximately US\$0.02 million cash from our acquisition of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He, representing the total cash and cash equivalent balance of these two companies as of their respective acquisition dates; (4) the cash effect on deconsolidation of Shenzhen Mingshan which was approximately US\$0.2 million, representing the cash and cash equivalent balance of Shenzhen Mingshan as of the date of deconsolidation; (5) in August 2011, we also made a capital injection of approximately US\$0.2 million in cash to Shenzhen Mingshan for our proportion of the unpaid registered capital, which was required to be fully contributed within two years from the incorporation of Shenzhen Mingshan; (6) we also received approximately US\$1.1 million cash consideration from the majority shareholder of Beijing Yang Guang, which resulted from the disposal of our 49% equity interest in Beijing Yang Guang to him in August 2011; and (7) we also spent approximately US\$2.2 million for the acquisition of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He. Net cash used in investing activities for the nine months ended September 30, 2010, which was approximately US\$0.45 million, was mainly the cash used for purchasing of computers and other office equipment.

Net cash provided by (used in) financing activities: Our net cash provided by financing activities for the nine months ended September 30, 2011 was approximately US\$0.003 million which mainly consisted of the following transactions: (1) cash dividends paid to our preferred stockholders of approximately US\$0.377 million; and (2) cash contributed by the noncontrolling interest shareholders of Beijing Chuang Fu Tian Xi, Zhao Shang Ke Hubei and Sheng Tian Hubei for approximately US\$0.374 million in the aggregate, in connection with the incorporation of these companies. Net cash used in financing activities was approximately US\$2.7 million for the nine months ended September 30, 2010, which mainly consisted of the following transactions: (1) cash dividends paid to our preferred



stockholders of approximately US\$0.61 million; and (2) cash contributed by the noncontrolling interest of Shenzhen Mingshan of approximately US\$0.14 million; and (3) a temporary loan to third parties for approximately US\$2.26 million, which was collected in October and December 2010.

## Restricted Net Assets

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

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

As a result of these PRC laws and regulations, our PRC subsidiary and VIEs are restricted in their ability to transfer a portion of their net assets to us. As of September 30, 2011 and December 31, 2010, net assets restricted in the aggregate, which includes paid-in capital and statutory reserve funds of our PRC subsidiary and VIEs that are included in our consolidated net assets, was approximately US\$3.9 million and US\$3.2 million, respectively.

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

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

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

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

Currently, under the Administration Rules, Renminbi is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the State Administration of Foreign Exchange (the "SAFE") is obtained and prior

registration with the SAFE is made. Foreign-invested enterprises like Rise King WFOE that need foreign exchange for the distribution of profits to its shareholders may effect payment from their foreign exchange accounts or purchase and pay foreign exchange rates at the designated foreign exchange banks to their foreign shareholders by producing board resolutions for such profit distribution. Based on their needs, foreign-invested enterprises are permitted to open foreign exchange settlement accounts for current account receipts and payments of foreign exchange along with specialized accounts for capital account receipts and payments of foreign exchange at certain designated foreign exchange banks.

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

As of September 30, 2011 and December 31, 2010, there were approximately US\$33.5 and US\$26 million retained earnings in the aggregate, respectively, which were generated by our PRC subsidiary and VIEs in Renminbi included in our consolidated net assets, aside from the \$1.6 million statutory reserve funds, that may be affected by increased restrictions on currency exchanges in the future and accordingly may further limit our PRC subsidiary' or VIEs' ability to make dividends or other payments in U.S. dollars to us, in addition to the approximately US\$3.9 million and US\$3.2 million restricted net assets, respectively, as discussed above.

### C. OFF BALANCE SHEET ARRANGEMENTS

Our Company did not have any significant off-balance sheet arrangements as of September 30, 2011.

### D. Tabular Disclosure of Contractual Obligations

The following table sets forth our contractual obligations as of September 30, 2011:

	Office Rental US\$('000)	Server hosting and board-band lease US\$('000)	Purchase of TV advertisement time US\$('000)	Purchase of internet advertisement resources US\$('000)	Total US\$('000)
Three months ending December 31, -2011	99	74	1,055	65	1,293
For the year ending December 31, -2012	382	113	-	-	495
-2013	509	-	-	-	509
-2014	509	-	-	-	509
-2015	509	-	-	-	509
-2016	340	-	-	-	340
Total	2,348	187	1,055	65	3,655

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable to smaller reporting companies.



#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the fiscal quarter ended September 30, 2011, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based on this evaluation, our principal executive officer and principal financial officer have concluded that during the period covered by this report, the Company's disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed by us in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

##### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the third fiscal quarter of 2011 covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

We are currently not a party to any legal or administrative proceedings and are not aware of any pending or threatened legal or administrative proceedings against us in all material aspects. We may from time to time become a party to various legal or administrative proceedings arising in the ordinary course of our business.

#### Item 1A. Risk Factors

This information has been omitted based on the Company's status as a smaller reporting company.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

#### Item 3. Defaults Upon Senior Securities

None.

#### Item 4. Removed and Reserved

#### Item 5. Other Information

None.



Item 6. Exhibits

Exhibit	Document Description
No.	
31.1	Certification of the Principal Executive Officer pursuant to Rule 13A-14(A)/15D-14(A) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Accounting and Financial Officer pursuant to Rule 13A-14(A)/15D-14(A) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Principal Executive Officer and of the Principal Accounting and Financial Officer pursuant to 18 U.S.C. 1350 (Section 906 of the Sarbanes-Oxley Act of 2002).
101	Interactive Data Files



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHINANET ONLINE HOLDINGS, INC.

Date: November 18, 2011

By: /s/ Handong Cheng

Name: Handong Cheng  
Title: Chief Executive Officer  
(Principal Executive Officer)

By:/s/ Zhige Zhang  
Name: Zhige Zhang  
Title: Chief Financial Officer  
(Principal Financial Officer)