ChinaNet Online Holdings, Inc.
Form 10-Q
May 16, 2011

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

FORM 10-Q

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

For the quarterly period ended March 31, 2011

or

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

For the transition period from ____ to _____

Commission File Number: 000-52672

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

Nevada	20-4672080
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices) (Zip Code)

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

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

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

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

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

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

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

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

As of May 13, 2011 the registrant had 17,560,333 shares of common stock outstanding.

TABLE OF CONTENTS

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

	March 31, 2011 (US $) (Unaudited)	December 31, 2010 (US $)
Assets		
Current assets:		
Cash and cash equivalents	$ 17,630	$ 15,590
Accounts receivable	5,720	4,319
Other receivables	4,185	7,811
Prepayment and deposit to suppliers	3,393	3,325
Due from equity investment affiliates	49	-
Due from related parties	376	185
Deposit for acquisitions	-	1,512
Inventories	2	2
Other current assets	48	29
Total current assets	31,403	32,773
Investment in and advance to equity investment affiliates	9,293	7,162
Property and equipment, net	1,923	2,010
Acquired intangible assets, net	1,946	51
Goodwill	1,900	-
Total Assets	$ 46,465	$ 41,996
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 510	$ 174
Advances from customers	867	2,120
Other payables	69	10
Accrued payroll and other accruals	390	470
Payable for acquisitions	950	-
Due to related parties	155	291
Due to Control Group	82	81
Due to director	156	559
Taxes payable	2,609	2,193
Dividend payable	253	255
Total current liabilities	6,041	6,153
Long-term liabilities:		
Deferred tax liability-non current	472	-
Long-term borrowing from director	133	132
Total Liabilities	6,646	6,285
Commitments and contingencies		

3

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

	March 31, 2011 (US $) (Unaudited)	December 31, 2010 (US $)
Equity:		
Series A convertible preferred stock (US$0.001 par value; authorized 8,000,000 shares; issued and outstanding 2,621,684 and 2,877,600 shares at March 31, 2011 and December 31, 2010, respectively; aggregate liquidation preference amount: $6,807 and $7,449, including accrued but unpaid dividends of $253 and $255, at March 31, 2011 and December 31, 2010, respectively)	3	3
Common stock (US$0.001 par value; authorized 50,000,000 shares; issued and outstanding 17,358,236 shares and 17,102,320 shares at March 31, 2011 and December 31, 2010, respectively)	17	17
Additional paid-in capital	18,721	18,614
Statutory reserves	1,587	1,587
Retained earnings	17,273	14,630
Accumulated other comprehensive income	1,123	930
Total ChinaNet Online Holdings, Inc.'s stockholders' equity	38,724	35,781
Noncontrolling interest	1,095	(70)
Total equity	39,819	35,711
Total Liabilities and Equity	$46,465	$ 41,996

See notes to consolidated financial statements

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

	Three months ended March 31, 2011 (US $) (Unaudited)	2010 (US $) (Unaudited)
Sales		
From unrelated parties	6,834	$ 10,034
From related parties	190	194
	7,024	10,228
Cost of sales		
From unrelated parties	1,866	6,727
From related parties	164	-
	2,030	6,727
Gross margin	4,994	3,501
Operating expenses		
Selling expenses	713	427
General and administrative expenses	890	794
Research and development expenses	353	134
	1,956	1,355
Income from operations	3,038	2,146
Other income (expenses)		
Changes in fair value of warrants	-	1,861
Interest income	1	2
Share of earnings (losses) in equity investment affiliates	(47)	-
Gain on deconsolidation of subsidiary	229	-
Other income	6	-
	189	1,863
Income before income tax expense and noncontrolling interest	3,227	4,009
Income tax expense	431	214
Net income	2,796	3,795
Net losses attributable to noncontrolling interest	16	-
Net income attributable to ChinaNet Online Holdings, Inc.	2,812	3,795

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

	Three months ended March 31,	
	2011	2010
	(US $)	(US $)
	(Unaudited)	(Unaudited)
Net income attributable to ChinaNet Online Holdings, Inc.	$ 2,812	$ 3,795
Dividend of Series A convertible preferred stock	(169)	(229)
Net income attributable to common stockholders of ChinaNet Online Holdings, Inc.	$ 2,643	$ 3,566
Earnings per share		
Earnings per common share		
Basic	$ 0.15	$ 0.22
Diluted	$ 0.14	$ 0.18
Weighted average number of common shares outstanding:		
Basic	17,244,315	16,234,409
Diluted	20,819,982	21,059,683
Comprehensive Income		
Net income	2,796	3,795
Foreign currency translation gain	196	3
	2,992	$ 3,798
Comprehensive Income		
Comprehensive income / (loss) attributable to noncontrolling interest	(13)	-
Comprehensive income attributable to ChinaNet’s Online Holdings, Inc.	3,005	3,798
	$ 2,992	$ 3,798

See notes to consolidated financial statements

6

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

	Three months ended March 31, 2011 (US $) (Unaudited)	2010 (US $) (Unaudited)
Cash flows from operating activities		
Net income	$ 2,796	$ 3,795
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and Amortization	199	92
Share-based compensation expenses	107	63
Changes in fair value of warrants	-	(1,861)
Share of losses in equity investment affiliates	47	-
Gain on deconsolidation of subsidiary	(229)	-
Gain on disposal of property and equipment	(3)	-
Deferred taxes	(15)	-
Changes in operating assets and liabilities		
Accounts receivable	(1,302)	(1,062)
Other receivables	3,691	1,979
Prepayment and deposit to suppliers	(162)	(1,770)
Due from equity investment affiliates	(49)	-
Due from related parties	(149)	331
Other current assets	(19)	(430)
Accounts payable	336	212
Advances from customers	(1,263)	(486)
Accrued payroll and other accruals	(60)	75
Due to Control Group	-	(4)
Due to director	(403)	63
Due to related parties	(137)	(24)
Other payables	39	(16)
Taxes payable	397	(701)
Net cash provided by operating activities	3,821	256
Cash flows from investing activities		
Purchases of property and equipment	(57)	(31)
Purchase of intangible assets	(11)	-
Cash from acquisition of subsidiaries	24	-
Cash effect on deconsolidation of a subsidiary	(181)	-
Advance to equity investment affiliates	(1,518)	-
Net cash used in investing activities	(1,743)	(31)

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

	Three months ended March 31, 2011 (US $) (Unaudited)	2010 (US $) (Unaudited)
Cash flows from financing activities		
Cash investment contributed by noncontrolling interest	74	-
Dividend paid to Series A convertible preferred stockholders	(171)	(285)
Increase of short-term loan to third parties	-	(1,463)
Net cash used in financing activities	(97)	(1,748)
Effect of exchange rate fluctuation on cash and cash equivalents	59	1
Net increase (decrease) in cash and cash equivalents	2,040	(1,522)
Cash and cash equivalents at beginning of the period	15,590	13,917
Cash and cash equivalents at end of the period	$ 17,630	$ 12,395
Supplemental disclosure of cash flow information		
Interest paid	$ -	$ -
Income taxes paid	$ 22	$ 1,019
Non-cash transactions:		
Warrant liability reclassify to additional paid in capital	$ -	$ 7,703
Restricted stock and options granted for future service	$ 193	$ 234

See notes to consolidated financial statements

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

1. Organization and nature of operations

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

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

The Company's wholly owned subsidiary, China Net BVI was incorporated in the British Virgin Islands on August 13, 2007. On April 11, 2008, China Net BVI became the parent holding company of a group of companies comprised of CNET Online Technology Limited, a Hong Kong company ("China Net HK"), which established and is the parent company of Rise King Century Technology Development (Beijing) Co., Ltd., a wholly foreign-owned enterprise ("WFOE") established in the PRC ("Rise King WFOE"). The Company refers to the transactions that resulted in China Net BVI becoming an indirect parent company of Rise King WFOE as the "Offshore Restructuring."

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 advertisement business. In October 2008, a series of contractual arrangements (the "Contractual Agreements") were entered between 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 Subsidiaries") 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 Subsidiaries' 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 Subsidiaries. In return, Rise King WFOE provides consulting services to the PRC Operating Subsidiaries. In addition, to ensure that the PRC Operating Subsidiaries and the PRC Shareholders perform their obligations under the Contractual Arrangements, the PRC Shareholders pledged to Rise King WFOE all of their equity interests in the PRC Operating Subsidiaries. They 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 Subsidiaries directly.

At the time the above Contractual Agreements were signed, the controlling shareholder of China Net BVI was Rise King BVI, who holds 55% of the Company’s common stock. The sole registered shareholder of Rise King BVI, Mr. Yang Li, who owned 10,000 common stock of Rising King BVI, entered into slow-walk agreements with the Control Group individuals respectively, 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 nominee for Mr. Zhang Zhige) 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 subsidiaries and affiliates (“the Group”) generates at least RMB 100,000,000 of the gross revenue for twelve months commencing from January 1, 2009 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 from January 1, 2010 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 from July 1, 2010 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 could have exercised the Option at the Alternative Exercise Price (which was US$ 2 per share), on the date that the Acquisition was completed or abandoned. Each Control Group individual could have purchased 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.

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

The Control Group individuals also entered an Entrustment Agreement with Rise King BVI collectively, 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 authorizing 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 reduction of the authorized capital/registered capital, issuing company bonds, merger, division, dissolution, liquidation of the Group or change of Group’s 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 agrees and confirms 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. The Entrustment Period commenced on the execution date of the agreement and was effective within a period of ten years, unless earlier terminated.

As described above, each of Mssrs. 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 the 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 the Company. On March 30, 2011, each of Mssrs. 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 PRC Operating Subsidiaries 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 PRC Operating Subsidiaries, and Rise King WFOE's ability to extract the profits from the operation of the PRC Operating Subsidiaries, and assume the residual benefits of the PRC Operating Subsidiaries. Because Rise King WFOE and its indirect parent are the sole interest holders of the PRC Operating Subsidiaries, the PRC Operating Subsidiaries are under common control with the Group, thus, China Net BVI consolidates the PRC Operating Subsidiaries from its inception, 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 the common stock of the Company. The transaction was regarded as a reverse acquisition whereby China Net BVI was considered to be the accounting acquirer as its shareholders retained control of the Company after the Share Exchange, although the Company is the legal parent company. The share exchange was treated as a recapitalization of the Company. As such, China Net BVI (and its historical financial statements) is the continuing entity for financial reporting purposes. Following the Share Exchange, the company changed its name from Emazing Interactive, Inc. to ChinaNet Online Holdings, Inc. The financial statements have been prepared as if China Net BVI had always been the reporting company and then on the share exchange date, had changed its name and reorganized its capital stock.

As of the date of the Share Exchange, through the above Contractual Agreements, the Company operates its business in China primarily through Business Opportunity Online and 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.

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

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 as a stand-alone business due to the lack of an advertisement business license and supporting financial resources. Pursuant to the aforementioned cooperation agreements, Beijing CNET Online committed to purchase equipment, and to provide working capital, technical and other related support to Shanghai Borongdingsi. Beijing CNET Online owns the equipment used in the kiosk business, is entitled to sign contracts in its name on behalf of the business, and holds the right to collect the advertisement revenue generated from the bank kiosk business exclusively until the recovery of the cost of purchase of the equipment. Thereafter, Beijing CNET Online has agreed to distribute 49% of the succeeding net profit generated from the bank kiosk advertising business, if any, to the minority shareholders of Shanghai Borongdingsi.

On 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 the Company, through its wholly owned subsidiary, Rise 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 were 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 the Company’s consolidated financial statements with no goodwill recognized in accordance to ASC Topic 810 “Consolidation”.

The Company, through one of its PRC operating subsidiaries, 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 (see Note 3). 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 the Company an entry into the Fujian Province, a base of fast growing small and medium enterprises and having a complete suite of marketing and franchise promotion services allows the Company to expand its market opportunity from franchises, dealerships and merchants looking to expand their businesses domestically in China.

On January 28, 2011, one of the Company’s PRC operating subsidiaries, 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, one of the Company's PRC operating subsidiaries, Business Opportunity Online, together with an individual, who was not affiliated with the Company, 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. 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 the above mentioned domain names. As of March 31, 2011, the above two mentioned websites were still under development and should be fully available by the end of June 2011.

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

On June 24, 2010, one of the Company's PRC operating subsidiaries, Business Opportunity Online, together with three other individuals, who were not affiliated with the Company, 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 of 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. As of March 31, 2011, Business Opportunity Online has invested RMB4,020,000 (approximately US$611,863) in Shenzhen Mingshan. On January 6, 2011, as approved by the shareholders of Shenzhen Mingshan, an independent third party investor, who was not affiliated with the Company, 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 and RMB5,000,000 to RMB25,000,000 and RMB20,000,000, respectively. Therefore, from January 6, 2011, the new investor became the majority shareholder of Shenzhen Mingshan. The Company's share of the equity interest in ShenZhen Minshan decreased from 51% to 20.4% and the Company ceased to have a controlling financial interest in ShenZhen Mingshan, but still retains an investment in and significant influence over Shenzhen Mingshan.

On December 8, 2010, the Company, through one of its PRC operating subsidiaries, Shanghai Jing Yang acquired a 49% interest of a newly established company, Beijing Yang Guang Media Investment Co., Ltd. ("Beijing Yang Guang") for cash consideration of RMB 7,350,000 (approximately US$1,118,704), which represents 49% of Beijing Yang Guang's paid-in capital and net assets of RMB15,000,000. The investment in Beijing Yang Guang provided the Company with the synergy to leverage lower TV time resources and hence improve the performance of the TV advertisement business segment and increase revenue from the Company's customers as a result of an additional value–added advertising and marketing channels to subscribe on the top of Internet.

As of March 31, 2011, the Company operated its business primarily in China through the above mentioned subsidiaries and investees. From time to time, the Company refers to them collectively as "PRC operating entities".

2. Summary of significant accounting policies

a) Basis of presentation

The consolidated interim financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The consolidated interim financial information as of March 31, 2011 and for the three months ended March 31, 2011 and 2010 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have not been included. The interim consolidated financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company's consolidated financial position as of March 31, 2011, its consolidated results of operations and cash flows for the three months ended March 31, 2011 and 2010, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

b) Principles of Consolidation

The consolidated financial statements include the financial statements of all the subsidiaries of the Company. All transactions and balances between the Company and its subsidiaries have been eliminated upon consolidation. According to the agreements between Beijing CNET Online and Shanghai Borongdingsi, although Beijing CNET Online legally owns 51% of Shanghai Borongdingsi's interests, Beijing CNET Online only controls the assets and liabilities related to the bank kiosks business, which has been included in the financial statements of Beijing CNET Online, but does not control other assets of Shanghai Borongdingsi, thus, Shanghai Borongdingsi's financial statements were not consolidated by the Company.

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

c) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the related disclosure of contingent assets and liabilities at the date of these consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company continually evaluates these estimates and assumptions based on the most recently available information, historical experience and various other assumptions that the Company 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.

d) Foreign currency translation and transactions

The functional currency of the Company's US holding company is United States dollars ("US$"), and the functional currency of China Net HK is Hong Kong dollars ("HK$"). The functional currency of the Company's PRC operating subsidiaries is Renminbi ("RMB"), and PRC is the primary economic environment in which the Company operates.

For financial reporting purposes, the financial statements of the Company's PRC operating subsidiaries, which are prepared using the RMB, are translated into the Company's 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 stockholders' equity is translated at historical exchange rates. Adjustments resulting from the translation are recorded as a separate component of accumulated other comprehensive income in stockholders' equity.

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

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

	March 31, 2011	December 31, 2010
Balance sheet items, except for equity accounts	6.5701	6.6118
	Three months ended March 31,	
	2011	2010
Items in the statements of income and comprehensive income, and statements cash flows	6.5894	6.8360

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

e) Cash and cash equivalents

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

f) Accounts receivable

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

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

g) Inventories

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

h) Investment in equity investment affiliates

Investee companies that are not consolidated, but over which the Company exercises 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 the Company exercises 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 the Company's consolidated balance sheets and statements of income and comprehensive income; however, the Company's 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. The Company's carrying value (including advance to the investee) in equity method investee companies is reflected in the caption "Investment in and advance to equity investment affiliates" in the Company's consolidated balance sheets.

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

i) Property and equipment, net

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

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

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

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

j) Acquired intangible assets, net

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

Intangible assets other than goodwill acquired through various acquisitions (see Note 3) are amortized on a straight-line basis over their expected useful economic lives.

If an acquired intangible asset is determined to have an indefinite useful life, it should not be amortized until its useful life is determined to be no longer indefinite. The Company reviews intangible assets' remaining useful lives in each reporting period. If such an asset is later determined to have a finite useful life, the asset will be tested for impairment. That asset will then be amortized prospectively over its estimated remaining useful life and accounted for in the same way as intangible assets subject to amortization.

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

k) Impairment of long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment loss is recognized for the difference between the carrying amount of the asset and its fair value.

For the three months ended March 31, 2011 and 2010, the Company did not record any impairment losses associated with long-lived assets.

l) Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its 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.

m) Deconsolidation

The Company accounts for deconsolidation of a subsidiary in accordance with ASC Topic 810 “Consolidation”.

In accordance with ASC Topic 810-10-40-5, the parent shall account for the deconsolidation of a subsidiary by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:

a. The aggregate of all of the following:

1. The fair value of any consideration received;

2. The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated;

3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.

b. The carrying amount of the former subsidiary's assets and liabilities.

n) Revenue recognition

The Company's revenue recognition policies are in compliance with ASC Topic 605 "Revenue Recognition". In accordance with ASC Topic 605, revenues are recognized when the 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.

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

Sales include revenues from reselling of advertising time purchased from TV stations and internet advertising, reselling of internet advertising spaces and other advertisement related resources. 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, the Company provides 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, the Company considers the services to have been delivered. The Company treats all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Based upon the Company's credit assessments of its customers prior to entering into contracts, the Company determines if collectability is reasonably assured. In situations where collectability is not deemed to be reasonably assured, the Company recognizes revenue upon receipt of cash from customers, only after services have been provided and all other criteria for revenue recognition have been met.

o) Cost of sales

Cost of sales primarily includes the cost of media advertising time, internet advertisement related resources and other technical services purchased and PRC business tax.

p) Advertising costs

Advertising costs for the Company's own brand building are not includable in cost of sales, they are expensed when incurred or amortized over the estimated beneficial period and are included in "selling expenses" in the statement of income and comprehensive income. For the three months ended March 31, 2011 and 2010, advertising expenses for the Company's own brand building were approximately US$465,000 and US$252,000, respectively.

q) Research and development expenses

Research and development costs are charged to expense when incurred. Expenses for research and development for the three months ended March 31, 2011 and 2010 were approximately US$353,000 and US$134,000, respectively.

r) Income taxes

The Company adopted ASC Topic 740 "Income taxes" and uses the liability method to account for income taxes. Under this method, deferred tax assets and liabilities are determined based on the difference between 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. The Company records 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.

s) Uncertain tax positions

The Company 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 three months ended March 31, 2011 and 2010, the Company did not have any interest and penalties associated with tax positions and did not have any significant unrecognized uncertain tax positions.

t) Share-based Compensation

The Company accounts for share-based compensation in accordance with ASC Topic 718 “Compensation-Stock Compensation” which requires that share-based payment transactions be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period, or vesting period.

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

u) Noncontrolling interest

The Company accounts for noncontrolling interests in accordance with ASC Topic 810-10-45, which requires the Company to present noncontrolling interests (previously referred to as minority interests) as a separate component of total shareholders' equity on the consolidated balance sheet and the consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the consolidated income and comprehensive income statement. ASC Topic 810-10-45 also requires that losses attributable to the parent and the noncontrolling interest in a subsidiary be attributed to those interests even if it results in a deficit noncontrolling interest balance.

v) Comprehensive income

The Company accounts for comprehensive income in accordance with ASC Topic 220 "Comprehensive Income", which establishes standards for reporting and displaying comprehensive income and its components in the consolidated financial statements. Comprehensive income is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. Accumulated other comprehensive income, as presented on the accompanying consolidated balance sheets are the cumulative foreign currency translation adjustments.

w) Earnings / (loss) per share

Earnings / (loss) per share are calculated in accordance with ASC Topic 260, "Earnings Per Share". Basic earnings per share is computed by dividing income attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Common shares issuable upon the conversion of the convertible preferred shares are included in the computation of diluted earnings per share on an "if-converted" basis when the impact is dilutive. The dilutive effect of outstanding common stock warrants is reflected in the diluted earnings per share by application of the treasury stock method when the impact is dilutive.

x) Commitments and contingencies

The Company has adopted ASC 450 "Contingencies" subtopic 20, in determining its accruals and disclosures with respect to loss contingencies. Accordingly, estimated losses from loss contingencies are accrued by a charge to income when information available prior to issuance of the financial statements indicates that it is probable that a liability have been incurred and the amount of the loss can be reasonably estimated. Legal expenses associated with the contingency are expensed as incurred. If a loss contingency is not probable or reasonably estimable, disclosure of the loss contingency is made in the financial statements when it is at least reasonably possible that a material loss could be incurred.

y) Fair value measurements

The Company's financial instruments primarily consist of cash and cash equivalents, accounts receivable, other receivables, prepayment and deposits, accounts payable, advances from customers, accruals and other payables. The carrying values of these financial instruments approximate fair values due to their short maturities.

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

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

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

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

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

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

z) Recent accounting pronouncements affecting the Company

Accounting standards that have been issued or proposed by the Financial Accounting Standards Board ("FASB") recently are not applicable to the Company.

3.Acquisitions

As described in Note 1, the acquisition of a 100% equity interest of Quanzhou Zhi Yuan and the acquisition of a 51% equity interest of Quanzhou Tian Xi Shun He were consummated on January 4, 2011 and February 23, 2011, respectively. Each acquisition was accounted for using the purchase method of accounting in accordance with ASC Topic 805 "Business Combinations", and accordingly the acquired assets and liabilities were recorded at their fair values on the dates of acquisitions and the results of their operations have been included in the Company's results of operations since the dates of their acquisitions. The Income approach is applied for identifiable intangible assets and non-controlling interests' valuation. The Monte Carlo simulation is applied for the valuation of contingent consideration. Contingent consideration arose from a term stipulated in the acquisition agreements with the sellers, which was that if pretax profit for 2012 and 2011 increases by less than 30% while compared to audited pretax profit of the prior year, the sellers need to compensate the acquirer for the difference between target pretax profit and actual result achieved then.

The income approach explicitly recognises that the current value of an asset is premised upon the expected receipt of future economic benefits focusing on the income producing capability of a business or an asset. It measures the current value of a business or asset by calculating the present value of its future economic benefits such as earnings, cost savings, tax deduction, and proceeds from disposition. Indications of value are developed by discounting these benefits to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation, and risk associated with the particular investment which reflects both current return requirements of the market and specific investment. The discount rate selected is generally based on rates of return available from alternative investments of similar type and quality as of each assessment date.

Acquisition of Quanzhou Zhi Yuan

On December 18, 2010, the Company, through one of its PRC operating subsidiaries, Beijing CNET Online entered into an equity interest acquisition agreement with the shareholders of Quanzhou Zhi Yuan. According to the acquisition agreement, the Company agreed to pay an aggregate cash consideration of RMB9,500,000 (approximately US$1,446,000) in exchange for a 100% equity interest of Quanzhou Zhi Yuan. The Company prepaid a deposit of RMB6,500,000 (approximately US$983,000) of the cash consideration to an independent agent who was entrusted by both of the counter-parties upon signing the agreement, the shareholders of Quanzhou Zhi Yuan would then fulfill the related obligations and process the relevant legal procedures and formalities as required in the acquisition agreements to complete the transaction. On January 4, 2011, the acquisition of a 100% equity interest of Quanzhou Zhi Yuan were approved and registered with the relevant PRC government authorities of Quanzhou City, Fujian Provision, and the prepaid cash consideration deposit was released to the shareholders of the Quanzhou Zhi Yuan accordingly. The Company determined the acquisition date of Quanzhou Zhi Yuan as of January 4, 2011, because this was the date both counter-parties had completed their obligations and received the corresponding benefits as outlined in the acquisition agreements and also the date the control of the acquiree were officially and legally transferred to the Company in fact.

The following table summarizes the preliminary purchase price allocation as of January 4, 2011:

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

	Fair Value US$('000)	Amortization Period (Years)
Cash and cash equivalents	$ 11	
Accounts receivables	17	
Property and equipment, net	57	
Other current liabilities	(13)	
Deferred tax liabilities	(196)	
Acquired intangible assets:		
Trade Name	113	Indefinite
Contract Backlog	18	0.7
Customer Relationship	547	8
Non-Compete Agreement	106	5
Goodwill:		
Assembled Workforce	20	
Other unidentifiable intangibles	708	
	728	
Total Value	$ 1,388	
Purchase price	$ 1,440	
Contingent returnable consideration	(52)	
Total amount to be allocated	$ 1,388	

Acquisition of Quanzhou Tian Xi Shun He

On December 22, 2010, the Company, through one of its PRC operating subsidiaries, Beijing CNET Online entered into an equity interest acquisition agreement with the shareholders of Quanzhou Tian Xi Shun He. According to the acquisition agreement, the Company agreed to pay an aggregate cash consideration of RMB7,500,000 (approximately US$1,142,000) in exchange for a 51% equity interest of Quanzhou Tian Xi Shun He. The Company prepaid a deposit of RMB3,500,000 (approximately US$529,000) of the cash consideration to an independent agent who was entrusted by both of the counter-parties upon signing the agreement, the shareholders of Quanzhou Tian Xi Shun He would then fulfill the related obligations and process the relevant legal procedures and formalities as required in the acquisition agreements to complete the transaction. On February 23, 2011, the acquisition of a 51% equity interest of Quanzhou Tian Xi Shun He were approved and registered with the relevant PRC government authorities of Quanzhou City, Fujian Provision, and the prepaid cash consideration deposit was released to the shareholders of the Quanzhou Tian Xi Shun He. The Company determined the acquisition date of Quanzhou Zhi Yuan as of February 23, 2011, because this was the date both counter-parties had completed their obligations and received the corresponding benefits as outlined in the acquisition agreements and also the date the control of the acquiree was officially and legally transferred to the Company in fact.

The following table summarized the preliminary purchase price allocation as of February 23, 2011:

	Fair Value US$('000)	Amortization Period (Years)

Cash and cash equivalents	$	12		
Accounts receivables and other receivables		55		
Property and equipment, net		41		
Other current liabilities		(34	)	
Deferred tax liabilities		(289	)	
Acquired intangible assets:				
Trade Name		182		Indefinite
Contract Backlog		170	0.6	
Customer Relationship		722	9	
Non-Compete Agreement		83	5	
Goodwill:				
Assembled Workforce		23		
Other unidentifiable intangibles		1,143		
		1,166		
Total Value		2,108		
Purchase price		1,138		
Fair value of non-controlling interest		1,034		
Contingent returnable consideration		(64	)	
Total amount to be allocated		2,108		

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

Based on the Company's assessment of the acquired companies' financial performance on its own or in total, it is not considered material to the Company. Thus the Company believes that the presentation of pro forma financial information with regard to a summary of the results of operations of the Company for the business combination is not necessary.

4. Cash and cash equivalents

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Cash on hand	73	39
Bank deposit	17,557	15,551
	17,630	15,590

5. Accounts receivable

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Accounts receivable	5,720	4,319
Allowance for doubtful debts	-	-
Accounts receivable, net	5,720	4,319

All of the accounts receivable are non-interest bearing. As of May 12, 2011, approximately US$2,505,000 of the Company's accounts receivable had been subsequently collected. Management believes that there will not be any collectability issue about these accounts receivable, therefore no allowance for doubtful accounts is required for the three months ended March 31, 2011.

6. Other receivables

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Short-term loan for marketing campaign	3,805	3,781
Short-term loans to third parties	304	3,781
Staff advances for normal business purpose	76	249
	4,185	7,811

20

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

Short-term loan for marketing campaign: for one of its major marketing campaigns, the Company made a marketing-related loan of RMB25,000,000 to a TV series of 36 episodes, called "Xiao Zhang Feng Yun". This TV series is produced for the commemoration of "The Republican Revolution of 1911" (the Chinese bourgeois democratic revolution led by Dr. Sun Yat-sen which overthrew the Qing Dynasty) and will be broadcasted on one or more of the CCTV channels and some of the provincial TV channels in year 2011. Year 2011 is the 100th Anniversary of the "Revolution of 1911" and hence, by participating in this TV series, the Company will gain the advertisement space on the closing of each episode. This loan had a length of approximately one year and is expected to have a return rate of 20%.

The Company loaned third parties on a subjective condition of search and/or obtain other potential value added communication channel resources with lower cost. Any of the third parties is required to pay back the capital within three month or on demand if no search contributed. The acquired resources are mainly used to self-advertising and marketing or advertising for clients in internet bundle packages in second and third tier cities or regions.

Management believes no allowance for doubtful accounts is required for these other receivables for the three months ended March 31, 2011.

7. Prepayments and deposit to suppliers

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Contract execution guarantees to TV advertisement and internet resources providers	2,631	2,778
Prepayments to TV advertisement and internet resources providers	745	413
Prepayment to online game operating service provider	-	91
Other deposits and prepayments	17	43
	3,393	3,325

Contract execution guarantee to TV advertisement and internet resources providers are paid as a contractual deposit to the Company's service providers. These amounts will be used to offset the service fee that needs to be paid to the service providers in the last month of each contract period.

According to the contracts signed between the Company and its suppliers, the Company is normally required to pay the contract amount in advance. These prepayments will be transferred to cost of sales when the related services are provided.

8. Due from equity investment affiliates

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)

Shenzhen Mingshan	49	-

Shenzhen Mingshan is one the equity investment affiliates of the Company. Amounts due from Shenzhen Mingshan as of March 31, 2011 were mainly related to the hosted computer servers sold to Shenzhen Mingshan by the Company during the three months ended March 31, 2011.

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

9. Due from related parties

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Beijing Fengshangyinli Technology Co., Ltd.	114	-
Beijing Telijie Century Environmental Technology Co., Ltd.	90	39
Soyilianmei Advertising Co., Ltd.	172	146
	376	185

These related parties are directly or indirectly owned by the Control Group or the management of the Company. Control Group refers to Mr. Handong Cheng, Mr. Xuanfu Liu and Ms. Li Sun, the owners of the Company's PRC Operating Subsidiaries, Business Opportunities Online and Beijing CNET Online before the Offshore Restructuring.

Amount due from Soyilianmei Advertising Co., Ltd. was related to the internet advertising resources purchased by the Company on behalf of this related party. The rest of the related party balances were outstanding receivables for the advertising services the Company provided to these related parties.

10. Deposit for acquisitions

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Quanzhou Zhi Yuan	-	983
Quanzhou Tian Xi Shun He	-	529
	-	1,512

As described in Note 3, the Company prepaid RMB6,500,000 (approximately US$983,000) and RMB3,500,000 (approximately US$529,000) of the cash consideration for the acquisition of a 100% equity interest of Quanzhou Zhi Yuan and a 51% equity interest of Quanzhou Tian Xi Shun He, respectively, as deposits to an independent agent who was entrusted by both of the counter-parties upon signing the agreement. The shareholders of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He would then fulfill the related obligations and process the relevant legal procedures and formalities as required in the acquisition agreements to complete the transaction. As agreed by all parties, the completion dates of these acquisition transactions and the transfer of the control of the acquirees were the dates that the equity interest transfers were approved and registered with the relevant PRC government authorities and the prepaid cash consideration would be released to the shareholders of the acquirees on its respective transaction completion date. Therefore, as of December 31, 2010, the cash considerations repaid were recorded as deposit for acquisitions.

On January 4, 2011 and February 23, 2011, the acquisition of a 100% equity interest of Quanzhou Zhi Yuan and the acquisition of a 51% equity interest of Quanzhou Tian Xi Shun He were approved and registered with the relevant PRC government authorities of Quanzhou City, Fujian Provision, respectively, and the prepaid cash considerations deposits were released to the shareholders of the acquirees in accordance. The Company determined the acquisition dates of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He as of January 4, 2011 and February 23, 2011, respectively, and the prepaid cash deposits were accounted for as part of the purchase price allocation (see Note 3).

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

11. Investment in and advance to equity investment affiliates

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Investment in equity investment affiliates	1,683	1,112
Advance to equity investment affiliates	7,610	6,050
	9,293	7,162

The following table summarizes the movement of the investment in and advance to equity investment affiliates for the three months ended March 31, 2011:

	Beijing Yang Guang US$('000)	Shenzhen Mingshan US$('000)	Total US$('000)
Balance as of January 1, 2011 (audited)	7,162	-	7,162
Deconsolidation of Shenzhen Mingshan	-	381	381
Gain on deconsolidation of Shenzhen Mingshan	-	229	229
Advances to Beijing Yang Guang	1,522	-	1,522
Share of Gain (losses) in equity investment affiliates	17	(64)	(47)
Exchange realignment	45	1	46
Balances as of March 31, 2011 (unaudited)	8,746	547	9,293

As of March 31, 2011, the Company's equity investment affiliates included Beijing Yang Guang and Shenzhen Mingshan.

Beijing Yang Guang:

Beijing Yang Guang was incorporated on October 25, 2010. On December 8, 2010, one of the Company's PRC operating subsidiaries, Shanghai Jing Yang acquired a 49% interest in Beijing Yang Guang for cash consideration of RMB7,350,000 (approximately US$1,119,000) and became the noncontrolling interest holder of Beijing Yang Guang. The investment in Beijing Yang Guang was accounted for under the equity method. For the three months ended March 31, 2011, the Company recognized its pro-rata share of earnings in Beijing Yang Guang of approximately US$17,000, which was reflected in the caption of "Share of earnings (losses) in equity investment affiliates" in the Company's consolidated statements of income and comprehensive income with a corresponding increase to the carrying value of the investment in Beijing Yang Guang in the Company's consolidated balance sheet.

In order to facilitate the daily operation of Beijing Yang Guang and supplement the working capital deficit to conduct the TV advertisement business, the Company agreed to provide RMB60,000,000 (approximately US$9,132,000) of working capital loan in the aggregate to Beijing Yang Guang. As of March 31, 2011, the Company has provided RMB50,000,000 (approximately US$7,610,000) of working capital loan to Beijing Yang Guang. This working capital loan is interest-free and payment on demand. The term of this capital loan is subject to annual review and renewal at the end of each fiscal year. The loan will be repaid on demand for the amount requested or on an annual basis if not demanded in one single payment at the end of each fiscal year.

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

Shenzhen Mingshan:

Shenzhen Mingshan was incorporated on June 24, 2010 by one of the Company's operating subsidiaries, Business Opportunities Online and three other individuals who were not affiliated with the Company. Shenzhen Mingshan was 51% owned by the Company and was a consolidated subsidiary of the Company from the date of incorporation through January 6, 2011. On January 6, 2011, an independent third party investor invested RMB15,000,000 (approximately US$2,283,070) cash into Shenzhen Mingshan and hence obtained 60% equity interest of Shenzhen Mingshan. The Company's share of equity interest then decreased from 51% to 20.4%. The carrying value of the investment to Shenzhen Mingshan immediately after the deconsolidation which was approximately US$381,000 was included in the balance sheet as investment in equity investment affiliates.

The deconsolidation of Shenzhen Mingshan was accounted for in accordance to ASC Topic 810 "Consolidation". The Company recognized a gain of approximately US$229,000 upon deconsolidation of Shenzhen Mingshan, which has been recorded as a gain on deconsolidation of subsidiary in the Company's consolidated statements of income and comprehensive income with a corresponding increase in the carrying value of the investment in Shenzhen Mingshan in the Company's consolidated balance sheet. This gain represents the excess of the fair value of the Company's retained equity interest over its carrying value as of the date of deconsolidation.

The Company determined the estimated fair value of its retained equity interest in Shenzhen Mingshan based on the valuation of Shenzhen Mingshan used when an independent third party purchased equity in Shenzhen Mingshan, which purchase price was negotiated on an arm's length basis. Under these circumstances, the Company estimated the fair value of their non-controlling interest based on the fair value of controlling interest purchased by the independent thrid party.

The Company applied the equity method of accounting prospectively from the date immediately after the deconsolidation. For the three months ended March 31, 2011, the Company recognized its pro-rate share of losses in Shenzhen Mingshan of approximately US$64,000, which was reflected in the caption of "Share of earnings (losses) in equity investment affiliates" in the Company's consolidated statements of income and comprehensive income with a corresponding decrease to the carrying value of the investment in Shenzhen Mingshan in the Company's consolidated balance sheet.

12. Property and equipment, net

Property and equipment consist of the following:

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Vehicles	588	584
Office equipment	1,240	1,183
Electronic devices	975	969
Total property and equipment	2,803	2,736
Less: accumulated depreciation	880	726

	1,923	2,010

Depreciation expenses in aggregate for the three months ended March 31, 2011 and 2010 were approximately US$133,000 and $80,000, respectively.

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

13. Acquired intangible assets, net

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Intangible assets not subject to amortization:		
Trade Name	297	-
Intangible assets subject to amortization:		
Contract Backlog	189	-
Customer Relationship	1,274	-
Non-Compete Agreement	190	-
Computer software	73	61
Total acquired intangible assets	2,023	61
Less: accumulated amortization	77	10
	1,946	51

Contract backlog, Customer relationship and Non-compete agreement were acquired through the acquisition transactions of Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He as described in Note 3.

Amortization expenses in aggregate for the three months ended March 31, 2011 and 2010 were approximately US$66,000 and US$ nil, respectively.

Based on the carrying value of the finite-lived intangible assets acquired from Quanzhou Zhi Yuan and Quanzhou Tian Xi Shun He recorded as of March 31, 2011, and assuming no subsequent impairment of the underlying intangible assets, the estimated future amortization expenses for the nine months ended December 31, 2011 is approximately US$298,000, and approximately US$187,000 per annual from fiscal year 2012.

14. Goodwill

Changes in goodwill for the three months ended March 31, 2011 were as follows:

	Amount US$('000) (Unaudited)
Balance as of January 1, 2011	-
Acquisitions: (Note 3)	
Quanzhou Zhi Yuan	728
Quanzhou Tian Xi Shun He	1,166
Exchange realignment	6
Balance as of March 31, 2011	1,900

15. Accrued payroll and other accruals

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Accrued payroll and staff welfare	228	258
Accrued operating expenses	162	212
	390	470

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

16. Payable for acquisitions

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Quanzhou Zhi Yuan	405	-
Quanzhou Tian Xi Shun He	545	-
	950	-

As described in Note 3, Beijing CNET Online entered into an equity interest acquisition agreement with the shareholders of Quanzhou Zhi Yuan and Quanzhou Tian Xi Sun He on December 18, 2010 and December 22, 2010, respectively. According to the acquisition agreements, the Company agreed to pay an aggregate cash consideration of RMB9,500,000 and an aggregate cash consideration of RMB7,500,000 in exchange for a 100% equity interest of QuanZhou Zhi Yuan and a 51% of the equity interest of Quanzhou Tian Xi Shun He, respectively. In December 2010, the Company prepaid a deposit of RMB6,500,000 and RMB3,500,000 of the cash consideration for the acquisition of the 100% of equity interest of Quanzhou Zhi Yuan and 51% equity interest of Quanzhou Tian Xi Shun He, respectively, to an independent agent who was entrusted by both of the counter-parties upon signing the agreement. These two acquisition transactions were subsequently consummated on January 4, 2011 and February 23, 2011, respectively. The outstanding payments to the sellers were recorded as payable for acquisitions as of March 31, 2011. According to the acquisition agreements, if pretax profit for 2012 and 2011 increases by less than 30% while comparing to audited pretax profit of the prior year, the sellers needs to compensate the Company for the difference between the target pretax profit and actual results achieved. Fair value of the contingently returnable considerations for the acquisition of a 100% equity interest of Quanzhou Zhi Yuan and a 51% equity interest of Quan Zhou Tian Xi Shun He, which was approximately US$52,000 and US$64,000, respectively, were deducted from the payable for acquisitions.

17. Due to related parties

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Shiji Huigu Technology Investment Co., Ltd	-	91
Beijing Saimeiwei Food Equipments Technology Co., Ltd	3	3
Beijing Telijie Century Environmental Technology Co., Ltd.	-	45
Due to legal (nominal) shareholders of Shanghai Jing Yang	152	152
	155	291

The related parties listed above are directly or indirectly owned by the Control Group, the Company provided advertising services to them. The advance payments listed above are received from these parties for advertising services will be provided in the future periods.

Shanghai Jing Yang was incorporated in December 2009 by the Company's senior management. Prior to establishing the Contractual Agreements with the Company (see Note 1), the legal shareholders contributed RMB1,000,000 (approximately US$152,000) as the original paid-in capital of Shanghai Jing Yang upon incorporation. This balance will be return to the legal (nominal) shareholders of Shanghai Jing Yang by the end of December 31, 2011.

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

18. Due to Control Group

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)
Due to Control Group	82	81

Due to Control Group represents the outstanding balance that due to the Control Group for the costs and operating expenses paid by them on behalf of the Company during the years ended December 31, 2007 and 2008.

19. Due to director

	March 31, 2011 US$('000) (Unaudited)	December 31, 2010 US$('000)