

ASIAINFO-LINKAGE, INC  
Form 10-Q  
August 06, 2010  
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**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 June 30, 2010

or

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

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

Commission File Number 001-15713

**ASIAINFO-LINKAGE, INC.**

(Exact name of registrant as specified in its charter)

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**DELAWARE** **752506390**  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
**4TH FLOOR, ZHONGDIAN INFORMATION TOWER**

**6 ZHONGGUANCUN SOUTH STREET, HAI DIAN DISTRICT**

**BEIJING 100086, CHINA**

(Address of principal executive offices, including zip code)

**+8610 8216 6688**

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

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

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

The number of shares outstanding of the registrant's common stock as of August 4, 2010 was 74,171,779.

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ASIAINFO-LINKAGE, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2010

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ASIAINFO-LINKAGE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)****(In thousands, except share and per share amounts)**

|   | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |                |
|---|--------------------------------|---------------|------------------------------|----------------|
|   | 2010                           | 2009          | 2010                         | 2009           |
| <b>Revenues:</b>                                |                                |               |                              |                |
| Software products and solutions                 | \$ 59,120                      | \$ 47,151     | \$ 116,871                   | \$ 89,588      |
| Service   | 6,385                          | 5,931         | 10,289                       | 10,930         |
| Third-party hardware                            | 1,359                          | 5,486         | 3,169                        | 9,026          |
| <b>Total revenues</b>                           | <b>66,864</b>                  | <b>58,568</b> | <b>130,329</b>               | <b>109,544</b> |
| <b>Cost of revenues:</b>                        |                                |               |                              |                |
| Software products and solutions                 | 23,082                         | 22,609        | 43,851                       | 40,823         |
| Service   | 2,757                          | 1,967         | 4,712                        | 3,897          |
| Third-party hardware                            | 1,304                          | 5,210         | 3,030                        | 8,526          |
| <b>Total cost of revenues</b>                   | <b>27,143</b>                  | <b>29,786</b> | <b>51,593</b>                | <b>53,246</b>  |
| <b>Gross profit</b>                             | <b>39,721</b>                  | <b>28,782</b> | <b>78,736</b>                | <b>56,298</b>  |
| <b>Operating expenses:</b>                      |                                |               |                              |                |
| Sales and marketing                             | 10,807                         | 9,929         | 21,120                       | 20,466         |
| General and administrative                      | 4,598                          | 3,652         | 13,258                       | 7,218          |
| Research and development                        | 9,776                          | 8,792         | 18,772                       | 16,007         |
| <b>Total operating expenses</b>                 | <b>25,181</b>                  | <b>22,373</b> | <b>53,150</b>                | <b>43,691</b>  |
| <b>Income from operations</b>                   | <b>14,540</b>                  | <b>6,409</b>  | <b>25,586</b>                | <b>12,607</b>  |
| <b>Other income</b>                             |                                |               |                              |                |
| Interest income                                 | 741                            | 534           | 1,402                        | 1,158          |
| Dividend income                                 | 250                            | 3             | 254                          | 174            |
| Gain from sales of short-term investments       | 472                            | 1,210         | 472                          | 1,210          |
| Other income (expenses), net                    | (50)                           | 9             | (50)                         | (14)           |
| <b>Total other income, net</b>                  | <b>1,413</b>                   | <b>1,756</b>  | <b>2,078</b>                 | <b>2,528</b>   |
| <b>Income before provision for income taxes</b> | <b>15,953</b>                  | <b>8,165</b>  | <b>27,664</b>                | <b>15,135</b>  |
| <b>Provision for income taxes</b>               | <b>2,482</b>                   | <b>962</b>    | <b>4,271</b>                 | <b>2,147</b>   |
| <b>Net income</b>                               | <b>13,471</b>                  | <b>7,203</b>  | <b>23,393</b>                | <b>12,988</b>  |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Less: Net loss attributable to noncontrolling interest                 | (435)      | (2)        | (858)      | (7)        |
| Net income attributable to AsiaInfo-Linkage, Inc.                      | \$ 13,906  | 7,205      | 24,251     | \$ 12,995  |
| <b>Earnings per share:</b>   |            |            |            |            |
| Net income attributable to AsiaInfo-Linkage, Inc. common stockholders: |            |            |            |            |
| Basic  | \$ 0.29    | \$ 0.16    | \$ 0.51    | \$ 0.30    |
| Diluted  | \$ 0.29    | \$ 0.16    | \$ 0.50    | \$ 0.29    |
| <b>Weighted average shares used in computation:</b>                    |            |            |            |            |
| Basic  | 47,328,078 | 44,586,996 | 47,277,978 | 44,048,268 |
| Diluted  | 48,325,405 | 45,917,056 | 48,264,122 | 45,554,547 |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****ASIAINFO-LINKAGE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)****(In thousands, except share amounts)**

|   | June 30, 2010     | December 31, 2009 |
|---|-------------------|-------------------|
| <b>ASSETS</b>   |                   |                   |
| Current Assets:   |                   |                   |
| Cash and cash equivalents   | \$ 224,040        | \$ 238,553        |
| Restricted cash   | 5,924             | 5,540             |
| Short-term investments held-to-maturity securities  | 14,726            | 13,716            |
| Short-term investments available-for-sale securities  | 29,433            | 27,674            |
| Accounts receivable (net of allowances of \$4,794 and \$2,619 as of June 30, 2010 and December 31, 2009, respectively)  | 120,861           | 129,646           |
| Inventories, net  | 8,496             | 9,535             |
| Other receivables   | 3,326             | 2,841             |
| Deferred income tax assets current  | 2,968             | 2,968             |
| Prepaid expenses and other current assets   | 6,860             | 5,679             |
| <b>Total current assets</b>   | <b>416,634</b>    | <b>436,152</b>    |
| Long-term investments   | 4,696             | 4,696             |
| Property and equipment, net   | 2,991             | 2,989             |
| Other acquired intangible assets, net   | 4,788             | 3,818             |
| Deferred income tax assets non-current  | 2,161             | 2,161             |
| Goodwill  | 29,139            | 22,262            |
| Prepaid land use right and other long-term prepayment   | 10,189            | 9,699             |
| <b>Total assets</b>   | <b>\$ 470,598</b> | <b>\$ 481,777</b> |
| <b>LIABILITIES AND EQUITY</b>   |                   |                   |
| Current Liabilities:  |                   |                   |
| Accounts payable  | \$ 51,379         | \$ 76,019         |
| Accrued expenses  | 25,552            | 21,793            |
| Deferred revenue  | 31,448            | 45,547            |
| Accrued employee benefits   | 29,797            | 39,403            |
| Other payables  | 6,552             | 6,187             |
| Income taxes payable  | 1,955             | 2,862             |
| Other taxes payable   | 7,678             | 7,620             |
| Deferred income tax liabilities current   | 1,818             | 1,340             |
| <b>Total current liabilities</b>  | <b>156,179</b>    | <b>200,771</b>    |
| Unrecognized tax benefits non-current   | 3,205             | 3,052             |
| Other long-term liabilities   | 163               | 163               |
| <b>Total liabilities</b>  | <b>159,547</b>    | <b>203,986</b>    |
| Redeemable noncontrolling interest  | 2,180             | 1,122             |
| Equity:   |                   |                   |
| AsiaInfo-Linkage, Inc. stockholders equity  |                   |                   |
| Common stock (100,000,000 shares authorized; \$0.01 par value; 50,335,443 shares and 50,115,821 shares issued as of June 30, 2010 and December 31, 2009, respectively; 47,335,443 | 503               | 501               |

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|   |                |                |
|---|----------------|----------------|
| shares and 47,115,821 shares outstanding as of June 30, 2010 and December 31, 2009, respectively)                       |                |                |
| Additional paid-in capital  | 252,377        | 244,838        |
| Treasury stock, at cost (3,000,000 shares and 3,000,000 shares as of June 30, 2010 and December 31, 2009, respectively) | (27,749)       | (27,749)       |
| Retained earnings   | 39,450         | 15,199         |
| Statutory reserve   | 22,306         | 22,306         |
| Accumulated other comprehensive income  | 21,184         | 20,212         |
| <b>Total AsiaInfo-Linkage, Inc. stockholders equity</b>   | <b>308,071</b> | <b>275,307</b> |
| Noncontrolling interest   | 800            | 1,362          |
| <b>Total equity</b>   | <b>308,871</b> | <b>276,669</b> |
| Total liabilities and equity  | \$ 470,598     | \$ 481,777     |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****ASIAINFO-LINKAGE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(In thousands, except share amounts)**

|  | <b>Six months Ended June 30,</b> |                |
|--|----------------------------------|----------------|
|  | <b>2010</b>                      | <b>2009</b>    |
| <b>Cash flows from operating activities:</b>   |                                  |                |
| Net income   | \$ 23,393                        | \$ 12,988      |
| <b>Adjustments to reconcile net income to net cash used in operating activities:</b> |                                  |                |
| Depreciation and amortization of property and equipment                              | 839                              | 657            |
| Share-based compensation expenses  | 3,906                            | 5,040          |
| Amortization of other acquired intangible assets                                     | 871                              | 629            |
| Gain on disposal of property and equipment   | (6)                              | (5)            |
| Gain from sales of available-for-sale securities                                     | (472)                            | (1,210)        |
| Provision for bad debt   | 2,175                            | 492            |
| Acquisition related costs  |                                  | (12)           |
| <b>Changes in operating assets and liabilities:</b>                                  |                                  |                |
| Accounts receivable  | 7,585                            | (51,706)       |
| Inventories  | 1,039                            | 4,845          |
| Other receivables  | (373)                            | (378)          |
| Prepaid expenses and other current assets  | (1,520)                          | 800            |
| Prepaid land use right and other long-term prepayment                                | (434)                            |                |
| Accounts payable   | (24,791)                         | 40,499         |
| Accrued expenses   | 3,032                            | 1,489          |
| Deferred revenue   | (14,490)                         | (13,154)       |
| Accrued employee benefits  | (10,006)                         | (3,876)        |
| Other payables   | 32                               | 2,310          |
| Other taxes payable  | (2,377)                          | (403)          |
| Income taxes payable   | (50)                             | 452            |
| <b>Net cash used in operating activities</b>   | <b>(11,647)</b>                  | <b>(543)</b>   |
| <b>Cash flows from investing activities:</b>   |                                  |                |
| (Increase) decrease in restricted cash   | (384)                            | 656            |
| Purchases of available-for-sale securities   | (2,919)                          |                |
| Purchases of held-to-maturity securities   | (14,654)                         | (10,555)       |
| Proceeds from sales of available-for-sale securities                                 | 1,937                            | 6,211          |
| Proceeds from maturity of held to maturity securities                                | 13,726                           |                |
| Purchases of property and equipment  | (635)                            | (510)          |
| Proceeds from disposal of property and equipment                                     | 6                                | 5              |
| Purchase of businesses, net of cash acquired   | (4,334)                          | (872)          |
| Long-term equity investment  |                                  | (25)           |
| <b>Net cash used in investing activities</b>   | <b>(7,257)</b>                   | <b>(5,090)</b> |
| <b>Cash flows from financing activities:</b>   |                                  |                |
| Proceeds from exercise of stock options  | 3,634                            | 10,967         |
| <b>Net cash provided by financing activities</b>                                     | <b>3,634</b>                     | <b>10,967</b>  |
| Effect of exchange rate changes on cash and cash equivalents                         | 757                              | 17             |



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|  |            |            |
|--|------------|------------|
| Net (decrease) increase in cash and cash equivalents | (14,513)   | 5,351      |
| Cash and cash equivalents at beginning of period     | 238,553    | 172,119    |
| Cash and cash equivalents at end of period           | \$ 224,040 | \$ 177,470 |

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****ASIAINFO-LINKAGE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (unaudited)**

(In thousands, except share amounts)

|   | Common Stock       |        | AsiaInfo-Linkage, Inc. Stockholders |                |   | Statutory Reserve | Accumulated Other Comprehensive Income |          | Noncontrolling Interest | Total Equity     | Comprehensive Income |
|---|--------------------|--------|-------------------------------------|----------------|---|-------------------|--|----------|-------------------------|------------------|----------------------|
|   | Outstanding Shares | Amount | Additional Paid-in Capital          | Treasury Stock | Retained earnings (Accumulated Deficit) |                   | Income                                 | Income   |                         |                  |                      |
| <b>Balance at January 1, 2010</b>   | 47,115,821         | \$ 501 | \$ 244,838                          | \$ (27,749)    | \$ 15,199                               | \$ 22,306         | \$ 20,212                              | \$ 1,362 | \$ 276,669              |                  |                      |
| Net income (loss)   |                    |        |                                     |                | 10,345                                  |                   |  | (423)    | 9,922                   | 9,922            |                      |
| Net loss attributable to redeemable noncontrolling interest   |                    |        |                                     |                |   |                   |  | 93       | 93                      |                  |                      |
| Other comprehensive income:   |                    |        |                                     |                |   |                   |  |          |                         |                  |                      |
| Foreign currency translation adjustments  |                    |        |                                     |                |   |                   | 51                                     |          | 51                      | 51               |                      |
| Net unrealized gain on available-for-sale investments, net of tax effects of \$(194)                                |                    |        |                                     |                |   |                   | 607                                    |          | 607                     | 607              |                      |
| <b>Comprehensive income</b>   |                    |        |                                     |                |   |                   |  |          |                         | <b>\$ 10,580</b> |                      |
| Stock option exercises  | 183,479            | 2      | 3,518                               |                |   |                   |  |          | 3,520                   |                  |                      |
| Restricted stock units vesting  | 17,622             |        |                                     |                |   |                   |  |          |                         |                  |                      |
| Share-based compensation (restricted stock units)   |                    |        | 201                                 |                |   |                   |  |          | 201                     |                  |                      |
| Share-based compensation (performance-based restricted stock units)   |                    |        | 1,770                               |                |   |                   |  |          | 1,770                   |                  |                      |
| <b>Balance at March 31, 2010</b>  | 47,316,922         | \$ 503 | \$ 250,327                          | \$ (27,749)    | \$ 25,544                               | \$ 22,306         | \$ 20,870                              | \$ 1,032 | \$ 292,833              |                  |                      |
| Net income (loss)   |                    |        |                                     |                | 13,906                                  |                   |  | (435)    | 13,471                  | 13,471           |                      |
| Net loss attributable to redeemable noncontrolling interest   |                    |        |                                     |                |   |                   |  | 203      | 203                     |                  |                      |
| Other comprehensive income:   |                    |        |                                     |                |   |                   |  |          |                         |                  |                      |
| Foreign currency translation adjustments  |                    |        |                                     |                |   |                   | 1,073                                  |          | 1,073                   | 1,073            |                      |
| Transfer to statements of operations of realized gain on available-for-sale investments, net of tax effects of \$35 |                    |        |                                     |                |   |                   | (437)                                  |          | (437)                   | (437)            |                      |
| Net unrealized loss on available-for-sale investments, net of tax effects of \$47                                   |                    |        |                                     |                |   |                   | (322)                                  |          | (322)                   | (322)            |                      |
| <b>Comprehensive income</b>   |                    |        |                                     |                |   |                   |  |          |                         | <b>\$ 13,785</b> |                      |
| Stock option exercises  | 15,721             |        | 115                                 |                |   |                   |  |          | 115                     |                  |                      |

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|   |            |        |            |             |           |           |           |        |            |  |  |
|---|------------|--------|------------|-------------|-----------|-----------|-----------|--------|------------|--|--|
| Restricted stock units vesting                                      | 2,800      |        |            |             |           |           |           |        |            |  |  |
| Share-based compensation (restricted stock units)                   |            | 242    |            |             |           |           |           |        | 242        |  |  |
| Share-based compensation (performance-based restricted stock units) |            | 1,693  |            |             |           |           |           |        | 1,693      |  |  |
| <b>Balance at June 30, 2010</b>                                     | 47,335,443 | \$ 503 | \$ 252,377 | \$ (27,749) | \$ 39,450 | \$ 22,306 | \$ 21,184 | \$ 800 | \$ 308,871 |  |  |

See accompanying notes to condensed consolidated financial statements.

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**ASIAINFO-LINKAGE, INC.**

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

**(In thousands, except share and per share amounts)**

**1. BASIS OF PREPARATION**

On July 1, 2010, AsiaInfo Holdings, Inc. ( AsiaInfo ) completed its combination with IT software and solutions provider Linkage Technologies International Holdings Limited ( Linkage ) and was renamed AsiaInfo-Linkage, Inc. ( AsiaInfo-Linkage ). Please note that second quarter 2010 and prior consolidated financial statements for AsiaInfo-Linkage reflect the standalone operating results and financial position of AsiaInfo and its consolidated subsidiaries and variable interest entities VIEs . Starting in the third quarter of 2010, AsiaInfo-Linkage will consolidate Linkage and its consolidated subsidiaries operating results and financial position. Please refer to Note 25 for detailed information regarding this acquisition.

(a) The accompanying unaudited condensed consolidated financial statements include the accounts of AsiaInfo-Linkage, Inc., its subsidiaries, and its VIEs (collectively, the Company ). All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( US GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X, as promulgated by the Securities and Exchange Commission (the SEC ). Accordingly, they do not include all of the information and notes required by US GAAP for completing annual financial statements. However, management believes that the disclosures are adequate to ensure the information presented is not misleading. US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, contingencies and results of operations. While management has based its assumptions and estimates on the facts and circumstances existing as of June 30, 2010, final amounts may differ from these estimates.

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

AsiaInfo-Linkage, Inc. uses the United States ( U.S. ) dollar as its reporting currency and functional currency. The financial records of the Company s People s Republic of China ( PRC ) subsidiaries and VIEs are maintained in Renminbi ( RMB ), their functional currency and the currency of the PRC. Their balance sheets are translated into U.S. dollars based on the exchange rate quoted by the People s Bank of China as of the balance sheet date. Their statements of operations are translated using a weighted average exchange rate for the period. Translation adjustments are reflected in accumulated other comprehensive income in stockholders equity.

The RMB is not freely convertible into U.S. dollars or other currencies. All foreign exchange transactions involving RMB must take place through the People s Bank of China or other institutions authorized to buy and sell foreign currencies. The exchange rates adopted for the foreign exchange transactions are the rates of exchange quoted by the People s Bank of China.

None of the assets of the Company s consolidated VIEs can be used only to settle obligations of these VIEs. As of June 30, 2010 and December 31, 2009, respectively, there was \$18,917 and \$20,542 of liabilities of the Company s consolidated VIEs for which creditors (or beneficial interest holders) did not have recourse to the general credit of AsiaInfo-Linkage or its subsidiaries.

(b) The accompanying unaudited condensed consolidated financial statements have been prepared using the same accounting policies as used in the preparation of the Company s consolidated financial statements on Form 10-K for the fiscal year ended December 31, 2009, as amended except for the following additional accounting policies:

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**ASIAINFO-LINKAGE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

**(In thousands, except share and per share amounts)**

**(1) Newly Adopted Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board (the FASB) issued an authoritative pronouncement that changes how a company determines whether an entity should be consolidated when such entity is insufficiently capitalized or is not controlled by the company through voting (or similar rights). The determination of whether a company is required to consolidate an entity is based on, among other things, the entity's purpose and design and the company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The pronouncement retains the scope of previously issued pronouncements but added entities previously considered qualifying special purpose entities, since the concept of these entities was eliminated by the FASB. The pronouncement is effective as of the beginning of the first fiscal year that begins after November 15, 2009. The adoption of this pronouncement did not have a significant impact on the Company's financial position or results of operations.

In January 2010, the FASB issued authoritative guidance to improve disclosures about fair value measurements. This guidance amends previous guidance on fair value measurements to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurement on a gross basis rather than on a net basis as currently required. This guidance also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for annual and interim periods beginning after December 15, 2009, except for the requirement to provide the Level 3 activities of purchases, sales, issuances, and settlements on a gross basis, which will be effective for annual and interim periods beginning after December 15, 2010. Early application is permitted and, in the period of initial adoption, entities are not required to provide the amended disclosures for any previous periods presented for comparative purposes. The adoption of this pronouncement did not have a significant impact on the Company's financial position or results of operations.

**(2) Recently Issued Accounting Pronouncements Not Yet Adopted**

In September 2009, the FASB issued an authoritative pronouncement regarding revenue arrangements with multiple deliverables. This pronouncement was issued in response to practice concerns related to accounting for revenue arrangements with multiple deliverables under the existing pronouncement. Although the new pronouncement retains the criteria from the existing pronouncement for when delivered items in a multiple-deliverable arrangement should be considered separate units of accounting, it removes the separation criterion under the existing pronouncement that objective and reliable evidence of the fair value of any undelivered items must exist for the delivered items to be considered a separate unit or separate units of accounting. The new pronouncement is effective for fiscal years beginning on or after June 15, 2010. Entities can elect to apply this pronouncement prospectively to new or materially modified arrangements after the pronouncement's effective date or retrospectively for all periods presented. Early application is permitted; however, if the entity elects prospective application and early adopts this pronouncement after its first interim reporting period, it must also retrospectively apply this pronouncement as of the beginning of that fiscal year and disclose the effect of the retrospective adjustments on the prior interim periods' revenue, income before taxes, net income, and earnings per share. The Company is in the process of evaluating the effect of adoption of this pronouncement.

In September 2009, the FASB issued an authoritative pronouncement regarding software revenue recognition for arrangements with multiple deliverables. The pronouncement addresses how consideration should be allocated to different units of accounting and removes the previous criterion that entities must use objective and reliable evidence of fair value in separately accounting for deliverables. The pronouncement provides that products containing both software and non-software components that function together to deliver the product's essential functionality are excluded from the scope of current revenue recognition guidance for software products. The pronouncement includes factors that entities should consider when determining whether the software and non-software components function together to deliver the product's essential functionality. The pronouncement is effective for fiscal years beginning on or after June 15, 2010. Entities can elect to apply this pronouncement prospectively to new or materially modified arrangements after the pronouncement's effective date, or retrospectively for all periods presented. Early application is permitted. However, if the entity elects prospective application and early adopts this pronouncement after its first interim reporting period, it must also retrospectively apply this pronouncement as of the beginning of that fiscal year and disclose the effect of the retrospective adjustments on the prior interim periods' revenue, income before taxes, net income, and earnings per share. The Company is in the process of evaluating the effect of adoption of this pronouncement.



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**ASIAINFO-LINKAGE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

**(In thousands, except share and per share amounts)**

In March 2010, FASB issued an authoritative pronouncement regarding the effect of denominating the exercise price of a share-based payment awards in the currency of the market in which the underlying equity securities trades and that currency is different from (1) entity's functional currency, (2) functional currency of the foreign operation for which the employee provides services, and (3) payroll currency of the employee. The guidance clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should be considered an equity award assuming all other criteria for equity classification are met. The pronouncement will be effective for interim and annual periods beginning on or after December 15, 2010, and will be applied prospectively. Affected entities will be required to record a cumulative catch-up adjustment for all awards outstanding as of the beginning of the annual period in which the guidance is adopted. The Company does not believe the adoption of this pronouncement will significantly impact the financial position or results of operations of the Company.

In April 2010, the FASB issued an authoritative pronouncement regarding the milestone method of revenue recognition. The scope of this pronouncement is limited to arrangements that include milestones relating to research or development deliverables. The pronouncement specifies criteria that must be met for a vendor to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. The criteria apply to milestones in arrangements within the scope of this pronouncement regardless of whether the arrangement is determined to have single or multiple deliverables or units of accounting. The pronouncement will be effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early application is permitted. Affected entities can apply this guidance prospectively to milestones achieved after adoption. However, retrospective application to all prior periods is also permitted. The Company is in the process of evaluating the effect of adoption of this pronouncement.

**2. FINANCIAL INSTRUMENTS**

Financial instruments consist of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, other receivables, accounts payable, accrued expenses, other payables, income taxes payable, other taxes payable and long-term investments in equity securities of unquoted companies.

Short-term investments are classified as available-for-sale securities, held-to-maturity securities and trading securities, as discussed in Note 4.

The fair values of long-term investments, which are carried at cost, are not readily determinable.

The carrying values of other financial instruments approximate their fair values due to the short-term nature of these instruments. The Company does not use derivative instruments to manage risks.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)****3. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of cash on hand, demand deposits and highly liquid investments, which are unrestricted as to withdrawal or use, and which have remaining maturities of three months or less when purchased. The following table provides additional information concerning the breakdown of the Company's cash and cash equivalents:

|                                     | As of June 30, 2010 | As of December 31, 2009 |
|-------------------------------------|---------------------|-------------------------|
| Cash                                | \$ 81,591           | \$ 128,213              |
| Cash equivalents:                   |                     |                         |
| Money market fund                   | 134,350             | 92,473                  |
| Seven-day notice deposits           | 2,209               | 12,009                  |
| Others                              | 5,890               | 5,858                   |
| <br>Total cash and cash equivalents | <br>\$ 224,040      | <br>\$ 238,553          |

**4. SHORT-TERM INVESTMENTS**

Short-term investments are classified as held-to-maturity securities, available-for-sale securities and trading securities.

As of June 30, 2010 and December 31, 2009, the Company's held-to-maturity securities consist of term deposits carried at cost of \$14,726 and \$13,716, respectively. The term deposits are either not allowed to be redeemed early or are subject to penalty for early redemption before their maturity. The carrying amounts of the held-to-maturity securities approximate their fair values due to their short-term nature. As of June 30, 2010 and December 31, 2009, the Company did not hold trading securities.

The following table provides additional information concerning the Company's available-for-sale securities, which consist principally of bond funds, balance funds, stock funds and corporate stocks issued by major financial institutions.

|                  | As of June 30, 2010 |                              |                               |               | As of December 31, 2009 |                              |                               |               |
|------------------|---------------------|------------------------------|-------------------------------|---------------|-------------------------|------------------------------|-------------------------------|---------------|
|                  | Cost                | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value | Cost                    | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value |
| Bond funds       | \$ 16,904           | \$ 1,954                     | \$                            | \$ 18,858     | \$ 16,812               | \$ 1,334                     | \$                            | \$ 18,146     |
| Balance funds    | 2,946               | 94                           | (99)                          | 2,941         | 1,465                   | 118                          | \$                            | 1,583         |
| Stock funds      | 5,847               | 1,567                        | \$                            | 7,414         | 5,815                   | 1,895                        | \$                            | 7,710         |
| Corporate stocks | 215                 | 5                            | \$                            | 220           | 215                     | 20                           | \$                            | 235           |
| <br>Total        | <br>\$ 25,912       | <br>\$ 3,620                 | <br>\$ (99)                   | <br>\$ 29,433 | <br>\$ 24,307           | <br>\$ 3,367                 | <br>\$                        | <br>\$ 27,674 |

Where applicable, the Company uses quoted prices in active markets for identical assets (Level 1 investments) to determine the fair value of trading and available-for-sale securities. If quoted prices in active markets for identical assets are not available to determine fair value, then the Company uses quoted prices for similar assets or inputs other than the quoted prices that are observable either directly or indirectly, which are included in Level 2 investments. The Company did not have Level 2 investments as of June 30, 2010. The Company's Level 3 investments other than derivatives primarily include investments in certain mutual funds without quoted prices as of the date of reporting. The Company values its



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Level 3 investments using the quoted market price as of the most recent priced day prior to the date of reporting because the Company believes the fair value of the investments would not have materially changed between the pricing date and the date of reporting.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

(In thousands, except share and per share amounts)

The available-for-sale securities measured and recorded at fair value as of June 30, 2010 and December 31, 2009 were as follows:

|                  | As of June 30, 2010   |   |  | Total Balance    |
|------------------|---|---|--|------------------|
|                  | Fair Value Measurements at the Reporting Date Using               |   |  |                  |
|                  | Quoted Prices in  |   |  |                  |
|                  | Active<br>Markets<br>for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                  |
| Bond funds       | \$ 18,858   | \$  | \$   | \$ 18,858        |
| Balance funds    |   |   | 2,941  | 2,941            |
| Stock funds      |   |   | 7,414  | 7,414            |
| Corporate stocks | 220   |   |  | 220              |
| <b>Total</b>     | <b>\$ 19,078</b>  | <b>\$</b>   | <b>\$ 10,355</b>                                   | <b>\$ 29,433</b> |

|                  | As of December 31, 2009   |   |  | Total Balance    |
|------------------|---|---|--|------------------|
|                  | Fair Value Measurements at the Reporting Date Using               |   |  |                  |
|                  | Quoted Prices in  |   |  |                  |
|                  | Active<br>Markets<br>for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                  |
| Bond funds       | \$ 18,146   | \$  | \$   | \$ 18,146        |
| Balanced funds   |   |   | 1,583  | 1,583            |
| Stock funds      |   |   | 7,710  | 7,710            |
| Corporate stocks | 235   |   |  | 235              |
| <b>Total</b>     | <b>\$ 18,381</b>  | <b>\$</b>   | <b>\$ 9,293</b>                                    | <b>\$ 27,674</b> |

The following table presents changes in Level 3 stock funds measured on a recurring basis for the six-month period ended June 30, 2010:

|                                      | Six Months Ended June 30, 2010 |         |
|--------------------------------------|--------------------------------|---------|
|                                      | 2010                           |         |
| Beginning balance at January 1, 2010 | \$                             | 9,293   |
| Purchases                            |                                | 2,946   |
| Redemption                           |                                | (1,465) |
| Realized gain                        |                                | (472)   |
| Unrealized gain                      |                                | (12)    |
| Exchange difference                  |                                | 65      |

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|                                 |    |        |
|---------------------------------|----|--------|
| Ending balance at June 30, 2010 | \$ | 10,355 |
|---------------------------------|----|--------|

The following table provides additional information on the realized gains of the Company during the three-month and six-month periods ended June 30, 2010. For purpose of determining gross realized gains, the cost of securities sold is based on specific identification.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

(In thousands, except share and per share amounts)

|                               | Three Months Ended June 30, |                 |               |                 |                 |                 |
|-------------------------------|-----------------------------|-----------------|---------------|-----------------|-----------------|-----------------|
|                               | 2010                        | 2010            |               | 2009            |                 | 2009            |
|                               | Proceeds                    | Costs           | Gains         | Proceeds        | Costs           | Gains           |
| Available-for-sale securities | \$ 1,937                    | \$ 1,465        | \$ 472        | \$ 6,211        | \$ 5,001        | \$ 1,210        |
| Trading securities            |                             |                 |               |                 |                 |                 |
| <b>Total</b>                  | <b>\$ 1,937</b>             | <b>\$ 1,465</b> | <b>\$ 472</b> | <b>\$ 6,211</b> | <b>\$ 5,001</b> | <b>\$ 1,210</b> |

|                               | Six Months Ended June 30, |                 |               |                 |                 |                 |
|-------------------------------|---------------------------|-----------------|---------------|-----------------|-----------------|-----------------|
|                               | 2010                      | 2010            |               | 2009            |                 | 2009            |
|                               | Proceeds                  | Costs           | Gains         | Proceeds        | Costs           | Gains           |
| Available-for-sale securities | \$ 1,937                  | \$ 1,465        | \$ 472        | \$ 6,211        | \$ 5,001        | \$ 1,210        |
| Trading securities            |                           |                 |               |                 |                 |                 |
| <b>Total</b>                  | <b>\$ 1,937</b>           | <b>\$ 1,465</b> | <b>\$ 472</b> | <b>\$ 6,211</b> | <b>\$ 5,001</b> | <b>\$ 1,210</b> |

The Company reported no impairment losses for its short-term investments for the three and six months ended June 30, 2010 and 2009, respectively.

**5. ACCOUNTS RECEIVABLE**

Accounts receivable balances included both billed and unbilled amounts. Revenue recognized in excess of billings is recorded as unbilled receivables. All billed and unbilled amounts are expected to be collected within one year. Accounts receivable balances included bank acceptance drafts receivable and commercial acceptance drafts receivable. These bank acceptance drafts and commercial acceptance drafts were non-interest bearing and were due within six months of issuance.

In recent periods the Company has begun to generate service revenues by acting as a sales agent for International Business Machines Corporation ( IBM ) or its distributors for certain products sold to China Mobile and its provincial subsidiaries (the IBM Arrangement ). The components of the Company's accounts receivable as of June 30, 2010 and December 31, 2009, including amounts attributable to the IBM Arrangement, were as follows:

|                                       | June 30, 2010    |               |                   | December 31, 2009 |                  |                   |
|---------------------------------------|------------------|---------------|-------------------|-------------------|------------------|-------------------|
|                                       | IBM              | Non-IBM       | Total             | IBM               | Non-IBM          | Total             |
|                                       | Arrangement      | Arrangement   |                   | Arrangement       | Arrangement      |                   |
| Billed accounts receivable            | \$ 8,935         | \$ 43,331     | \$ 52,266         | \$ 21,985         | \$ 36,064        | \$ 58,049         |
| Unbilled accounts receivable          | 19,039           | 52,503        | 71,542            | 35,700            | 37,212           | 72,912            |
| Bank acceptance drafts                |                  | 1,335         | 1,335             |                   | 15               | 15                |
| Commercial acceptance drafts          |                  | 512           | 512               |                   | 1,289            | 1,289             |
| Less: accounts receivable allowance   |                  | (4,794)       | (4,794)           |                   | (2,619)          | (2,619)           |
| <b>Total accounts receivable, net</b> | <b>\$ 27,974</b> | <b>92,887</b> | <b>\$ 120,861</b> | <b>\$ 57,685</b>  | <b>\$ 71,961</b> | <b>\$ 129,646</b> |

**6. INVENTORIES, NET**

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The components of inventories, net as of June 30, 2010 and December 31, 2009 were as follows:

|                | <b>June 30, 2010</b> | <b>December 31, 2009</b> |
|----------------|----------------------|--------------------------|
| Raw materials  | \$ 949               | \$ 806                   |
| Finished goods | 7,547                | 8,729                    |
| <b>Total</b>   | <b>\$ 8,496</b>      | <b>\$ 9,535</b>          |

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

(In thousands, except share and per share amounts)

**7. LONG-TERM INVESTMENTS**

On September 12, 2008, the Company acquired 2,170,000 redeemable convertible Series B Preferred Shares of C-Platform Corporation ( C-Platform ), for a total cash consideration of \$4,696, including \$52 in transaction costs. The total consideration had been paid as of March 31, 2009. Following the transaction, the Company owned approximately 19.9% of C-Platform s issued and outstanding share capital, or 17% of C-Platform s share capital on a fully-diluted basis. Since the Company does not have the ability to exercise significant influence over the operating and financial policies of C-Platform, the Company uses the cost method of accounting to record its investment in C-Platform. C-Platform is a Cayman Islands company, which, through its subsidiaries in China, provides data operating services, a form of value-added telecommunications services, to telecommunications operators in China.

No impairment losses were recognized in 2009 or in the three and six months ended June 30, 2010.

**8. ACQUISITION**

On May 1, 2010, the Company, through a subsidiary of the Company, consummated the acquisition of 80% equity interest of Hangzhou Zhongbo Software Technology Co., Ltd. ( Hangzhou Zhongbo ) for an aggregate purchase price of \$7,068 in cash. Goodwill acquired through this acquisition was \$6,833. Hangzhou Zhongbo provides IT solutions to broadcasting operators in China.

**9. GOODWILL**

The changes in the carrying amount of goodwill by reporting segments during the six months ended June 30, 2010 were as follows:

|  | As of June 30, 2010      |                     |                  |
|--|--------------------------|---------------------|------------------|
|  | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total            |
| <b>Gross amount:</b>                                   |                          |                     |                  |
| Beginning balance at January 1, 2010                   | \$ 46,102                | \$ 21,395           | \$ 67,497        |
| Goodwill recognized in acquisition of Hangzhou Zhongbo | 6,833                    |                     | 6,833            |
| Exchange differences                                   | 41                       | 3                   | 44               |
| Ending balance at June 30, 2010:                       | 52,976                   | 21,398              | 74,374           |
| <b>Accumulated impairment loss:</b>                    |                          |                     |                  |
| Beginning balance at January 1, 2010:                  | (26,380)                 | (18,855)            | (45,235)         |
| Charge for the year                                    |                          |                     |                  |
| Exchange differences                                   |                          |                     |                  |
| Ending balance at June 30, 2010:                       | (26,380)                 | (18,855)            | (45,235)         |
| <b>Goodwill, net</b>                                   | <b>\$ 26,596</b>         | <b>\$ 2,543</b>     | <b>\$ 29,139</b> |

**10. OTHER ACQUIRED INTANGIBLE ASSETS, NET**

The changes in the carrying amounts of the components of other acquired intangible assets, net as of June 30, 2010 and December 31, 2009 were as follows:

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|                                     | June 30, 2010         |                          |                             |                     | December 31, 2009     |                          |                             |                     |
|-------------------------------------|-----------------------|--------------------------|-----------------------------|---------------------|-----------------------|--------------------------|-----------------------------|---------------------|
|                                     | Gross carrying amount | Accumulated amortization | Foreign exchange difference | Net carrying amount | Gross carrying amount | Accumulated amortization | Foreign exchange difference | Net carrying amount |
| Core technologies                   | \$ 2,331              | \$ (2,331)               | \$                          | \$                  | \$ 2,331              | \$ (2,321)               | \$                          | \$ 10               |
| Trade names                         | 341                   | (324)                    |                             | 17                  | 341                   | (309)                    |                             | 32                  |
| Contract backlogs                   | 2,974                 | (2,495)                  | 12                          | 491                 | 2,451                 | (2,463)                  | 12                          |                     |
| Customer lists                      | 131                   | (134)                    | 12                          | 9                   | 131                   | (119)                    | 12                          | 24                  |
| Customer relationships              | 3,557                 | (2,242)                  | 285                         | 1,600               | 2,739                 | (1,901)                  | 280                         | 1,118               |
| Distribution network                | 870                   | (870)                    |                             |                     | 870                   | (870)                    |                             |                     |
| Software                            | 1,758                 | (1,605)                  | 156                         | 309                 | 1,758                 | (1,457)                  | 154                         | 455                 |
| Non-compete agreements              | 938                   | (239)                    | 24                          | 723                 | 446                   | (188)                    | 23                          | 281                 |
| Corporate business agency agreement | 2,037                 | (398)                    |                             | 1,639               | 2,037                 | (139)                    |                             | 1,898               |
|                                     | \$ 14,937             | \$ (10,638)              | \$ 489                      | \$ 4,788            | \$ 13,104             | \$ (9,767)               | \$ 481                      | \$ 3,818            |

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)**

The future amortization expenses for the net carrying amount of intangible assets with definite lives as of June 30, 2010 are expected to be as follows:

|      |          |
|------|----------|
| 2010 | \$ 1,003 |
| 2011 | 1,478    |
| 2012 | 1,142    |
| 2013 | 654      |
| 2014 | 511      |
|      | \$ 4,788 |

**11. PREPAID LAND USE RIGHT AND OTHER LONG-TERM PREPAYMENT**

The Company has commenced the process to obtain land use rights for a piece of land in Beijing, on which the Company plans to construct a building for use as its new corporate headquarters. In October 2009, the Company entered into an agreement with Zhongguancun Software Park Development Co., Ltd. ( ZSPD ), pursuant to which ZSPD agreed to develop the land in preparation for construction of the building, for an aggregate consideration of approximately \$10,777. In connection with the agreement, the Company will be eligible to enter into a land transfer agreement with relevant PRC government authorities in order to obtain land use rights with respect to such land. As of June 30, 2010, the Company had paid approximately \$9,699 pursuant to the agreement with ZSPD, with the remaining amount payable in the remainder of 2010. The Company has recorded the \$9,699 as prepaid land use right and other long-term prepayment on its consolidated balance sheets as of June 30, 2010. The Company expects to report land use rights and other long-term prepayments at cost less accumulated amortization and to amortize the cost of the land use rights and other long-term prepayments on a straight-line basis over the term of the land use rights and other long-term prepayments to be amortized, which is expected to be 50 years.

**12. COMPREHENSIVE INCOME**

The components of comprehensive income during the three and six months ended June 30, 2010 and 2009 were as follows:

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|---|--------------------------------|----------|------------------------------|-----------|
|   | 2010                           | 2009     | 2010                         | 2009      |
| Net income  | \$ 13,471                      | \$ 7,203 | \$ 23,393                    | \$ 12,988 |
| Transfer to statements of operation of realized gain on available-for-sale investments net of tax effects of \$35 and \$350, \$35 and \$350 for the three and six months ended June 30, 2010 and 2009, respectively | (437)                          | (860)    | (437)                        | (860)     |
| Net unrealized (loss) gain on available-for-sale investments, net of tax effects of \$47 and \$77, \$(147) and \$(501) for the three and six months ended June 30, 2010 and 2009, respectively                      | (322)                          | 770      | 285                          | 1,950     |
| Change in cumulative foreign currency translation adjustment  | 1,073                          | 69       | 1,124                        | (28)      |
| Comprehensive income  | 13,785                         | 7,182    | 24,365                       | 14,050    |



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|   |           |          |           |           |
|---|-----------|----------|-----------|-----------|
| Comprehensive loss attributable to noncontrolling interest  | (435)     | (2)      | (858)     | (7)       |
| Comprehensive income attributable to AsiaInfo-Linkage, Inc. | \$ 14,220 | \$ 7,184 | \$ 25,223 | \$ 14,057 |

### 13. CREDIT FACILITIES

As of June 30, 2010, the Company had short-term credit facilities for working capital purposes totaling \$32,088 expiring in March 2011. As of June 30, 2010, the credit facilities were secured by bank deposits of \$5,009 and credit facilities of \$6,446 were pledged as security for issuing standby letters of credit and accounts payable to hardware suppliers and customers. As of June 30, 2010, unused short-term credit facilities were \$25,642. In addition, the Company had standby letters of credit and bank acceptance drafts as of June 30, 2010, which were collateralized by bank deposits of \$915. Total bank deposits pledged as security for credit facilities, standby letters of credit, and bank acceptance drafts totaled \$5,924 as of June 30, 2010 and were presented as restricted cash in the consolidated balance sheets. As of December 31, 2009, the Company had total short-term credit facilities totaling \$31,968, which will expire in December 2010 and were secured by bank deposits of \$5,000.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)****14. ACCOUNTS PAYABLE**

Accounts payable included bank acceptance drafts payable of \$3,123 and \$1,932 and commercial acceptances payable of nil and \$426 as of June 30, 2010 and December 31, 2009, respectively. These bank acceptance drafts and commercial acceptances were non-interest bearing and were due within six months of issuance.

As of June 30, 2010 and December 31, 2009, the Company's accounts payable balance related to its sales agency arrangement with IBM was approximately \$36,720 and \$62,121, respectively, under which the Company is contractually obligated to pay its vendor only when the customer, China Mobile, pays the Company.

**15. VALUE-ADDED TAXES REBATE**

Revenue from software products and solutions included the benefit of the rebate of value-added taxes on sales of software and services received from the Chinese tax authorities as part of the PRC government's policy of encouraging software development in the PRC. The rebate totaled \$5,521 and \$3,822 for the six months ended June 30, 2010 and 2009, respectively.

**16. INCOME TAXES**

The Company is subject to U.S. federal and state income taxes and the Company's subsidiaries and VIEs incorporated in the PRC are subject to PRC income taxes.

Reconciliation between the provision for income taxes computed by applying the U.S. federal tax rate to income before income taxes and the actual provision for income taxes is as follows:

|  | Six months Ended June 30,<br>2010 | 2009 |
|--|-----------------------------------|------|
| U.S. federal rate  | 35%                               | 35%  |
| Difference between statutory rate and foreign effective tax rate | (28)                              | (28) |
| Subpart F income inclusion and other dividend income             | 4                                 | 1    |
| Share-based compensation   | 2                                 | 5    |
| Other permanent differences                                      | 2                                 | 1    |
|  | 15%                               | 14%  |

Aggregate undistributed earnings of approximately \$80,664 at June 30, 2010 of the Company's PRC subsidiaries and VIEs that are available for distribution to the Company are considered to be indefinitely reinvested under US GAAP and, accordingly, no provision has been made for the Chinese dividend withholding taxes that would be payable upon the distribution of those amounts to AsiaInfo-Linkage, Inc. Additionally, the Chinese tax authorities have clarified that distributions made out of pre-January 1, 2008 retained earnings would not be subject to the withholding tax. The Company has not quantified the deferred income tax liability that would arise if earnings in the six months ended June 30, 2010 were to be distributed or were determined to be no longer permanently reinvested.

The Company is subject to taxation in the U.S. and various states and foreign jurisdictions. There is no ongoing examination by any taxing authority at this time. The Hong Kong Inland Revenue Department has concluded its examination of our Hong Kong subsidiary's tax filings tax years and no adjustment was made as a result of the examination. The Company's various tax years from 2000 to 2009 remain open in these taxing jurisdictions.

**17. SHARE-BASED COMPENSATION**

**2002 Stock Option Plan and the Prior Plans**

Under the Company's 2002 Stock Option Plan (the "2002 Plan"), the Company was authorized to grant options for the purchase of up to 4,500,000 shares of common stock to employees, directors and consultants at prices not less than the fair market value on the date of grant for incentive stock options and nonqualified options. Shares as to which an option is granted under the 2002 Plan but remains unexercised at the expiration, forfeiture or other termination of such option may be the subject of the grant of further options. Prior to adopting the 2002 Stock Option Plan, the Company adopted annual stock option plans for each of 1995, 1996, 1997, 1998, 1999 and 2000 (such plans, together with the 2002 Stock Option Plan, are referred to hereinafter as the "Option Plans").

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)**

The vesting periods of the options under the Option Plans are determined based on the individual stock option agreements. Options granted prior to 1998 generally vest and become exercisable over three years at an equal annual rate. Exercise terms of options granted in 1998, 1999, 2000 and 2002 are substantially similar to those of options granted prior to 1998 except that the vesting and exercise periods are generally over four one-year cliffs at an annual rate of 20%, 20%, 30% and 30% for the 1999 plan, generally over four years at an annual rate of 25% for the 2000 plan, and are generally no more than four years at an annual rate of 25% for the 2002 Plan.

Activities for the Option Plans are summarized as follows:

|  | Number of shares | Weighted average exercise price per share | Aggregate Intrinsic Value |
|--|------------------|---|---------------------------|
| Outstanding, January 1, 2010               | 1,064,605        | \$ 11.51                                  |                           |
| Granted                                    |                  |   |                           |
| Forfeited                                  | (39,900)         | 25.57                                     |                           |
| Exercised                                  | (262,971)        | 20.82                                     |                           |
| Outstanding, March 31, 2010                | 761,734          | 7.56                                      | \$ 14,516                 |
| Granted                                    |                  |   |                           |
| Forfeited                                  |                  |   |                           |
| Exercised                                  | (15,721)         | 7.28                                      |                           |
| Outstanding, June 30, 2010                 | 746,013          | 7.57                                      | \$ 10,791                 |
| Vested and expected to vest, June 30, 2010 | 746,013          | 7.57                                      | 10,791                    |
| Exercisable, June 30, 2010                 | 746,013          | \$ 7.57                                   | \$ 10,791                 |

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of \$21.86 of the Company's common stock on the last trading day (June 30, 2010).

The total intrinsic value of options exercised for each of the three months ended June 30, 2010 and 2009 was \$325 and \$15,255, respectively; and for each of the six months ended June 30, 2010 and 2009 was \$1,424 and \$16,685, respectively.

As of June 30, 2010, there was no unrecognized share-based compensation cost relating to share options.

**2005 Stock Incentive Plan – restricted stock units (RSUs)**

Under the Company's 2005 Stock Incentive Plan (the "2005 Plan"), the Company may grant participants restricted stock awards, stock options, or other types of equity incentives. The number of shares authorized for issuance is (a) 600,000 shares plus (b) any authorized shares of the Company's common stock that, as of April 21, 2005, were available for issuance under the 2002 Plan, or that thereafter become available for issuance under the 2002 Plan in accordance with its terms.

A restricted stock unit ("RSU") is an agreement to issue stock at the time when the award vests. These units are vested on an annual basis equally over four years, 25% on each anniversary of the grant date. The fair value of each RSU is measured on the grant date based on the market price of the stock on the grant date. The Company also has the right, in its sole discretion, to pay cash in lieu of the issuance of vested shares of common stock. No such cash payment right was exercised by the Company.



**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)**

RSUs as of June 30, 2010 and changes during the three months ended June 30, 2010 were as follows:

|  | Number of shares | Weighted average<br>grant date fair value |
|--|------------------|---|
| Restricted stock units unvested at January 1, 2010 | 101,800          | \$ 11.26                                  |
| Granted  | 86,600           | 25.43                                     |
| Vested   | (17,622)         | 9.59                                      |
| Forfeited  |                  |   |
| Restricted stock units unvested at March 31, 2010  | 170,778          | \$ 18.62                                  |
| Granted  |                  |   |
| Vested   | (2,800)          | 17.31                                     |
| Forfeited  | (3,000)          | 20.70                                     |
| Restricted stock units unvested at June 30, 2010   | 164,978          | \$ 18.60                                  |

Total intrinsic value of RSUs vested for each of the three months ended June 30, 2010 and 2009 was \$66 and \$5.5, respectively; and for each of the six months ended June 30, 2010 and 2009 was \$566 and \$5.5, respectively.

As of June 30, 2010, there was \$2,641 in unrecognized share-based compensation cost related to RSUs, which is expected to be recognized in the Company's consolidated statements of operations over a weighted-average vesting period of 1.68 years. To the extent the actual forfeiture rate is different from the original estimate, the actual share-based compensation related to these awards may be different from the expectation.

**2008 Stock Incentive Plan**

On February 25, 2008, the Board of Directors of the Company authorized the 2008 Stock Incentive Plan, as amended (the "2008 Plan"). The 2008 Plan was subsequently approved by the Company's stockholders at the 2008 annual meeting of stockholders. Under the 2008 Plan, the Company may grant participants restricted stock awards, stock options, or other types of equity incentives. The number of shares authorized for issuance is (a) 2,000,000 shares plus (b) any authorized shares of the Company's common stock that, as of February 25, 2008, were available for issuance under the 2005 Plan, or that thereafter become available for issuance under the 2005 Plan in accordance with its terms.

As of June 30, 2010, 1,669,400 performance stock units (PSUs) were granted under the 2008 Plan. These awards will vest based on certain performance-based criteria, such as the Company's operating margin annual growth rate, provided the award holder continues to be an employee of the Company at the time the performance goals are met. Each PSU represents a contingent right of the participant to receive a payment in respect of a share of the Company's common stock, whether in shares, cash, or a combination thereof, subject to the terms and conditions of the participant's PSU agreement. The Company also has the right, in its sole discretion, to pay cash in lieu of the issuance of vested shares of common stock. No such cash payment right was exercised by the Company.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)**

PSUs as of June 30, 2010 and changes during the six months ended June 30, 2010 were as follows:

|  | Number of shares | Weighted average<br>grant date fair<br>value |
|--|------------------|--|
| Performance-based restricted stock units unvested at January 1, 2010 | 1,081,413        | \$ 13.17                                     |
| Granted  |                  |  |
| Vested   |                  |  |
| Forfeited  | (2,835)          | 13.10  |
| Performance-based restricted stock units unvested at March 31, 2010  | 1,078,578        | \$ 13.17                                     |
| Granted  |                  |  |
| Vested   |                  |  |
| Forfeited  | (16,638)         | 13.10  |
| Performance-based restricted stock units unvested at June 30, 2010   | 1,061,940        | \$ 13.17                                     |

Total intrinsic value of the PSUs granted under the 2008 Plan and vested for each of the six months ended June 30, 2010 and 2009 was nil and nil, respectively.

As of June 30, 2010, there was \$1,748 in unrecognized share-based compensation cost related to the PSUs, which is expected to be recognized in the Company's consolidated statements of operations over a weighted-average vesting period of 0.25 year. To the extent the actual forfeiture rate is different from the original estimate, the actual share-based compensation related to these awards may be different from the expectation.

The amount of share-based compensation attributable to cost of revenues, sales and marketing, general and administrative expenses, and research and development is included in those line items on the face of the Company's consolidated statements of operations. For the three months and six months ended June 30, 2010 and 2009, share-based compensation expenses related to stock options, RSUs and PSUs were allocated as follows:

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2010                           | 2009     | 2010                         | 2009     |
| Cost of revenues                       | \$ 480                         | \$ 1,102 | \$ 1,000                     | \$ 1,395 |
| Sales and marketing                    | 566                            | 1,099    | 1,112                        | 1,450    |
| General and administrative             | 604                            | 1,067    | 1,223                        | 1,427    |
| Research and development               | 285                            | 590      | 571                          | 768      |
| Total share-based compensation expense | \$ 1,935                       | \$ 3,858 | \$ 3,906                     | \$ 5,040 |

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)****18. EARNINGS PER SHARE**

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations:

|   | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2010                           | 2009       | 2010                         | 2009       |
| Net income attributable to AsiaInfo-Linkage, Inc. common stockholders (numerator) | \$ 13,906                      | \$ 7,205   | \$ 24,251                    | \$ 12,995  |
| Shares (denominator)  |                                |            |                              |            |
| Weighted average common stock outstanding   |                                |            |                              |            |
| Basic   | 47,328,078                     | 44,586,996 | 47,277,978                   | 44,048,268 |
| Dilutive effect of share-based compensation                                       | 997,327                        | 1,330,060  | 986,144                      | 1,506,279  |
| Diluted   | 48,325,405                     | 45,917,056 | 48,264,122                   | 45,554,547 |
| Earnings per share  |                                |            |                              |            |
| Net income attributable to AsiaInfo-Linkage, Inc. common stockholders             |                                |            |                              |            |
| Basic   | \$ 0.29                        | \$ 0.16    | \$ 0.51                      | \$ 0.30    |
| Diluted   | \$ 0.29                        | \$ 0.16    | \$ 0.50                      | \$ 0.29    |

As of June 30, 2010 and 2009, the Company had 5,000 and 415,600 common stock options outstanding, respectively, that were excluded from the computation of diluted earnings per share (EPS), as their exercise prices exceeded the average market values in those periods. These options could potentially have a dilutive effect on the Company's EPS in the future.

**19. SEGMENT INFORMATION**

Since October 2004, the Company has been organized as two business units, AsiaInfo Technologies, encompassing the Company's traditional telecommunications business, and Lenovo-AsiaInfo, providing IT services, including security products and services, IT consulting, software customization, and business process outsourcing services, to the enterprise market in China. After disposing of certain non-core business lines during 2005 and 2006, Lenovo-AsiaInfo now focuses on IT security solutions for the small and medium-sized enterprise market in China. In accordance with the FASB guidance, the Company determined that each of these two business units represents an operating segment, of which discrete financial information is available and is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Each operating segment has three product lines: (1) software products and solutions, (2) services, and (3) third-party hardware.

The Company's chief operating decision maker is the Company's Business Committee, comprising the Company's Chief Executive Officer, Chief Financial Officer and senior management team, who allocate resources and evaluate performance of segments based on the following table of condensed consolidated statements of operations and total assets. Accordingly, other items such as inter-segment sales, interest income (expense), income tax expenses (benefit), depreciation and amortization are not disclosed by segment, since such information is not used by the Company's chief operating decision making group to assess the operating performance of individual segments.





**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

(In thousands, except share and per share amounts)

The following sets forth the condensed consolidated statements of operations and total assets for the Company's operating segments based on the Company's three major product lines:

|   | Three Months Ended June 30, |                 |                  |                       |                 |                 |
|---|-----------------------------|-----------------|------------------|-----------------------|-----------------|-----------------|
|   | 2010                        |                 | Total            | 2009                  |                 | Total           |
|   | AsiaInfo Technologies       | Lenovo-AsiaInfo |                  | AsiaInfo Technologies | Lenovo-AsiaInfo |                 |
| <b>Revenues:</b>                          |                             |                 |                  |                       |                 |                 |
| Software products and solutions           | \$ 51,773                   | \$ 7,347        | \$ 59,120        | \$ 41,776             | \$ 5,375        | \$ 47,151       |
| Service                                   | 6,288                       | 97              | 6,385            | 5,883                 | 48              | 5,931           |
| Third-party hardware                      | 1,237                       | 122             | 1,359            | 5,039                 | 447             | 5,486           |
| <b>Total revenues</b>                     | <b>59,298</b>               | <b>7,566</b>    | <b>66,864</b>    | <b>52,698</b>         | <b>5,870</b>    | <b>58,568</b>   |
| <b>Cost of revenues:</b>                  |                             |                 |                  |                       |                 |                 |
| Software products and solutions           | 21,015                      | 2,067           | 23,082           | 20,275                | 2,334           | 22,609          |
| Service                                   | 2,668                       | 89              | 2,757            | 1,892                 | 75              | 1,967           |
| Third-party hardware                      | 1,175                       | 129             | 1,304            | 4,786                 | 424             | 5,210           |
| <b>Total cost of revenues</b>             | <b>24,858</b>               | <b>2,285</b>    | <b>27,143</b>    | <b>26,953</b>         | <b>2,833</b>    | <b>29,786</b>   |
| <b>Gross profit</b>                       | <b>34,440</b>               | <b>5,281</b>    | <b>39,721</b>    | <b>25,745</b>         | <b>3,037</b>    | <b>28,782</b>   |
| <b>Segment expenses:</b>                  |                             |                 |                  |                       |                 |                 |
| Sales and marketing                       | 7,300                       | 3,507           | 10,807           | 7,569                 | 2,360           | 9,929           |
| General and administrative <sup>(1)</sup> | 722                         | 140             | 862              | 727                   | (78)            | 649             |
| Research and development                  | 8,384                       | 1,392           | 9,776            | 7,787                 | 1,005           | 8,792           |
| <b>Total segment expenses</b>             | <b>16,406</b>               | <b>5,039</b>    | <b>21,445</b>    | <b>16,083</b>         | <b>3,287</b>    | <b>19,370</b>   |
| <b>Contribution profit (loss)</b>         | <b>\$ 18,034</b>            | <b>\$ 242</b>   | <b>\$ 18,276</b> | <b>\$ 9,662</b>       | <b>\$ (250)</b> | <b>\$ 9,412</b> |

|                                 | Six Months Ended June 30, |                 |                |                       |                 |                |
|---------------------------------|---------------------------|-----------------|----------------|-----------------------|-----------------|----------------|
|                                 | 2010                      |                 | Total          | 2009                  |                 | Total          |
|                                 | AsiaInfo Technologies     | Lenovo-AsiaInfo |                | AsiaInfo Technologies | Lenovo-AsiaInfo |                |
| <b>Revenues:</b>                |                           |                 |                |                       |                 |                |
| Software products and solutions | \$ 105,528                | \$ 11,343       | \$ 116,871     | \$ 81,158             | \$ 8,430        | \$ 89,588      |
| Service                         | 10,122                    | 167             | 10,289         | 10,730                | 200             | 10,930         |
| Third-party hardware            | 2,891                     | 278             | 3,169          | 7,963                 | 1,063           | 9,026          |
| <b>Total revenues</b>           | <b>118,541</b>            | <b>11,788</b>   | <b>130,329</b> | <b>99,851</b>         | <b>9,693</b>    | <b>109,544</b> |

Cost of revenues:

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|   |           |          |           |           |            |           |
|---|-----------|----------|-----------|-----------|------------|-----------|
| Software products and solutions           | 40,660    | 3,191    | 43,851    | 37,189    | 3,634      | 40,823    |
| Service                                   | 4,579     | 133      | 4,712     | 3,740     | 157        | 3,897     |
| Third-party hardware                      | 2,746     | 284      | 3,030     | 7,564     | 962        | 8,526     |
| Total cost of revenues                    | 47,985    | 3,608    | 51,593    | 48,493    | 4,753      | 53,246    |
| Gross profit                              | 70,556    | 8,180    | 78,736    | 51,358    | 4,940      | 56,298    |
| Segment expenses:                         |           |          |           |           |            |           |
| Sales and marketing                       | 14,914    | 6,206    | 21,120    | 15,985    | 4,481      | 20,466    |
| General and administrative <sup>(1)</sup> | 2,977     | 153      | 3,130     | 1,453     | 44         | 1,497     |
| Research and development                  | 15,972    | 2,800    | 18,772    | 14,082    | 1,925      | 16,007    |
| Total segment expenses                    | 33,863    | 9,159    | 43,022    | 31,520    | 6,450      | 37,970    |
| Contribution profit (loss)                | \$ 36,693 | \$ (979) | \$ 35,714 | \$ 19,838 | \$ (1,510) | \$ 18,328 |

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

(In thousands, except share and per share amounts)

|                             | As of June 30, 2010   |                 |            | As of December 31, 2009 |                 |            |
|-----------------------------|-----------------------|-----------------|------------|-------------------------|-----------------|------------|
|                             | AsiaInfo Technologies | Lenovo-AsiaInfo | Total      | AsiaInfo Technologies   | Lenovo-AsiaInfo | Total      |
| Total assets <sup>(2)</sup> | \$ 413,852            | \$ 56,746       | \$ 470,598 | \$ 423,237              | \$ 58,540       | \$ 481,777 |

(1) General and administrative expenses reported reflect only the direct controllable expenses of each business unit and do not include allocation of corporate general and administrative expenses. The credit amount in the Lenovo-AsiaInfo segment primarily reflects the results of certain bad debt provision reversals recorded in three months ended June 30, 2009.

(2) Included in total assets are net accounts receivable of \$119,168 and \$1,693 for AsiaInfo Technologies and Lenovo-AsiaInfo, respectively, at June 30, 2010 and \$125,445 and \$4,201 for AsiaInfo Technologies and Lenovo-AsiaInfo, respectively, at December 31, 2009. The following is a reconciliation of operating segment contribution profit to income before provision for income taxes:

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|---|--------------------------------|----------|------------------------------|-----------|
|   | 2010                           | 2009     | 2010                         | 2009      |
| Total contribution profit for reportable segments | \$ 18,276                      | \$ 9,412 | \$ 35,714                    | \$ 18,328 |
| Corporate general and administrative expenses     | (3,736)                        | (3,003)  | (10,128)                     | (5,721)   |
| Interest income                                   | 741                            | 534      | 1,402                        | 1,158     |
| Gain from sales of short-term investments         | 472                            | 1,210    | 472                          | 1,210     |
| Dividend income                                   | 250                            | 3        | 254                          | 174       |
| Other income (expense), net                       | (50)                           | 9        | (50)                         | (14)      |
| Income before provision for income taxes          | \$ 15,953                      | \$ 8,165 | \$ 27,664                    | \$ 15,135 |

Since revenues net of cost of third-party hardware sales were reported to the chief operating decision maker, the Company also provides the following table, which reconciles revenues net of cost of third-party hardware sales to total revenues as presented in the Company's consolidated statements of operations:

|   | Three Months Ended June 30, |                 |           |                       |                 |           |
|---|-----------------------------|-----------------|-----------|-----------------------|-----------------|-----------|
|   | 2010                        |                 |           | 2009                  |                 |           |
|   | AsiaInfo Technologies       | Lenovo-AsiaInfo | Total     | AsiaInfo Technologies | Lenovo-AsiaInfo | Total     |
| Revenues, net of cost of third-party hardware sales | \$ 58,123                   | \$ 7,437        | \$ 65,560 | \$ 47,912             | \$ 5,446        | \$ 53,358 |
| Third-party hardware cost                           | 1,175                       | 129             | 1,304     | 4,786                 | 424             | 5,210     |
| Total revenues                                      | \$ 59,298                   | \$ 7,566        | \$ 66,864 | \$ 52,698             | \$ 5,870        | \$ 58,568 |

Six Months Ended June 30,

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|   | 2010                     |                     |            | 2009                     |                     |            |
|---|--------------------------|---------------------|------------|--------------------------|---------------------|------------|
|   | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total      | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total      |
| Revenues, net of cost of third-party hardware sales | \$ 115,795               | \$ 11,504           | \$ 127,299 | \$ 92,287                | \$ 8,731            | \$ 101,018 |
| Third-party hardware cost                           | 2,746                    | 284                 | 3,030      | 7,564                    | 962                 | 8,526      |
| Total revenues                                      | \$ 118,541               | \$ 11,788           | \$ 130,329 | \$ 99,851                | \$ 9,693            | \$ 109,544 |

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)****20. RELATED PARTY TRANSACTIONS**

The Company entered into a series of contractual agreements with Lenovo in connection with the acquisition of Lenovo's non-telecommunications IT services business in October 2004. In conjunction with that acquisition, the Company delivered 5,472,414 shares of its common stock to Lenovo. Among them, 648,769 shares were returned to the Company from an escrow account in February 2007. As of June 30, 2010, Lenovo owned approximately 7% of the Company's outstanding common stock.

The following table provides a summary of the Company's transactions with Lenovo during the three months and six months ended June 30, 2010 and 2009, respectively:

|                          | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|--------------------------|-----------------------------|-------|---------------------------|-------|
|                          | 2010                        | 2009  | 2010                      | 2009  |
| Sales and marketing      | \$ 10                       | \$ 14 | \$ 25                     | \$ 28 |
| Total operating expenses | \$ 10                       | \$ 14 | \$ 25                     | \$ 28 |

|                                | As of June 30, 2010 | As of December 31, 2009 |
|--------------------------------|---------------------|-------------------------|
| Balances with related parties: |                     |                         |
| Other receivables              | \$ 2                | \$                      |
| Advances to suppliers          | 945                 |                         |

The Company entered into consulting agreements with Tom Manning, one of its directors, in January 2009 and February 2009, pursuant to which Mr. Manning agreed to provide certain management and consulting services to the Company. As of June 30, 2010, the Company paid approximately \$443 to Mr. Manning pursuant to the agreements.

**21. COMMITMENTS AND CONTINGENCIES**

*Product warranty* The Company's product warranty accrual reflected management's best estimate of probable liability under its product warranties. Management determines the warranty accrual based on historical experience and other currently available evidence. Product warranty accrual was recorded as a component of accrued expenses in the accompanying balance sheets.

Changes in the product warranty accrual for the six months ended June 30, 2010 were as follows:

|                                      | Six Months Ended June 30, 2010 |
|--------------------------------------|--------------------------------|
| Beginning balance at January 1, 2010 | \$ 266                         |
| Current period provision             | 17                             |
| Expired warranty                     | (24)                           |
| Foreign exchange difference          | 1                              |
| Ending balance at June 30, 2010      | \$ 260                         |

*Litigation* In December 2001, a securities class action case was filed in New York City against the Company, certain of its officers and directors and the underwriters of the Company's initial public offering (IPO). The lawsuit alleged violations of the U.S. federal securities laws and was

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docketed in the U.S. District Court for the Southern District of New York as Hassan v. AsiaInfo Holdings, Inc., et al. The lawsuit alleged, among other things, that the underwriters of the Company's IPO improperly required their customers to pay the underwriters excessive commissions and to agree to buy additional shares of the Company's common stock in the aftermarket as conditions of their purchasing shares in the Company's IPO. The lawsuit further claimed that the alleged practices of the underwriters should have been disclosed in the Company's IPO prospectus and registration statement. The suit seeks rescission of the plaintiffs' alleged purchases of the Company's common stock as well as unspecified damages. In addition to the case against the Company, various other plaintiffs have filed approximately 1,000 other, substantially similar class action cases (collectively, the IPO Allocation Cases) against approximately 300 other publicly traded companies and their IPO underwriters in New York City, which along with the case against the Company, have all been transferred to a single federal district judge for purposes of case management.

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**ASIAINFO-LINKAGE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

**(In thousands, except share and per share amounts)**

In April 2009, the Company and most of the other issuer defendants in the IPO Allocation Cases reached a definitive agreement with the plaintiffs and the underwriter defendants to settle the IPO Allocation Cases. The agreement was filed with the court in April 2009 and a final approval was granted by the court in October 2009. The final approval was subject to appeal until November 2009. Several objectors filed timely appeals and those appeals remain pending. If the settlement is approved, the Company expects any damages payable to the plaintiffs to be fully funded by its directors' and officers' liability insurance policies. If the litigation proceeds, the Company intends to continue to defend the litigation vigorously. Moreover, if the litigation proceeds, the Company believes that the underwriters may have an obligation to indemnify the Company for the legal fees and other costs of defending this suit and that its directors' and officers' liability insurance policies would also cover the defense and potential exposure in the suit.

In addition, in June 2007 the Company received a letter from a putative stockholder demanding that the Company investigate and prosecute a claim for alleged short-swing trading in violation of Section 16(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), by the underwriters of the Company's IPO and certain of the Company's unidentified directors, officers and stockholders. In October 2007, the putative stockholder commenced a civil lawsuit in the U.S. District Court for the Western District of Washington against Morgan Stanley and Deutsche Bank, two of the lead underwriters of the Company's IPO, alleging violations of Section 16(b) of the Exchange Act. The complaint alleges that the combined number of shares of the Company's common stock beneficially owned by the lead underwriters and certain unnamed officers, directors and principal stockholders exceeded ten percent of the Company's outstanding common stock from the date of the Company's IPO in March 2000, for at least one year. It further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b), and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). None of the Company's directors, officers or stockholders is named as defendants in this action, although the Company is named as a nominal defendant. In July 2008, the Company together with several other issuers who are also named as nominal defendants in the action filed a joint motion to dismiss the action. In March 2009, the court granted the motion, dismissing the complaint without prejudice on the ground that the plaintiff failed to make an adequate demand to the Company prior to filing the complaint. The plaintiff subsequently appealed the judgment to the Court of Appeals for the Ninth Circuit, and the underwriter defendants have filed certain cross-appeals. Briefing with respect to these appeals concluded in November 2009 and the appeals remain pending.

The Company intends to continue to defend vigorously the two litigation matters described above. While the Company cannot guarantee the outcome of these proceedings, the Company believes that the final results of these lawsuits will not have a material effect on the Company's consolidated financial condition, results of operations or cash flows.

**22. STOCK REPURCHASE PROGRAM**

On September 11, 2007, the Company announced the authorization of a stock repurchase program under which the Company was entitled, from time to time for a period of four months, depending on market conditions, share price and other factors, to make one or more purchases, on the open market or in privately negotiated transactions, subject to availability, of up to 3,000,000 shares of its outstanding common stock. As of December 31, 2007, the Company repurchased 244,300 shares of its common stock at a total cost of \$1,953 pursuant to this repurchase program.

On February 27, 2008, the Company's Board of Directors authorized an extension to the 2007 share repurchase program through July 10, 2008. Under the extended program, the Company was authorized from time to time, depending on market conditions, share price and other factors make one or more purchases on the open market or in privately negotiated transactions, subject to availability, of up to 2,755,700 shares of its outstanding common stock. Any common stock repurchased by the Company became part of its treasury stock and may be retired or used by the Company to finance or execute acquisitions or other arrangements. As of July 10, 2008, the Company had repurchased 166,400 shares of its common stock at a total cost of \$1,664 pursuant to this repurchase program.

On September 17, 2008, the Company announced a new stock repurchase program under which the Company was authorized to repurchase up to 3,000,000 shares of its outstanding common stock. As of December 31, 2008, the Company had repurchased 2,589,300 shares of its common stock at a total cost of \$24,132.



No repurchases occurred in 2009 and in the six months ended June 30, 2010.

**Table of Contents****ASIAINFO-LINKAGE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****(In thousands, except share and per share amounts)****23. NONCONTROLLING INTEREST**

(a) In September 2008, the Company established a new subsidiary, Shanghai Xinjia Science & Technology Co., Ltd ( AISH ) in Shanghai, with a total capital contribution of \$732. The Company and Mr. Yao Yuan, the other shareholder of AISH, hold 90% and 10% of AISH's share capital, respectively. AISH mainly provides software and services to telecommunication carriers in Shanghai.

(b) In October 2009, the Company acquired 60% of the share capital of SmartCall Holding Limited and the remaining 40% of the share capital was recorded as noncontrolling interest.

**24. REDEEMABLE NONCONTROLLING INTEREST**

(a) In September 2009, the Company formed AsiaInfo International Pte Ltd ( AIP ) with Alpha Growth International Pte Ltd, a company incorporated under the laws of Singapore ( AGI ), in Singapore. AIP has total issued and paid-up share capital of \$4,000. The Company contributed \$2,800 to AIP in cash, which represents 70% of AIP's share capital. AGI contributed \$1,200 to the AIP in cash, which represents 30% of AIP's share capital. AIP serves as an exclusive agent to market and distribute the Company's telecommunications software and service solutions in certain regions in Southeast Asia until December 2014 or such other date as the Company and AGI may mutually agree. The Company has consolidated AIP since its incorporation.

Pursuant to the agreement with AGI, the Company granted a put option to AGI to sell, while the Company received a call option from AGI to purchase, the 30% equity interest held by AGI. The options are exercisable within a 30 day-period from the date of issuing the audit report of AIP's 2013 financial statements. The exercise prices for the call and the put options of the 30% equity interest held by AGI are the same and are determined by a formula based on the performance of AIP for years 2012 and 2013.

(b) As discussed in Note 8, on May 1, 2010, the Company, through a subsidiary of the Company, consummated the acquisition of 80% equity interest of Hangzhou Zhongbo for an aggregate purchase price of \$7,068 in cash. Hangzhou Zhongbo provides IT solutions to broadcasting operators in China.

Pursuant to the agreement with Hangzhou Zhongbo, the Company granted a put option to Hangzhou Zhongbo to sell, while the Company received a call option from Hangzhou Zhongbo to purchase, the 20% equity interest held by Hangzhou Zhongbo. The options are exercisable after December 31, 2011. The exercise prices for the call and the put options of the 20% equity interest held by Hangzhou Zhongbo are the same and are determined by a formula based on the performance of Hangzhou Zhongbo for years 2010 and 2011.

These noncontrolling interests were recorded outside of the permanent equity on the consolidated balance sheets initially at the fair value of the noncontrolling interests as of the date of incorporation or the date of acquisition of these subsidiaries. Subsequently, each noncontrolling interest was carried at the higher of (1) the initial carrying amount, increased or decreased for the noncontrolling interest's share of net income or loss or (2) the accreted amount to the expected redemption value. The change of the carrying amounts of the redeemable noncontrolling interest is recognized as net income attributable to noncontrolling interest in the consolidated statements of operations. For the three months ended March 31, 2010 and the three months ended June 30, 2010, the amounts charged to the net income attributable to noncontrolling interests were \$93 and \$203, respectively, which represents the noncontrolling interests' share of net loss of these subsidiaries.

|                                     | <b>Redeemable<br/>Noncontrolling<br/>Interest</b> |
|-------------------------------------|---|
| <b>Balance at December 31, 2009</b> | <b>\$ 1,122</b>                                   |
| Incorporation of new subsidiaries   |   |

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|                                  |                 |
|----------------------------------|-----------------|
| Net loss                         | (93)            |
| Adjustment to redemption value   |                 |
| <b>Balance at March 31, 2010</b> | <b>\$ 1,029</b> |
| Acquisition of Hangzhou Zhongbo  | 1,354           |
| Net loss                         | (203)           |
| Adjustment to redemption value   |                 |
| <b>Balance at June 30, 2010</b>  | <b>\$ 2,180</b> |

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**ASIAINFO-LINKAGE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)**

**(In thousands, except share and per share amounts)**

**25. SUBSEQUENT EVENTS**

The Company evaluated events occurring after June 30, 2010 until the date the consolidated financial statements were issued.

On July 1, 2010, the Company completed its business combination with Linkage, a leading IT software and solutions provider in China. Pursuant to the Business Combination Agreement dated December 4, 2009, as supplemented on June 5, 2010 by the Supplemental Agreement (collectively, the Combination Agreement), the Company purchased from Linkage 100% of the outstanding share capital of Linkage's wholly-owned subsidiary, Linkage Technologies, which carries out all of the operations of Linkage, for \$60,000 in cash and 26,832,731 shares of the Company's common stock. The aggregate market value of the common stock and the total consideration were \$581,734 and \$641,734 as of the date of acquisition. The transaction was accounted for as a business combination and purchase accounting was applied accordingly. The Company is in the process of performing the purchase price allocation.

Concurrently and in connection with the closing, the Company entered into an escrow agreement with Linkage, Mr. Sun as agent for the shareholders of Linkage, and The Bank of New York Mellon. Pursuant to the agreement, 10% of the Consideration (consisting of \$6,000 in cash and 2,683,273 shares of the Company's common stock) was deposited into an escrow account for a period of 18 months as security for the indemnification obligations of Linkage and certain key Linkage shareholders under the Combination Agreement.

In connection with the closing, on July 1, 2010, the Company changed its corporate name to AsiaInfo-Linkage, Inc.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Except for historical information, the statements contained in this quarterly report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. The Private Securities Litigation Reform Act of 1995, or the Reform Act, contains certain safe harbors regarding forward-looking statements. Certain of the forward-looking statements include management's expectations, intentions and beliefs with respect to our growth, our operating results, the nature of the industry in which we are engaged, our business strategies and plans for future operations, our needs for capital expenditures, capital resources and liquidity, and similar expressions concerning matters that are not historical facts. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. These cautionary statements are being made pursuant to the provisions of the Reform Act with the intention of obtaining the benefits of the safe harbor provisions of the Reform Act. The factors that could cause actual results to differ materially include, but are not limited to, the factors discussed under the heading "Risk Factors" in Part II Other Information below and in the reports we file with the U.S. Securities and Exchange Commission, or the SEC, from time to time.

In this report, AsiaInfo, the Company, we, us and our refer to AsiaInfo-Linkage, Inc. and its subsidiaries and consolidated variable interest entities, or VIEs.

**Overview**

We are a leading provider of high-quality telecommunications software solutions and IT security products and services in China. In the telecommunications market, our software and services enable our customers to build, maintain, operate, manage and continuously improve their communications infrastructure. Our largest customers are the major telecommunications carriers in China and their provincial subsidiaries. In addition to providing customized software solutions to China's telecommunications carriers, we also offer sophisticated IT security products and services to many small- and medium-sized companies and government agencies in China.

We commenced our operations in the United States, or the U.S., in 1993 and moved our major operations from the U.S. to China in 1995. We began generating significant network solutions revenues in 1996 and significant software revenues in 1998. We conduct the bulk of our business through our operating subsidiaries, most of which are Chinese companies. In July 2010, we completed our previously announced business combination with Linkage Technologies International Holdings Limited, or Linkage and, in connection with the closing, changed our corporate name to AsiaInfo-Linkage, Inc.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of large telecommunications customers, such as China Mobile, China Unicom and China Telecom and their respective provincial subsidiaries. The following table shows our revenues and percentage of total revenues derived from those three customers (and their respective provincial subsidiaries) for the three months ended June 30, 2010 and 2009.

|               | Three Months Ended June 30,   |                                 |                               |                                 |
|---------------|-------------------------------|---------------------------------|-------------------------------|---------------------------------|
|               | 2010                          |                                 | 2009                          |                                 |
|               | Revenues<br>(in<br>thousands) | Percentage of Total<br>Revenues | Revenues<br>(in<br>thousands) | Percentage of Total<br>Revenues |
| China Mobile  | \$ 44,335                     | 66%                             | \$ 38,206                     | 65%                             |
| China Telecom | 2,604                         | 4%                              | 4,966                         | 9%                              |
| China Unicom  | 11,559                        | 17%                             | 9,510                         | 16%                             |
| Total         | \$ 58,498                     | 87%                             | \$ 52,682                     | 90%                             |

As a result of our reliance on our key customers in the telecommunications industry, our operating results are influenced by governmental spending policies in that sector. Historically, a number of state-mandated restructurings in China's telecommunications sector have led to cancellation or delays in telecommunications-related capital expenditures, and have negatively impacted our operating results in certain periods. However, certain state-mandated restructurings in China's telecommunications sector have caused our revenues to increase as carriers have increased spending on software and IT infrastructure designed to increase their competitiveness. Any future restructurings affecting our major telecommunications customers may result in delays or cancellation of telecommunications-related spending, which could have an adverse impact on our business.



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Since our acquisition of the non-telecommunications-related IT services business of Lenovo in October 2004, we have been organized as two business segments: AsiaInfo Technologies, encompassing our traditional telecommunications business, and Lenovo-AsiaInfo, providing IT security products and services to China's enterprise market. For financial reporting purposes, each of the two business segments is further organized into three product lines:

software products and solutions;

services; and

third-party hardware.

### **Recent Developments**

On July 1, 2010, we completed our previously announced business combination with Linkage. Pursuant to the Business Combination Agreement dated December 4, 2009, as supplemented on June 5, 2010 by the Supplemental Agreement, by and among the Company, Linkage, certain shareholders of Linkage, and Libin Sun as agent for the shareholders of Linkage, which we collectively refer to as the Combination Agreement, we purchased from Linkage 100% of the outstanding share capital of its wholly-owned subsidiary, Linkage Technologies Investment Limited, or Linkage Technologies, for \$60 million in cash and 26,832,731 shares of our common stock, resulting in Linkage Technologies becoming our wholly-owned subsidiary. In connection with the closing, on July 1, 2010 we changed our corporate name to AsiaInfo-Linkage, Inc.

### **Revenues**

We report our revenues on the basis of the three principal types of revenues derived from our business: software products and solutions revenue, service revenue and third-party hardware revenue. We allocate revenues of bundled arrangements in the three categories based on the selling prices of each component as set out in sales contracts. Please refer to Note 19 to the condensed consolidated financial statements included in this report for detailed financial information regarding segment reporting.

**Software products and solutions revenue.** We typically sell our software as part of a total solutions package for our customers, which includes proprietary software licenses, professional services related to the design and implementation of the solutions (such as consulting, training, technical support and maintenance) and, in cases where the customer requests a turn-key solution, related hardware. Software products and solutions revenue includes two types of revenues: software license revenue and software services revenue. Software license revenue consists of fees received from customers for licenses or sublicenses to use our software products or third-party software products in perpetuity, typically up to a specified maximum number of users. In most cases where a customer is required to purchase additional licenses from us because the number of users exceeds the number of licensed users, we enter into an extension agreement with the customer to expand and upgrade the customer's system. These extension contracts will usually include a license for the additional users, updated versions of our software and, if required, additional services and hardware for the customer's network. Our software license revenue also includes the benefit of value-added tax rebates on software license sales, which reflect the Chinese government's policy of encouraging the development of China's software industry. Software services revenue consists of revenue from software installation, customization, training and other services. We also record reductions from revenue for our estimates of expected software sales returns from distributors based on current sales and historical sales returns.

**Service revenue.** Service revenue consists of revenue from professional services, including IT services, management consulting, and network planning, design, systems integration and training services.

In addition, in recent periods we have begun to generate service revenues by acting as a sales agent for International Business Machines Corporation, or IBM, or its distributors for certain products sold to China Mobile and its provincial subsidiaries, or the IBM Arrangement. The service fee under the IBM Arrangement is determined as a percentage of the gross contract amount. We have evaluated the criteria outlined in guidance issued by the Financial Accounting Standards Board, or the FASB, regarding reporting revenue gross as principal versus net as an agent, in determining whether to record as revenues the gross amount billed to China Mobile and related costs or the net amount earned after deducting hardware costs paid to the vendor, even though we bear inventory risks after the vendor ships the products to us and we bill gross amounts to China Mobile. We record the net amount earned after deducting hardware costs as agency service revenue because (1) the vendor is the primary obligor in these transactions, (2) we have no latitude in establishing the prices, (3) we are not involved in the determination of the product specifications, (4) we do not bear credit risk because we are contractually obligated to pay the vendor only when China Mobile pays us, and (5) we do not have the right to select suppliers.





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**Third-party hardware revenue.** Other than the IBM Arrangement, we sometimes procure for, and sell hardware to, our customers as part of certain turn-key solutions. We typically minimize our exposure to hardware inventory risks by sourcing equipment from hardware vendors against letters of credit from our customers. For these hardware transactions, we have also evaluated the criteria outlined in FASB guidance. As a result of the evaluation, we record the gross amounts billed to our customers as revenues because (1) we are the primary obligor in these transactions, (2) we bear the inventory risk, (3) we have latitude in establishing prices, (4) we are involved in the determination of the product specifications, (5) we bear credit risk, and (6) we have the right to select suppliers. As the telecommunications-related IT services market in China develops, our customers are increasingly purchasing hardware directly from hardware vendors and retaining us for our software and professional services.

**Net revenue (non-GAAP).** Although we report our revenue on a gross basis, inclusive of hardware acquisition costs, we manage our business internally based on revenues net of hardware costs, or net revenues (non-GAAP), which is consistent with our strategy of providing our customers with high-value IT professional services and, where efficient, outsourcing lower-end services such as hardware acquisition and installation. This strategy may result in lower growth rates for total revenue as against prior periods, but will not adversely impact revenue net of hardware costs. The following table shows our revenue breakdown on this basis and reconciles our net revenues (non-GAAP) to total revenues:

**Reconciliation of Net Revenues (non-GAAP) to Total Revenues  
Three Months Ended June 30,**

|   | 2010                     |                     |           | 2009                     |                     |           |
|---|--------------------------|---------------------|-----------|--------------------------|---------------------|-----------|
|   | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total     | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total     |
| Revenues net of hardware costs:         |                          |                     |           |                          |                     |           |
| Software products and solutions revenue | \$ 51,773                | \$ 7,347            | \$ 59,120 | \$ 41,776                | \$ 5,375            | \$ 47,151 |
| Service revenue                         | 6,288                    | 97                  | 6,385     | 5,883                    | 48                  | 5,931     |
| Third-party hardware revenue            | 62                       | (7)                 | 55        | 253                      | 23                  | 276       |
| Total revenues net of hardware costs    | 58,123                   | 7,437               | 65,560    | 47,912                   | 5,446               | 53,358    |
| Total hardware costs                    | 1,175                    | 129                 | 1,304     | 4,786                    | 424                 | 5,210     |
| Total revenues                          | \$ 59,298                | \$ 7,566            | \$ 66,864 | \$ 52,698                | \$ 5,870            | \$ 58,568 |

**Reconciliation of Net Revenues (non-GAAP) to Total Revenues  
Six Months Ended June 30,**

|   | 2010                     |                     |            | 2009                     |                     |            |
|---|--------------------------|---------------------|------------|--------------------------|---------------------|------------|
|   | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total      | AsiaInfo<br>Technologies | Lenovo-<br>AsiaInfo | Total      |
| Revenues net of hardware costs:         |                          |                     |            |                          |                     |            |
| Software products and solutions revenue | \$ 105,528               | \$ 11,343           | \$ 116,871 | \$ 81,158                | \$ 8,430            | \$ 89,588  |
| Service revenue                         | 10,122                   | 167                 | 10,289     | 10,730                   | 200                 | 10,930     |
| Third-party hardware revenue            | 145                      | (6)                 | 139        | 399                      | 101                 | 500        |
| Total revenues net of hardware costs    | 115,795                  | 11,504              | 127,299    | 92,287                   | 8,731               | 101,018    |
| Total hardware costs                    | 2,746                    | 284                 | 3,030      | 7,564                    | 962                 | 8,526      |
| Total revenues                          | \$ 118,541               | \$ 11,788           | \$ 130,329 | \$ 99,851                | \$ 9,693            | \$ 109,544 |

We believe total revenues net of hardware costs in each of the segments of our business more accurately reflect our core business, which is the provision of software solutions and services. We also believe this measure provides transparency to our investors because it is the measure used by our management to evaluate the competitiveness and performance of our business in each of the segments. In addition, third-party hardware revenue tends to fluctuate from period to period depending on the requirements of our customers. As a result, a presentation that excludes hardware costs allows investors to better evaluate the performance of our core business and we report this presentation to our chief operating decision maker.



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### **Cost of Revenues**

**Software products and solutions costs.** Software products and solutions costs consist primarily of three components:

packaging and written manual expenses for our proprietary software products and solutions;

compensation and travel expenses for the professionals involved in modifying, customizing or installing our software products and solutions and in providing consultation, training and support services; and

software license fees paid to third-party software providers for the right to sublicense their products to our customers as part of our solutions offerings.

The costs associated with designing and further developing our proprietary software are classified as research and development expenses as incurred.

**Service costs.** Service costs consist primarily of compensation and travel expenses for the professionals involved in designing and implementing IT services, management consulting and network solutions projects.

**Third-party hardware costs.** We recognize hardware costs in full upon delivery of the hardware to our customers. In order to minimize our working capital requirements, we generally obtain from our hardware vendors payment terms that are timed to permit us to receive payment from our customers for the hardware before our payments to hardware vendors are due. However, in large projects we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements.

Amortization of intangible assets, depreciation of properties and equipment, and rental expenses are also included in cost of revenue.

### **Operating Expenses**

Operating expenses are comprised of sales and marketing expenses, general and administrative expenses, and research and development expenses. Compensation expenses consistently comprise a significant portion of our total operating expenses.

Sales and marketing expenses include compensation expenses for employees in our sales and marketing departments, third-party advertising expenses, sales commissions and sales consulting fees, as well as the depreciation and amortization expenses allocated to our sales and marketing departments.

Research and development expenses relate to the development of new software and the modification of existing software. We expense such costs as they are incurred.

### **Taxes**

Except for certain hardware procurement and resale transactions, we conduct substantially all of our business through our Chinese subsidiaries and VIEs. Prior to the enactment of China's new Chinese Enterprise Income Tax Law, or the EIT Law, which became effective on January 1, 2008, foreign-invested enterprises, or FIEs, were generally subject to a 30% state enterprise income tax plus a 3% local income tax. However, most of our operating subsidiaries in China, as FIEs, were entitled to tax holidays or certain preferential tax treatments, which thus reduced their effective rate of income tax to 15% or lower in some cases. Since the EIT Law became effective, all resident enterprises are subject to a flat 25% income tax rate, unless they are otherwise eligible for certain preferential tax treatments under the new rules.

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Pursuant to the implementation rules to the EIT Law issued in December 2007, and the several subsequent transition rules, certain of our subsidiaries in China can continue to enjoy preferential tax rates, as long as they are qualified as high and new technology enterprises, or HNTEs. Some of our subsidiaries and VIEs in China became subject to a normal 25% income tax rate, while certain of our subsidiaries and VIEs in China remain eligible for the lower rates under the transition rules. The HNTE status allows qualifying entities to be eligible for a 15% tax rate for three years. At the conclusion of the three-year period, the qualifying enterprise has the option to renew its HNTE status for an additional three years through a simplified application process if such enterprise's business operations continue to qualify for HNTE status. After the first six years, the enterprise would have to complete a new application process in order to renew its HNTE status. As of December 2009, we had received certification of HNTE status for AsiaInfo Technologies, AsiaInfo Technologies (Chengdu), or AICD, and Lenovo Security, which allows for a reduced 15% tax rate starting January 1, 2009. Accordingly, we have used the reduced rate of 15% in the calculations of current and deferred tax balances for AICD. AsiaInfo Technologies was approved as a key software enterprise, and it is eligible for the preferential tax rate of 10% for 2008 and 2009 and 15% for 2010. Lenovo Security was subject to an applicable tax rate of 0% from 2005 to 2007 and 7.5% from 2008 to 2009. If Lenovo Security continues to maintain its HNTE status in 2010, then it will remain subject to an applicable tax rate of 12.5% in 2010.

Sales of hardware procured in China are subject to a 17% value-added tax. Most of our sales of hardware procured outside of China are made through our U.S. parent company, AsiaInfo-Linkage, Inc., and thus are not subject to the value-added tax. We effectively pass value-added tax on hardware sales through to our customers and do not include them in revenues reported in our financial statements. Companies that develop their own software and register the software with the relevant authorities in China are generally entitled to a value-added tax refund. If the net amount of the value-added tax payable exceeds 3% of software sales and software-related services, the excess portion of the value-added tax is refundable immediately. This policy is effective until the end of 2010. The benefit of the rebate of value-added tax is included in software revenue. Historically, the value-added tax refund is not taxable for income tax purposes as long as the refund is used for research and development activities. However, according to a new tax circular which was issued by the PRC State Administration of Taxation in January 2009, although the value-added tax refund would remain non-taxable when the refund is used for expenses or purchase of or expenses associated with fixed assets, the expenses and depreciation associated with such fixed assets are not tax deductible for income tax purposes. This circular also stipulates that any VAT refund not spent after five years since being received shall be treated as taxable income. It