

China Digital TV Holding Co., Ltd.  
Form 20-F  
April 28, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 20-F**

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

**OR**

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

**For the fiscal year ended December 31, 2014**

**OR**

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

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

**OR**

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

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

Commission file number 001-33692

**CHINA DIGITAL TV HOLDING CO., LTD.**

(Exact name of Registrant as specified in its charter)

<b>N/A</b>	<b>Cayman Islands</b>
<b>(Translation of Registrant's name into English)</b>	<b>(Jurisdiction of incorporation or organization)</b>
<b>Jingmeng High-Tech Building B, 4th Floor</b>	

**No. 5 Shangdi East Road**

**Haidian District, Beijing 100085**

**People's Republic of China**

**(Address of principal executive offices)**

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**(Name, telephone, email and/or facsimile number and address of Company contact person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on which Registered</b>
<b>Ordinary shares, par value US\$0.0005 per share*</b>	<b>New York Stock Exchange</b>
<b>American depositary shares, each representing one ordinary share</b>	

\* Not for trading, but only in connection with the listing on the New York Stock Exchange of American depositary shares, or ADSs, each representing one ordinary share.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**(Title of Class)**

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

**None**

**(Title of Class)**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

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As of December 31, 2014, 59,705,570 ordinary shares, par value US\$0.0005 per share, were issued and outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statement included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued  Other

by the International Accounting Standards Board

If  Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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**INTRODUCTION**

Except where the context otherwise requires and for purposes of this annual report only:

**ADSs** refers to our American depositary shares, each of which represents one ordinary share of CDTV Holding;

**ADRs** refers to American depositary receipts, which, if issued, evidence our ADSs;

**CA systems** refers to conditional access systems provided to the PRC's digital television market, which consist of: (1) smart cards that are inserted into set-top boxes at the subscriber's end or terminal end; (2) software installed at the digital television network operator's transmission point, or head end; and (3) software for set-top boxes, enabling digital television network operators to control the distribution of content and value-added services to their subscribers and block unauthorized access to their networks;

**China** or the **PRC** refers to the People's Republic of China, excluding, for the purposes of this annual report, Hong Kong, Macau and Taiwan;

**RMB** or **Renminbi** refers to the legal currency of China;

**U.S.** or **United States** refers to the United States of America;

**U.S. dollars** or **US\$** refers to the legal currency of the United States; and

**U.S. GAAP** refers to generally accepted accounting principles in the United States.

All references to CDTV Holding, we, us or our include China Digital TV Holding Co., Ltd., its subsidiaries, the businesses acquired from Novel-Tongfang Information Engineering Co., Ltd., or N-T Information Engineering, and, in the context of describing our operations and consolidated financial information, also include Beijing Novel-Super Digital TV Technology Co., Ltd. (formerly known as Beijing Novel-Tongfang Digital TV Technology Co., Ltd.), or N-S Digital TV, and its subsidiaries.

**FORWARD-LOOKING STATEMENTS**

This annual report contains 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, with respect to our business, operating results and financial condition as well as our current expectations, assumptions, estimates and projections about our industry. All statements other than statements of historical fact in this annual report are forward-looking statements. These forward-looking statements can be

identified by words or phrases such as the words anticipate, believe, estimate, expect, intend, plan, may, to, should, will and similar expressions. These forward-looking statements include, without limitation, statements relating to:

changes in technology standards in the digital television broadcasting industry and our ability to adapt to these changes;

our expectations regarding demand for our products and services;

our ability to develop new products and services, and expand our sales and distribution network and other aspects of our operations;

expected changes in our revenues and cost and expense items;

our expectation regarding the financial performance of Beijing Super TV Co., Ltd., or Super TV;

our ability to continue to operate as a going concern after the completion of the planned sale of Super TV;



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our ability to maintain our listing on the New York Stock Exchange, or the NYSE, after the completion of the planned sale of Super TV;

our ability to effectively protect our intellectual property rights as well as not infringe on the intellectual property rights of others;

the competitiveness of our products and services;

the level of competition in the CA systems market;

government policies and regulations relating to the digital television broadcasting industry, the CA systems industry and other areas relevant to our business activities;

any significant changes to the PRC government's ongoing digitalization program;

general economic and business conditions in the PRC and elsewhere;

our future business development and economic performance;

our future business development plans and strategic initiatives; and

the future expansion of the PRC digital television broadcasting market, and factors driving that growth. These forward-looking statements involve various risks and uncertainties. These forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from the information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in Item 3. Key Information D. Risk Factors and the following:

general economic and business conditions in the PRC and elsewhere;

governmental, statutory, regulatory or administrative initiatives affecting us;

trends in the PRC's digital television broadcasting industry, including the continued progress of digitalization in the PRC and the continued growth of digital television network operators;

the financial performance of Super TV in the Covered Period (as defined below);

future profitability of our remaining business and operations;

exchange rate fluctuations between the Renminbi and other currencies; and

the availability of qualified management and technical personnel.

Due to these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this annual report may not occur in the way we expect, or at all. Accordingly, you should not place undue reliance on any forward-looking information. The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update or otherwise revise the forward-looking statements in this annual report, whether as a result of new information, future events or otherwise.

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**PART I**

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

Not Applicable.

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

Not Applicable.

**Item 3. Key Information**

**A. Selected Financial Data**

**Our Selected Consolidated Financial Data**

The following selected consolidated financial data should be read in conjunction with Item 5. Operating and Financial Review and Prospects and our audited consolidated financial statements and the notes thereto included elsewhere in this annual report on Form 20-F. The selected consolidated statement of operations data for the years ended December 31, 2012, 2013 and 2014, and the selected consolidated balance sheet data as of December 31, 2013 and 2014 set forth below are derived from our audited consolidated financial statements included elsewhere in this annual report. The selected consolidated statement of operations data for the years ended December 31, 2010 and 2011 and the selected historical consolidated balance sheet data as of December 31, 2010, 2011 and 2012 set forth below are derived from our audited consolidated financial statements which are not included in this annual report.

Our audited historical consolidated financial statements have been prepared and presented in accordance with U.S. GAAP.

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Our historical results for any prior period do not necessarily indicate our results to be expected for any future period.

	For the years ended December 31,									
	2010		2011		2012		2013		2014	
	(In thousands of U.S. dollars, except share and per share data)									
<b>Consolidated Statements of Operations Data:</b>										
Revenues										
Products	US\$	82,518	US\$	95,162	US\$	85,319	US\$	82,926	US\$	73,520
Services		5,225		5,378		4,925		5,521		9,423
Total revenues		87,743		100,540		90,244		88,447		82,943
Business and related taxes		(620)		(1,445)		(1,501)		(1,283)		(1,410)
Net revenues		87,123		99,095		88,743		87,164		81,533
Cost of revenues										
Products		15,148		16,100		16,880		17,009		13,845
Services		3,040		3,027		3,952		4,652		4,384
Total cost of revenues		18,188		19,127		20,832		21,661		18,229
Gross profit		68,935		79,968		67,911		65,503		63,304
Total operating expenses										
Income from operations		25,325		35,240		40,452		44,167		42,088
Interest income		43,610		44,728		27,459		21,336		21,216
Interest expense		5,294		6,810		6,318		1,901		1,312
Gain/(loss) from forward contracts				(1,452)		(739)				
Impairment loss on long-term investments				404		(690)				
Other (expense)/income		(5,000)		594		549		534		3,069
Income before income taxes		(92)		51,084		28,410		23,771		25,597
Income tax expense		43,812		9,762		22,232		727		6,373
Net income before loss from equity method investments		10,250		41,322		6,178		23,044		19,224
Loss from equity method investments, net of income taxes		33,562		(1,052)		(640)		(468)		(59)
Net income		(151)		40,270		5,538		22,576		19,165

Net loss attributable to noncontrolling interest		(10)	(730)	(1,389)	(1,832)	(1,725)
Net income attributable to holders of ordinary shares	US\$	33,421	41,000	6,927	24,408	20,890
<b>Earnings per share data:</b>						
Net income per ordinary share basic	US\$	0.57	0.70	0.12	0.41	0.35
Net income per ordinary share diluted	US\$	0.57	0.69	0.12	0.41	0.34
Weighted average shares used in calculating basic net income per share ordinary shares		58,313,467	58,934,912	59,011,396	59,111,594	59,369,708
Weighted average shares used in calculating diluted net income per share		58,779,027	59,075,466	59,092,804	59,176,457	61,716,779
<b>Consolidated Balance Sheet Data:</b>						
Cash and cash equivalents	US\$	148,944	201,557	130,697	79,085	62,042
Total assets		273,642	321,338	193,565	148,806	139,111
Total liabilities		94,622	111,016	110,402*	37,834	37,084
Total China Digital TV Holding Co., Ltd. shareholders equity		178,500	206,442	80,458*	110,036	101,462
Noncontrolling interest		520	3,880	2,705	936	565
Total liabilities and equity	US\$	273,642	321,338	193,565	148,806	139,111

\*The amount reflects an adjustment to dividend payable included in total liabilities and additional paid-in capital included in equity, respectively, in the amount of US\$971,377 to the amount reported in our unaudited financial results for the three months and full year ended December 31, 2012 announced on February 26, 2013 to rectify an error.

### Exchange Rate Information

Our business is primarily conducted in China and substantially all of our revenues are denominated in Renminbi. We present our historical consolidated financial statements in U.S. dollars. In addition, solely for the convenience of the reader, this annual report contains translations of certain Renminbi amounts into U.S. dollars at specific rates. For January 1, 2010 and all later dates and periods, the exchange rate refers to the exchange rate as set forth in the H.10 statistical release of the Federal Reserve Board. Unless otherwise indicated, conversions of Renminbi into U.S. dollars in this annual report are based on the exchange rate on December 31, 2014. We make no representation that any Renminbi amounts could have been, or could be, converted into U.S. dollars or vice versa, as the case may be, at any particular rate, the rates stated below, or at all. For a detailed explanation of the risk of currency rate fluctuations, please see Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China Fluctuations in exchange rates could result in foreign currency exchange losses. The PRC government imposes controls over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and

through restrictions on foreign trade.

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On April 24, 2015, the daily exchange rate reported by the Federal Reserve Board was RMB6.1930 to US\$1.00. The following table sets forth additional information concerning exchange rates between Renminbi and U.S. dollars for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we use in this annual report or will use in the preparation of our future periodic reports or any other information to be provided to you.

	<b>RMB per US\$1.00</b>	
	<b>High</b>	<b>Low</b>
October 2014	6.1385	6.1107
November 2014	6.1429	6.1117
December 2014	6.2256	6.1490
January 2015	6.2535	6.1870
February 2015	6.2695	6.2399
March 2015	6.2741	6.1955
April 2015 (through April 24, 2015)	6.2152	6.1927

The following table sets forth the average exchange rates between Renminbi and U.S. dollars for each of 2010, 2011, 2012, 2013 and 2014 calculated by averaging the exchange rates on the last day of each month during each of the relevant years.

**Average Exchange Rate**

	<b>RMB per US\$ 1.00</b>
2010	6.7603
2011	6.4475
2012	6.2990
2013	6.1412
2014	6.1704

**B. Capitalization and Indebtedness**

Not Applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not Applicable.

**D. Risk Factors**

*You should carefully consider all of the information in this annual report, including the risks and uncertainties described below, before deciding to invest in our ADSs. The trading price of our ADSs could decline due to any of these risks and uncertainties, and you may lose all or part of your investment.*





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### **Risks Relating to Our Business and Industry**

*We derive substantially all of our revenues from customers who are installing new CA systems, and if we are unable to continue attracting new customers to install our CA systems or persuade existing customers to purchase our system upgrades or value-added applications, our revenues, profitability and prospects may be materially and adversely affected.*

CA systems vendors in more mature digital television markets, such as the United States and Europe, derive revenues not only from the purchase of new CA systems by television network operators who are switching from analog to digital transmissions, but also from the purchase of new and replacement smart cards, system upgrades and new value-added services by existing customers. In the PRC, however, cable television network operators are still in the process of purchasing CA systems and introducing digital content and services to their subscribers. To date, none of our customers has made a follow-on purchase for system upgrades or card replacements. As a result, the success of our business depends primarily on our ability to attract a continuing stream of customers who are switching from analog to digital transmission. As the digitalization process in the PRC continues, the number of cable television network operators who have not switched from analog to digital transmission, who are the prospective customers of our CA systems, has been decreasing significantly. According to GL Research, an independent market research firm, the digitalization rate of PRC cable television users has reached 80.72% as of November 30, 2014. If we are unable to continue attracting sufficient numbers of such customers, or to develop a significant additional source of recurring revenues, our revenues and profitability may be materially reduced and our prospects may suffer.

*Changes in the regulatory environment and government policies of the PRC could have a material adverse effect on our business, financial condition and results of operations.*

Strong PRC government support has been a significant driver of the PRC television broadcasting industry's transition from analog to digital transmission. Although the PRC government has set a target for substantially all cable television networks to switch to digital transmissions in the urban areas, we cannot assure you that the government will not change or adjust its digitalization policies at any time, including canceling or relaxing the target for completing such digitalization. If the digitalization process in the PRC were to be slowed down or otherwise adversely affected by any government action or inaction, we may not be able to develop a broader customer base or attract new business from existing customers, and our growth and prospects would be materially and adversely affected.

Furthermore, the television broadcasting industry in the PRC is highly regulated. Government regulations with respect to television broadcasting content, the amount and content of advertising, the pricing of pay-television subscriptions, the role of private-sector investment and the role of foreign investment significantly influence the business strategies and operating results of our customers. For example, the PRC State Administration of Press, Publication, Radio, Film and Television (formerly, the PRC General Administration of Press and Publication and the PRC State Administration of Radio, Film and Television), or the SAPPRFT, issues licenses without which our customers cannot operate, and may withdraw such licenses for violation of its regulations. Among other things, the SAPPRFT must approve the creation of new premium content channels and has the power to order television network operators to stop airing programs or advertising that it considers illegal or inappropriate. Any adverse government actions against television network operators could, in turn, cause us to lose existing or potential customers.

In addition, many of our customers are directly or indirectly owned by the central PRC government or provincial or local governments. As a result, their business strategies and capital expenditure budgets are significantly influenced by government policies at various levels. Any change in the business strategies of our customers that leads to a reduction in the funds available to purchase our CA systems could have a material adverse effect on our business, financial condition and results of operations. Furthermore, the ongoing consolidation of the PRC cable television broadcasting

industry could, among other things, substantially increase the bargaining power of the consolidated network operators over us and require us to reduce the prices of our CA systems and other products and services, which could, in turn, materially reduce our revenues and profitability.

***If significant numbers of television viewers in the PRC are unwilling to pay for digital television or related value-added services, our business and profits will suffer.***

The substantial majority of our revenues are derived from digital television network operators who purchase our head-end CA systems software and smart cards to insert in the set-top boxes of their subscribers. As a result, we are substantially dependent upon the television network operators' ability to sell digital television subscriptions to viewers. In addition, the success of our efforts to generate future revenues by offering value-added services to television viewers ultimately depends on whether viewers are willing to pay for such value-added services.

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We cannot assure you that television network operators will be successful in promoting digital television or value-added services. In particular, television viewers in the PRC are accustomed to receiving television programming and content for free or at a very low price. Even viewers who are accustomed to paying for cable television subscriptions have historically paid very low rates and may not be willing to pay significantly higher rates for digital television services, or additional fees for value-added services. If digital television network operators are unable to develop unique and compelling content to differentiate their product offerings from the content provided through analog transmissions or offer value-added services that meet viewers' needs at an affordable price, these operators may find it difficult to persuade viewers to accept the pay-television model or pay more for digital television or value-added services than viewers have historically paid for analog television. In that event, our customers' digital subscriber numbers may not grow and we may be unable to sustain our current level of revenues, net income and/or growth.

***If large numbers of television network operators who have already installed our CA system head-end software do not purchase sufficient quantities of our smart cards, our financial condition and results of operations would be materially and adversely affected.***

Television network operators who purchase and install our CA systems head-end software generally purchase our smart cards in batches over a period of several months to several years as they roll out digital services to their subscribers in stages. Substantially all of our revenues are derived from the sale of smart cards to customers who are engaged in such service roll-outs. However, certain television network operators have in the past installed our CA systems head-end software and subsequently failed to purchase sufficient quantities of our smart cards. Factors that may cause a television network operator to suspend or halt its digitalization using our products include, but are not limited to, changes in such television network operator's management priorities or financial position, and a decision by such television network operator to carry out digitalization using the CA systems of a competitor.

In January 2010, the PRC government stepped up its policy to encourage convergence of television broadcasting, telecommunications and Internet services. Although this policy may lead to acceleration of the digitalization of cable networks as the cable operators prepare themselves for potential competition from telecommunications operators, it may also have a material adverse effect on our business. In particular, as a response to that policy, and as an important measure to strengthen the competitiveness of the cable television industry as a whole, the SAPPRFT has increased its efforts to consolidate the cable television industry. As a result, some provincial cable operators have completed consolidation of and gained increasing influence over the municipal cable operators, including the latter's purchase and investment decisions. If the provincial cable operators, who may be CA customers of our competitors or otherwise prefer our competitors' products, direct the municipal cable operators to suspend or cancel their orders for our smart cards or purchase smart cards from our competitors, our business could suffer.

Furthermore, the SAPPRFT released a unified CA systems standard in March 2012, which requires a unified CA system that is compatible with different terminals developed by different vendors to be used. Although this standard has not yet been implemented, upon such implementation, it would allow television network operators greater flexibility in selecting vendors of CA systems and related upgrades, including those of our competitors.

If large numbers of television network operators who have already installed our CA systems head-end software fail to purchase commercial quantities of our smart cards, our financial condition and results of operations would be materially and adversely affected.

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***Our business will suffer if we do not respond effectively to technological or commercial changes in our industry.***

Our business and the market in which we operate are characterized by rapid commercial and technological change, evolving industry standards and frequent product enhancements. As digital broadcasting becomes more popular in the PRC, television network operators are likely to seek more sophisticated CA technology that offers them greater reliability, flexibility and functionality in delivering protected content or value-added services to viewers. As methods of distributing information and entertainment evolve, CA technology may also need to evolve to provide content protection for distribution platforms other than television. Our continued success will depend, in part, on our ability to develop and market products and services that respond to technological changes and evolving market demand or industry standards in a timely and cost-effective manner. We will need to invest significant financial resources in research and development to keep pace with technological advances in the CA systems industry and related industries. However, research and development activities are inherently uncertain, and our significant expenditures on research and development may not yield corresponding benefits. If we fail to develop and introduce products and services that effectively respond to technical changes and evolving market demand or industry standards and compete effectively with products and services offered by our competitors, our sales may be significantly reduced and our revenues and profitability will suffer.

***We depend, and expect to continue to depend, on a limited number of customers for a significant portion of our revenues in any single period. If one customer defers or cancels its orders or chooses our competitors' products or services, our revenues and net income could decline significantly.***

The revenues generated by our top five customers for a particular year as a percentage of our total revenues increased from 23.5% in 2010 to 26.9% in 2014. We currently still derive, and we expect to continue to derive, a significant portion of our revenues from a limited number of customers, although the particular customers may vary from period to period. As digital cable television systems are still at the developing stage in the PRC, the largest shipments of smart cards tend to be to operators who are launching new digital transmission systems and need to purchase in bulk for their established networks. If a customer significantly reduces the volume of its purchases from us, defers or cancels orders or terminates its relationship with us, our revenues and net income could decline significantly and, as a result, our financial condition and results of operations could be materially and adversely affected.

***Our business may suffer if cable television network operators, who currently comprise our primary customer base, fail to compete effectively with existing and emerging alternative platforms for delivering television programs, including terrestrial networks, Internet Protocol television, mobile television and satellite broadcasting networks.***

Our existing customers are mainly cable television network operators in the PRC, which compete with traditional terrestrial television networks for the same pool of viewers. As technologies continue to develop, other means of delivering information and entertainment to television viewers are also continuing to evolve. For example, some telecommunications companies in the PRC are seeking to compete with terrestrial broadcasters and cable television network operators by offering Internet Protocol television, or IPTV, which allows telecommunications companies to stream television programs through telephone lines. The SAPPRT has issued seven IPTV licenses, and seven Internet TV licenses for integration platforms, and it may issue significantly more IPTV and Internet TV licenses in the future. We may not be as successful in selling our CA systems to the operators of IPTV, or terrestrial, satellite or mobile television networks as we have been in selling to cable television network operators. To the extent that the terrestrial television networks, telecommunications companies or satellite television network operators compete successfully with cable television network operators for viewers, the ability of our existing cable customer base to attract and retain subscribers may be severely disrupted. As a result, demand for additional smart cards could falter and our business, financial condition and results of operations would be materially and adversely affected.



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***Our business could be harmed if the security of our customers' networks is compromised due to a failure of our CA systems or a security breach of the software or hardware supplied by other vendors.***

We face risks relating to a failure of our CA systems to block unauthorized access to the television networks of our customers. Our CA systems use a combination of signal scrambling and encryption to prevent unauthorized viewing of our customers' television programs. An important component of our CA systems is the smart cards we provide for our customers' individual subscribers. Unauthorized viewing and use of content could be accomplished by counterfeiting our smart cards, stealing our systems' authorization messages or security codes, or in any other way thwarting our CA systems' security features. Any significant security breach could require us to develop and implement solutions that could be costly or time-consuming, or to replace an operator's smart cards at our own expense. For example, pursuant to our contracts with buyers of our CA systems, if we were unable to remedy such security breach with system modifications, we could be obligated to replace the cards free of charge if the breach occurs within the first year (or in some cases, within the first two or three years) after the sale. Even though we have not experienced any significant counterfeiting or other security breach, we cannot assure you that our current assumptions regarding the security of our CA systems are reasonable. We could be obligated to incur a significant portion of the cost of replacing our smart cards in future years if any significant counterfeiting or security breach occurs. See Item 4. Information on the Company B. Business Overview Our Products and Services CA Systems. The cost of smart card replacement and the damage to our reputation could have a material adverse effect on our business, financial condition and results of operations.

In addition to our CA systems, the secured transmission of digital television programming also relies on certain other software and hardware components, such as set-top boxes supplied by other vendors, used by our customers' digital television networks. A security breach of any of these other software and hardware components could result in unauthorized access to the television networks of our customers. For example, in November 2007, it was discovered that an individual located in the city of Daqing in Heilongjiang Province had provided shared access to the local digital television network to over 100 other persons without authorization by hacking into certain set-top boxes used on that network, which do not have advanced security features due to cost considerations. We believe we are not liable for such security breach of software or hardware components that are supplied by other vendors under the terms of our contractual arrangements. However, our business, financial condition and results of operations could still be materially and adversely affected if these security breaches result in the affected television network operators having difficulty recruiting new subscribers or retaining existing subscribers. Furthermore, as our CA systems are used on the affected networks, our reputation could also be severely harmed by being associated with such security breaches on our customers' networks.

***We generally do not have long-term contracts with suppliers of computer chips or the companies that manufacture our smart cards. If any of our computer chip suppliers or smart-card manufacturers is unable to fulfill our orders in time or at all, we may be unable to deliver smart cards to our customers.***

As a general matter, we do not have long-term contracts with our suppliers. We purchase substantially all of the computer chips that are used in our smart cards from two suppliers, STMicroelectronics, or STM, and Infineon Technologies AG, or Infineon. In addition, we have arrangements with a number of smart-card manufacturers, including China Electronics Smart Card Co., Ltd., or China Electronics, the China Sciences Group and Beijing Sanyou Hengrui Technology Co., Ltd., to embed the computer chips into plastic cards. We typically place purchase orders with our computer chip and smart card suppliers as needed to meet our customers' demand. Our computer chip and smart card suppliers are generally not under any contractual obligation to accept our purchase orders or fulfill them within our desired time frame. However, we currently maintain a one-year contract with each of the manufacturers that requires them to fulfill our orders in accordance with an agreed schedule. Any significant delay or failure by any of our suppliers or manufacturers to fulfill our orders for computer chips or smart cards could force us

to obtain computer chips or smart cards from alternative sources at a higher cost, which would reduce our operating margins, or could prevent us from delivering smart cards in the required quantities to our customers on a timely basis. Any such failure by us could have a material adverse effect on our reputation and ability to retain customers, as well as our business, financial condition and results of operations, and may also subject us to claims for compensation from our customers.

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***We face intense competition, which could reduce our market share and harm our financial performance.***

The market for digital television CA systems and software applications is intensely competitive. Several of the world's leading developers and producers of CA systems, including Irdeto Access B.V. and NDS Limited, operate in the PRC market. We also compete with domestic CA systems vendors, including DVN Holdings Ltd. and Sumavision Technologies Co., Ltd. Some of our competitors have substantially greater financial, technical and other resources than we do, and may respond more quickly than we could to technological or commercial changes in our industry. In addition, some competitors offer their CA systems at a lower price or with a longer credit term than we do. We may need to reduce our prices to compete with them, which may lead to reduced margins or loss of market share. We cannot assure you that we will be able to compete effectively in the market for digital television CA systems and software applications in the PRC. See Item 4. Information on the Company B. Business Overview Competition.

***We depend upon key personnel, including our senior executives and technical and engineering staff, and our business and prospects would greatly suffer if we lose their services.***

Our future success depends heavily on the continued service of our key executives. In particular, we rely on the expertise and experience of Dr. Zengxiang Lu, chairman of our board of directors and our chief executive officer, and Jianhua Zhu, member of our board of directors, in our business operations and technology development efforts, and on their relationships with the regulatory authorities, our customers, our suppliers and our employees. If any of them becomes unable or unwilling to continue in their present positions, or if they join a competitor or form a competing company, we may not be able to replace them easily, our business may be significantly disrupted and our business, financial condition and results of operations may be materially and adversely affected. We do not currently maintain key-man insurance for any of our key personnel. Furthermore, our future success depends heavily upon our ability to recruit and retain experienced technical and engineering staff. There is substantial competition for qualified technical personnel from other companies in our industry as well as from businesses outside our industry, and we may not be successful in retaining technical and engineering employees and recruiting new ones. If we are unsuccessful in our recruitment and retention efforts, our business and prospects may be materially and adversely affected.

***Our attempts to diversify our business and expand our revenues by providing new solutions and products may not be successful and may prove costly.***

We have been pursuing strategies to expand and diversify our revenues, including developing and commercializing new solutions and products, such as value-added digital television services, cloud computing technology-based digital video delivery solutions and advanced digital television terminals. To this end, we established Beijing Novel-Super Media Investment Co., Ltd., or N-S Media Investment, Beijing Cyber Cloud Co., Ltd., or Cyber Cloud, and Beijing Joysee Technology Co., Ltd., or Joysee, over the past several years. See Item 4. Information on the Company A. History and Development of the Company. However, we have no prior experience cooperating with television network operators or other third parties in providing new solutions and products, and may not be successful in doing so. In addition, our attempts to develop this new business model may be time-consuming and may distract our management from developing our existing lines of business, which could have a material adverse effect on our business, financial condition and results of operations.

***We may face difficulties implementing our acquisition strategy, including identifying suitable opportunities and integrating acquired businesses and assets with our existing operations.***

As part of our business strategy, we intend to enhance our capabilities by acquiring other companies, businesses or technologies that complement our existing business or enhance our product portfolio and proprietary technology. However, our ability to implement our acquisition strategy will depend on our ability to identify suitable acquisition



candidates, our ability to compete effectively to attract and reach agreement with acquisition candidates on commercially reasonable terms and the availability of financing to complete larger acquisitions, as well as our ability to obtain any required shareholder or government approvals. In addition, any particular acquisition may not produce the intended benefits. For example, we may not be successful in integrating acquisitions with our existing operations and personnel, and the process of integration may cause unforeseen operating difficulties and expenditures and may divert significant attention of our management that would otherwise be available for the ongoing development of our business. If we make future acquisitions, we may issue new shares that dilute the interests of our other shareholders, expend cash, incur debt, assume contingent liabilities or create additional expenses related to the impairment of goodwill or the amortization of other intangible assets with estimable useful lives.

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***Our business could be harmed if a defect in our software, technology or services interferes with, or causes any failure in, our customers' systems.***

Our software and technology are integrated into the television transmission infrastructure of our customers. Accordingly, a defect, error or performance problem with our software or technology could interfere with, or cause a critical component of, one or more of our customers' systems to fail for a period of time. Any negligence or error of our employees in the course of their performance of system integration, upgrade or maintenance services for our customers may also cause malfunctioning, suspension or failure of our customers' systems. Occurrence of such incidents could result in claims for substantial damages against us, regardless of whether we are responsible for such failure. Any claim brought against us could be expensive to defend and require the expenditure of a significant amount of resources, regardless of whether we prevail. In addition, we do not currently maintain any product or business liability insurance. Although we have not experienced any such material interference or failure in the past, our potential exposure to this risk may increase as sales of our products and customer demand for our upgrade or maintenance services grow. Any future problem in this area could cause severe customer service problems and reputational damage.

***N-S Digital TV may be deemed not to be in full compliance with certain legal regulatory requirements relating to the production, sale and export of encryption products, and the relevant PRC government authorities could require N-S Digital TV to cease such activities and impose administrative penalties including fines, which could have a material adverse effect on our business, financial condition and results of operations.***

The applicable PRC regulations generally require a company that engages in the production and sale of encryption products to obtain two licenses, one for the production of encryption products and the other for the sale and distribution of encryption products, and the implementation rules for issuing these two licenses were promulgated in December 2005. Under these regulations and implementation rules, a company generally is only allowed to produce and/or sell encryption products that use algorithms designated by the encryption authority and such products shall also be certified by the encryption authority. In addition, these regulations and implementation rules also require a company to obtain prior approval from the encryption authority for the export of encryption products. The encryption authority initially designated permitted algorithms for CA systems in 2007 and a final and official designation remains pending. Like many other vendors of CA systems in the PRC, N-S Digital TV has been producing and selling CA systems using algorithms other than those initially designated by the encryption authority. We understand that, in practice, the PRC government has allowed a transition period, of a duration yet to be determined at its sole discretion, for vendors of CA systems to comply with this requirement to use the algorithms to be finally and officially designated by the government. See Item 4. Information on the Company B. Business Overview Regulation Regulation of Encryption Industry. N-S Digital TV has engaged in the production and sale of encryption products since its establishment in May 2004, but it did not obtain the license for the production of encryption products until June 2006 and the license for the sale of encryption products until September 2008. In December 2008 and February 2009, certain CA system products we developed by using the algorithms designated by the encryption authority were certified by the encryption authority. However, we have not decided when N-S Digital TV will produce and sell those products using the designated algorithms, and various factors, in addition to the permissible transition period for adoption, will affect this decision, including whether products using algorithms designated by the encryption authority will be generally accepted by the cable television industry (including CA system vendors and cable television operators). Furthermore, N-S Digital TV has engaged in the export of encryption products since 2010, but it did not obtain the prior approval from the encryption authority for such export. If N-S Digital TV fails to adopt the algorithms designated by the encryption authority for any of the CA systems products it produces and sells by the end of the transition period or at any time during the transition period at the request of the government, it may be required to discontinue the production and sale of its non-compliant CA systems. If the relevant PRC government authorities deem N-S Digital TV's production of encryption products prior to June 2006, sale of encryption products prior to

September 2008 or export of encryption products since 2010 to be in violation of the applicable regulations, they may impose sanctions against N-S Digital TV. These sanctions may include confiscation of income from non-compliant activities, fines of up to three times the amount of income from non-compliant activities and revocation of the licenses already issued. Imposition of such sanctions may result in material disruptions to our business operations, damage to our reputation and significant financial losses.

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***Enforcement of certain PRC regulatory requirements regarding the use of encryption products may prevent prospective customers from purchasing our CA systems.***

The applicable PRC regulations require users to use only encryption products that are certified by the encryption authority. The CA systems we currently produce and sell have not been certified by the encryption authority because we have not adopted the government-designated algorithms for such CA systems. We believe that because the PRC government provides for a transition period, which will be for a duration to be determined at its sole discretion, for us to adopt the algorithms to be finally and officially designated by the government, it is unlikely that the government will enforce the above-mentioned regulatory requirements with respect to the use or purchase of our CA systems during that transition period. In December 2008 and February 2009, certain CA system products we developed by using the algorithms designated by the encryption authority were certified by the encryption authority. However, as stated above, we have not decided when N-S Digital TV will produce and sell those CA system products certified by the encryption authority and various factors, in addition to the permissible transition period for adoption, will affect this decision. If we have not obtained the certification for the CA systems that we produce and sell upon the expiration of the transition period or at an earlier time the PRC government may otherwise require, enforcement of the above-mentioned regulatory requirements could prevent our prospective customers from purchasing our non-compliant CA systems, which could materially reduce our revenues and net income. In addition, even if we produce and sell products certified by the PRC encryption authority, we cannot assure you that we will be able to successfully market and sell such products.

***We may incur development costs in order to use the algorithms designated by the PRC encryption authority for CA systems.***

A company generally is only allowed to produce and/or sell encryption products that have adopted the algorithms designated by the PRC encryption authority. As the encryption authority did not designate any algorithms for CA systems until 2007, we have been using algorithms in our CA systems other than those designated by the encryption authority. If we are required by the government authorities to instead use the algorithms designated by the encryption authority in our CA systems, we may incur costs to develop new products adopting such algorithms. Development costs, the amount of which remains unclear, may cause our profit margin to decline significantly as well as materially reduce our profitability.

***If we fail to protect our intellectual property rights, it could harm our business and competitive position.***

We are required to continually improve our products and services to stay competitive in the marketplace, and as a result intellectual property is critical to our continued success. We rely on a combination of patent, trademark and copyright laws, trade secrets, confidentiality procedures and contractual provisions to protect our intellectual property rights and the obligations we have to third parties from whom we license intellectual property rights. Nevertheless, these afford only limited protection and policing unauthorized use of proprietary technology can be difficult and expensive. In addition, intellectual property rights historically have not been enforced in the PRC to the same extent as in the United States, and intellectual property theft presents a serious risk in doing business in the PRC. We may not be able to detect unauthorized use of, or take appropriate steps to enforce, our intellectual property rights and this could have a material adverse effect on our business, financial condition and results of operations.

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***We may be exposed to infringement or misappropriation claims by third parties that, if determined adversely to us, could require us to pay significant damage awards.***

Our success depends largely on our ability to use and develop our technology and know-how without infringing the intellectual property rights of third parties. The validity and scope of any claims relating to our technology patents would involve complex technological, legal and factual questions and analyses and, as a result, the outcome of such claims would be highly uncertain. We may be subject to litigation involving claims of patent infringement or violation of other intellectual property rights of third parties. The defense of such claims would be both costly and time-consuming, and could significantly divert the efforts and resources of our management and technical personnel. An adverse determination in any such litigation or proceedings to which we may become a party could subject us to significant liability to third parties, require us to seek licenses from third parties, pay ongoing royalties or redesign our products, or subject us to injunctions prohibiting the manufacture and sale of our products or the use of our technologies. Protracted litigation could also result in our customers or potential customers deferring or limiting their purchase or use of our products until resolution of such litigation. In addition, we could face disruptions to our business and damage to our reputation, and our financial condition and results of operations could be materially adversely affected.

***We face risks associated with the marketing, distribution and sale of our products internationally, which could impair our ability to expand our business abroad.***

In 2013 and 2014, we derived 11.0% and 7.9%, respectively, of our sales from outside the PRC. The international marketing, distribution and sale of our products expose us to a number of risks, including:

fluctuations in currency exchange rates;

difficulty in engaging and retaining distributors that are knowledgeable about, and are able to function effectively in, overseas markets;

increased costs associated with maintaining marketing efforts in various countries;

difficulty and cost relating to compliance with different commercial and legal requirements in the overseas markets;

inability to obtain, maintain or enforce intellectual property rights; and

trade barriers such as export requirements, tariffs, taxes and other restrictions and expenses.

***We rely on a single facility for most of our business operations. Any destruction of, or significant disruption to, this facility could severely affect our ability to conduct normal business operations.***

Most of our business operations, including the encoding of our smart cards, which is an essential part of the smart card manufacturing process, all our research and development activities and our corporate headquarters are concentrated

within a single facility that we lease in Beijing, PRC. As we do not maintain back-up facilities, we rely on this facility for the continued operation of our business. In addition, we currently do not maintain any business disruption or similar insurance coverage. A major earthquake, fire or other catastrophic event that results in the destruction of, or significant disruption to, the facility could severely affect our ability to complete sales or conduct other normal business operations, which would materially reduce our revenues and net income.

***Our operating results may fluctuate significantly from quarter to quarter, which could materially and adversely affect the price of our ADSs.***

Our quarterly operating results have varied significantly in the past and are likely to continue to vary significantly in the future. Our quarterly revenues may fluctuate as a result of a number of factors, many of which are outside of our control. For example, our quarterly revenues substantially depend upon the timing of smart card orders placed by our customers. A significant portion of our quarterly revenues has generally reflected orders from a limited number of large customers for our CA systems. Our cost of revenues and operating expenses may also fluctuate from quarter to quarter. As a result, you may not be able to rely on period-to-period comparisons of our operating results as an indication of our future performance. In addition, our actual quarterly results may differ from market expectations, which may cause the price of our ADSs to decline significantly.

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***Failure to manage our growth or develop appropriate internal organizational structures, an effective internal control environment and risk monitoring and management systems in line with our growth could have a material adverse effect on our business and prospects.***

Our business and operations have expanded since our inception. Significant management resources must be expended to develop and implement appropriate structures for internal organization and information flow, an effective internal control environment and risk monitoring and management systems in line with our growth, as well as to hire and integrate qualified employees into our organization. We cannot assure you that our existing internal control and risk monitoring and management systems would continue to be adequate. If we fail to appropriately develop and implement structures for internal organization and information flow, an effective internal control environment and a risk monitoring and management system, we may not be able to identify unfavorable business trends, administrative oversights or other risks that could materially and adversely affect our business, financial condition and results of operations.

***We have identified a material weakness in our internal controls over financial reporting which could, if not remedied, result in material misstatements in our financial statements.***

We are subject to the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act. Section 404 of the Sarbanes-Oxley Act requires that we include a report of management on our internal controls over financial reporting in our annual report on Form 20-F. In addition, our independent registered public accounting firm must report on the effectiveness of our internal controls over financial reporting.

Although we have concluded that our consolidated financial statements as of and for the year ended December 31, 2014 present fairly, in all material respects, the financial position, results of operations and cash flow of our company and its subsidiaries in conformity with generally accepted accounting principles, we have identified a material weakness in internal controls over financial reporting related to inadequate design and operating ineffectiveness of controls over a complex transaction. See Item 15. Controls and Procedures for further details. Under standards established by the Public Company Accounting Oversight Board, a material weakness is a deficiency, or combination of deficiencies, in internal controls over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

We have taken and/or plan to take measures to address the material weakness identified above. We are still in the process of enhancing our relevant controls over planned sale of Super TV and we will design and implement more robust financial reporting and management controls for complex and extraordinary transactions going forward. If our remedial measures are insufficient to address the material weakness, or if additional material weaknesses or significant deficiencies in our internal controls over financial reporting are discovered or occur in the future, our consolidated financial statements may contain material misstatements, and we could be required to restate our audited consolidated financial statements. This could cause investors to lose confidence in our reported financial information, harm our results of operations and lead to a significant decline in the trading price of our ADSs. Furthermore, ineffective internal controls over financial reporting could expose us to increased risk of fraud or misuse of corporate assets and subject us to potential delisting from the stock exchange on which we list, regulatory investigations and sanctions.

***We may need additional capital and we may not be able to obtain it.***

In order for us to grow, remain competitive, develop new products and services, expand our customer base and carry out acquisitions, we may seek to obtain additional capital in the future through selling additional equity or debt securities or obtaining a credit facility. Our ability to obtain additional capital in the future is subject to a variety of uncertainties, including:

our future financial condition, results of operations and cash flows;



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conditions in the United States and other capital markets in which we may seek to raise funds;

investors' perception of, and demand for, securities of digital television components and related companies; and

economic, political and other conditions in the PRC and elsewhere.

We may be unable to obtain additional capital in a timely manner or on acceptable terms or at all. Furthermore, the additional issuances of equity securities may result in significant dilution to our shareholders. The incurrence of debt would result in increased interest expense and could require us to agree to operating and financial covenants that would restrict our operations.

***Although we were not classified as a passive foreign investment company, or PFIC, in 2014, we had been classified as a PFIC in prior years, which could result in adverse United States federal income tax consequences to U.S. holders of our ADSs and may result in additional adverse United States Federal income tax consequences to such holders in subsequent years.***

Based on analyses of our income and the value of our assets, we believe we were not a PFIC for the taxable year ended December 31, 2014 for U.S. federal income tax purposes. However, because we may have substantial passive assets in the form of cash and cash equivalents, among others, we provide no assurance that we will not be classified as a PFIC for the taxable year ending December 31, 2015 or future taxable years, as PFIC status is tested each year and depends on our assets and income in such year. Our PFIC status for the current taxable year 2015 will not be determinable until after the close of the taxable year ending December 31, 2015.

We will be classified as a PFIC in any taxable year if either: (1) the average percentage value of our gross assets during the taxable year that produce passive income or are held for the production of passive income is at least 50% of the value of our total gross assets; or (2) 75% or more of our gross income for the taxable year is passive income. If we hold substantial cash, cash equivalents and other passive assets, as we currently do, a significant decrease in the market price of our outstanding shares would increase the risk of us becoming a PFIC.

In general, a U.S. holder that owns our ADSs or shares in a year in which we are a PFIC will continue to be treated as owning stock of a PFIC even if we do not satisfy either of the above tests for being classified as a PFIC in a future year unless such U.S. holder makes certain elections. Accordingly, even though we did not satisfy those tests for being classified as a PFIC for the year ended December 31, 2014, U.S. holders that previously acquired our ADSs in a year when we were a PFIC may continue to be treated as owning stock in a PFIC.

In any taxable year in which we are classified as a PFIC or you are treated as owning stock in a PFIC, and you are a U.S. holder of our ADSs or shares, unless you make a mark-to-market election, you will generally be taxed at higher ordinary income rates, rather than lower capital gain rates, if you dispose of our ADSs or shares for a gain, even if we are not a PFIC in the year of disposition. In addition, a portion of the tax imposed on your gain would be increased by an interest charge if you dispose of our ADSs or shares in a year after the first year in which we were treated as a PFIC that you hold our ADSs or shares. Similar treatment would apply if you receive distributions from us that are characterized as excess distributions. Moreover, you will not be able to benefit from any preferential tax rate with respect to any dividend distribution that you may receive from us in a year in which we are a PFIC or in the following year. Finally, you will also be subject to special United States federal income tax reporting requirements. For more information on the United States federal income tax consequences to you that would result from our classification as a PFIC, including the consequences of making a mark-to-market election, see Item 10. Additional Information E.

Taxation United States Federal Income Taxation PFIC Rules. You should consult your tax advisor regarding the application of the PFIC rules to your investment in our ADSs or shares.

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**Table of Contents*****Our bank accounts are not fully insured or similarly protected against loss.***

As of December 31, 2014, approximately 93.5% of our bank deposits were placed with three commercial banks in the PRC. Applicable PRC laws did not require that banks provide deposit insurance or similar protections to depositors in the PRC until the State Council promulgated the Regulations on Deposit Insurance in February 2015, which will become effective on May 1, 2015. The maximum reimbursement limit for all the principal and interest of the deposits in all the insured deposit accounts opened by one depositor with one insured bank is currently set at RMB500,000, which amount may be adjusted by the competent government authorities. As a result, our bank accounts with deposits in excess of RMB500,000 are not fully insured or similarly protected. If a commercial bank with which we have placed our cash deposits becomes insolvent, or if we are otherwise unable to withdraw funds, we may be unable to recover the cash on deposit with that bank for amounts in excess of RMB500,000. As a result, our liquidity and cash flows, as well as financial condition and results of operations, could be materially and adversely affected.

***If the PRC government determines that N-S Digital TV is a vendor of non-PRC CA systems by virtue of it being a subsidiary of a foreign-invested company, we could face difficulty selling our CA systems in the PRC.***

SAPPRFT policy requires any cable television network operator who uses a non-PRC CA system to install a parallel PRC CA system. Under this policy, vendors of non-PRC CA systems may sell only to cable network operators who have already installed a PRC CA system or who are willing to purchase a parallel PRC CA system. This may result in a competitive disadvantage for vendors of non-PRC CA systems relative to vendors of PRC CA systems. Such policy does not expressly indicate whether the CA systems produced by a foreign-invested company incorporated in the PRC, such as our subsidiary Super TV, or a subsidiary of a foreign invested company incorporated in the PRC, such as our subsidiary N-S Digital TV, fall into the category of non-PRC CA systems. In light of the above, at the time of the Company's initial public offering, we established and controlled, through contractual arrangements, N-S Digital TV to conduct our CA system business and obtained the license for the production and sales of commercial encryption products required for our business. In order to consummate the sale of Super TV to Tongda Venture Capital Co., Ltd., or Tongda Venture, and meet the approval requirements of the China Securities Regulatory Commission, or CSRC, that, among other things, require that the assets of a China-listed company generally be held and owned by it or its subsidiaries while the contractual arrangements may not be accepted, our contractual arrangements with N-S Digital TV and its nominee shareholders were terminated, and the 100% equity interest in N-S Digital TV formerly held by the nominee shareholders was transferred to Super TV in June 2014. As a result, N-S Digital TV has become Super TV's subsidiary, a subsidiary of a foreign-invested company.

There are substantial uncertainties regarding the interpretation and application of the above-described PRC government policy and relevant PRC laws, rules and regulations. The PRC government may determine that N-S Digital TV is a vendor of non-PRC CA systems by virtue of it being a subsidiary of a foreign-invested company. In such case, cable network operators may cancel their orders for our CA systems to avoid being required to install a parallel PRC CA system, and we may also lose potential customers who are not willing, or have no plan, to install a parallel PRC CA system for economic or other reasons. As a result, our business, financial condition and results of operations could be materially and adversely affected.

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***The structure for operating our business may result in the relevant PRC government regulators revoking or refusing to renew N-S Digital TV's licenses for the production and sale of commercial encryption products, or refusing to issue any other license required to engage in an encryption-related business.***

Our CA systems business uses encryption technology and thus is required by relevant PRC laws, rules and regulations to obtain licenses to produce and sell commercial encryption products. Although foreign-invested enterprises incorporated in the PRC, such as our subsidiaries Super TV and N-S Digital TV, are not expressly prohibited from conducting a business that uses encryption technology, the PRC encryption authority has generally taken a restrictive approach towards foreign participation in the PRC encryption industry. N-S Digital TV, our wholly-owned subsidiary through which we conduct our CA systems business, has obtained licenses to produce and sell commercial encryption products as required for our business. If the PRC encryption authority determines that our control over N-S Digital TV is contrary to its generally restrictive approach towards foreign participation in the PRC encryption industry, we cannot assure you that the PRC encryption authority will not reconsider N-S Digital TV's eligibility to hold the licenses to produce and sell commercial encryption products. The PRC encryption authority may revoke, or refuse to renew, N-S Digital TV's licenses to produce and sell commercial encryption products, or refuse to grant any other encryption-related license that may be required for our business in the future. If that were to happen, we might have to discontinue all or a substantial portion of our business pending the reissuance, extension or issuance of the required license. In addition, we might have to restructure our operations in order to have such licenses reissued, extended or issued. As a result, our business, financial condition and results of operations could be materially and adversely affected.

***Certain of our existing shareholders have substantial influence over our company and their interests may not be aligned with the interests of our other shareholders.***

As of March 31, 2015, our two largest shareholders and key executives, namely Dr. Zengxiang Lu and Jianhua Zhu, beneficially owned a total of approximately 34.73% of our outstanding shares. Accordingly, they will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have the power to prevent or cause a change in control. In addition, without the consent of these shareholders, we could be prevented from entering into transactions that could be beneficial to us. These shareholders may cause us to take actions that are opposed by other shareholders as the interests of these shareholders may differ from the interests of our other shareholders. See Item 7. Major Shareholders and Related Party Transactions for more information regarding the share ownership of our officers, directors and significant shareholders.

**Risks Relating to the Planned Sale of Super TV**

***The sale of Super TV may not be completed if the parties fail to obtain applicable regulatory approvals or satisfy other closing conditions, or otherwise, and the parties' ability to realize anticipated benefits of the transaction may be impaired by any requirements, limitations, costs or restrictions that regulatory authorities may impose.***

There will be uncertainties in completing the sale of Super TV, which remains subject to conditions precedent involving approvals by the relevant regulatory authorities, including without limitation, the CSRC and the PRC Ministry of Commerce, or the MOFCOM. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Conditions to Closing. The completion of the private placement, or the Private Placement, by Tongda Venture to fund the consideration in connection with the sale of Super TV, or the Consideration, is also subject to regulatory clearance. The transaction is expected to be subject to close scrutiny by the regulatory authorities amid increasingly stringent standards for similar transactions. There is no assurance that these

approvals or regulatory clearance will be obtained within an expected timeframe, or at all. The transaction will terminate if it has not been completed by December 31, 2015.

Additionally, as a condition to their approval of the transaction, regulatory authorities may impose requirements, limitations or costs or require amendments to the terms and conditions of the transaction. If the parties were to agree to these requirements, limitations, costs, or restrictions, the ability to realize the anticipated benefits of the transaction may be impaired.

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***We are obligated to compensate Tongda Venture if Super TV, the divested business, does not perform as projected.***

Under the terms of the profit compensation agreement as part of the agreement to transfer the entire equity interest in Super TV to Tongda Venture, or the Profit Compensation Agreement, in the event that net profit (before or after adjustment for non-recurring gains and losses, whichever is less) of Super TV in any of 2014, 2015 and 2016, or the Covered Period, is less than the profit target (being RMB190.10 million, RMB283.67 million and RMB340.66 million for 2014, 2015 and 2016, respectively), Golden Benefit Technology Limited, or Golden Benefit (a wholly-owned subsidiary incorporated in Hong Kong), will be obligated to compensate Tongda Venture for the deficiencies by transferring its shares in Tongda Venture back to Tongda Venture and/or cash, based on a pre-determined formula. At the end of the Covered Period, if there is an impairment loss of Super TV and if the amount of such impairment loss is greater than the aggregate compensation already paid by Golden Benefit during the Covered Period, Golden Benefit shall be obligated to compensate Tongda Venture for such difference, in cash or by transferring its shares in Tongda Venture back to Tongda Venture. Compensation payable in aggregate under the Profit Compensation Agreement shall be subject to a cap equal to the amount of the Consideration.

China Digital TV provides a joint and several guarantee of Golden Benefit's obligations under the Profit Compensation Agreement. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Profit Compensation Scheme.

If Super TV fails to meet the profit targets during the Covered Period or there is any impairment loss at the end of the Covered Period, the worst-case scenario under the Profit Compensation Agreement would result in Golden Benefit being obligated to return the entire amount of the Consideration to Tongda Venture. Such amount would exceed the net amount of consideration that Golden Benefit expects to receive from the sale of Super TV, because Golden Benefit is expected to pay PRC withholding tax at a rate of 10% on the gains of Golden Benefit on the sale of Super TV, which equals the consideration minus the original investment cost, subject to the final assessment by PRC tax authorities. In the event we have to return a portion or all of the Consideration as such compensation, our financial position, liquidity and results of operations may be materially and adversely affected and the value of your investment in our shares could be significantly diminished. If we are not able to fully settle such obligations due to our limited financial resources or otherwise, we could be subject to lawsuits or petitions for a voluntary or involuntary bankruptcy of our company.

***We will not be able to control the business operations of Super TV after the consummation of the transaction, although we are obligated to compensate Tongda Venture if Super TV does not perform as projected.***

As described above, we are obligated to compensate Tongda Venture if Super TV, the divested business, does not perform as projected.

The terms and conditions of the transaction provide that the board of directors and senior management of Super TV will remain unchanged following the sale of Super TV and within the Covered Period. It is anticipated that Tongda Venture and the board and the senior management of Super TV after the consummation of the transaction will continue to maximize the profitability of Super TV. However, as Tongda Venture is entitled to compensation from us in case Super TV fails to reach the profit targets, its interest is not fully aligned with ours in this regard. In addition, since Tongda Venture will be the sole shareholder of Super TV after the consummation of the transaction, we will not be able to control the business operations of Super TV to ensure the profit targets will be achieved.

***We will be liable to Tongda Venture for a breach or violation of any representation, warranty, covenant or other obligation under the Share Transfer Agreement.***

Golden Benefit has made certain representations, warranties and covenants under the share transfer agreement, or the Share Transfer Agreement. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Representations and Warranties and Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Covenants. If there is a breach of any representation, warranty, covenant or other obligation under the Share Transfer Agreement, Golden Benefit will be liable, and we will also be jointly and severally liable through the guarantee we provided under the Share Transfer Agreement. Significant claims by Tongda Venture may expose us to contingent liabilities and have a material adverse effect on our financial condition and results of operations. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Event of Default.

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***The businesses to be retained by us after the consummation of the transaction are significantly smaller than our current operations and still generate losses; we may not be able to rely on the retained businesses to sustain our business operations.***

Following the sale of Super TV (which operates our CA, Screen Cross Multi-Screen Broadcasting Systems, or Screen Cross, formerly known as network broadcasting platform, and video-on-demand businesses) to Tongda Venture, our retained businesses (other than the approximately 17.24% equity interest in Tongda Venture, which will hold a 100% equity interest in Super TV) will primarily consist of Cyber Cloud, which was established in January 2011 and mainly engages in the research and development of cloud computing technology-based digital video delivery solutions.

We intend to further develop our retained businesses to sustain our business operations. However, given that these companies only have a short operating history, and we have no substantial track record of cooperating with television network operators or other third parties in providing new solutions and products, we may not be successful in doing so, and these businesses may not become profitable in the foreseeable future, or at all.

We may also maximize our profitability through further reducing corporate overhead costs. Because our business will be smaller following the sale of Super TV, we believe that there will be many ways in which corporate overhead costs can be significantly reduced. However, if we are not successful in fully implementing such cost reductions, our ability to increase our profitability may be impaired.

***Our financial performance will be affected by that of Tongda Venture while we will not have control over Tongda Venture, and our influence over it will be limited.***

Under the terms of the share subscription agreement, or the Share Subscription Agreement, Tongda Venture agrees to issue to Golden Benefit 77,294,685 new shares of Tongda Venture as part of the Consideration. As a result, Golden Benefit is expected to hold approximately 17.24% of the share capital of Tongda Venture, and the board of directors of Tongda Venture will be increased from six members to nine members, among whom Golden Benefit will be entitled to recommend for appointment two directors. These directors will be appointed as members of the Venture and Strategy Committee of Tongda Venture's board of directors. In addition, Golden Benefit is entitled to recommend for appointment up to two senior management members of Tongda Venture to oversee the business related to Super TV. Moreover, only Cinda Investment Co., Ltd., or Cinda Investment, will hold a greater percentage of the share capital of Tongda Venture, and to our knowledge, all other shareholders are mutually independent.

Based on the above facts, we expect to account for this investment using the equity method. As this investment will constitute a material part of our assets, the operating results of Tongda Venture are expected to significantly affect our financial performance. Tongda Venture was founded in 1991 and is listed on the Shanghai Stock Exchange (Stock Code: 600647), and is mainly engaged in the business of developing and managing real estate properties, including residential communities, office buildings, and parking lots. Upon the consummation of the transaction, however, it is expected that its businesses will primarily comprise the CA, Screen Cross and video-on-demand businesses to be acquired from our company.

The financial performance of Tongda Venture may affect the financial condition of our Company, and we may have to incur impairment loss on this investment if the financial performance of Tongda Venture worsens significantly.

Furthermore, the consideration shares (with the aggregate value of RMB800 million), or the Consideration Shares, will be subject to a 36-month lock-up. During this lock-up period, we are prohibited from disposing of a portion or all of these shares even if it is commercially attractive to do so, and our ability to otherwise maximize the value of such shares is also significantly restricted.





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In addition, prior to the Private Placement, Cinda Investment is the controlling shareholder of Tongda Venture and holds approximately 41.03% of the share capital of Tongda Venture; following the Private Placement, Cinda Investment will hold approximately 26.53% of the share capital of Tongda Venture. As Golden Benefit is expected to hold approximately 17.24% of the share capital of Tongda Venture following the completion of the sale of Super TV, we will not be able to control the operations of the business of Tongda Venture and our influence thereon is also limited.

### ***Following the sale of Super TV, we may be deemed an investment company and subject to related requirements and restrictions under the U.S. Investment Company Act.***

The regulatory scope of the U.S. Investment Company Act of 1940, as amended, or the Investment Company Act, which was enacted principally for the purpose of regulating vehicles for pooled investments in securities, generally extends to companies engaged primarily in the business of investing, reinvesting, owning, holding or trading in securities. However, the Investment Company Act may also be deemed to be applicable to a company that does not hold itself out to be an investment company but that, due to the nature of its financial holdings, may be deemed to fall within the definitional scope of an investment company under such Act.

Following the consummation of the transaction, China Digital TV will retain the business of Cyber Cloud and will hold approximately 17.24% of the share capital of Tongda Venture. At that time, the share capital of Tongda Venture will represent a majority of the assets of China Digital TV (excluding cash and cash equivalents) and, as a result, China Digital TV may be deemed an investment company. If China Digital TV is deemed to be an investment company, it may become subject to certain restrictions relating to its activities, including restrictions on the nature of its operations and the issuance of securities. In addition, the Investment Company Act imposes certain requirements on companies deemed to be within its regulatory scope, including registration as an investment company.

However, as we intend to, and our board of directors has authorized us to take actions so that we will, be engaged primarily, as soon as reasonably possible and in any event before the first anniversary of the consummation of the transaction, or the Rule 3a-2 period, in a business other than that of investing, reinvesting, owning, holding or trading in securities, we intend to rely upon Rule 3a-2 under the Investment Company Act to avoid being deemed an investment company during the Rule 3a-2 period.

In the event that it is determined that we are unable to rely on Rule 3a-2 under the Investment Company Act or that we are unable to be engaged primarily in a business other than that of investing, reinvesting, owning, holding or trading in securities prior to the first anniversary of the consummation of the transaction, compliance with the requirements and restrictions of the Investment Company Act would likely have a material adverse effect on us.

### ***The sale of Super TV may have adverse consequences for U.S. taxable investors.***

If Super TV was classified as a PFIC at any time during the holding period of a U.S. taxable investor, the sale of Super TV may cause such U.S. taxable investors to be subject to tax under the indirect disposition rules of the PFIC regime regardless of whether he or she receives any distributions in connection with the sale. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Material U.S. Federal Income Tax Consequences.

### ***If we pay a cash dividend in connection with the sale of Super TV, U.S. taxable investors may be subject to adverse consequences under the PFIC regime.***

Because we have been classified as a PFIC in prior years (although we do not believe we were a PFIC for the taxable year ended December 31, 2014), and we may be a PFIC in the taxable year ending December 31, 2015 as a result of the consummation of the sale of Super TV, U.S. taxable investors who receive distributions from us may be subject to adverse consequences under the PFIC regime. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Material U.S. Federal Income Tax Consequences.

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### ***Our ability to pay dividends is contractually restricted.***

During the period from the valuation date, or June 30, 2014, to the closing date, or the date on which Tongda Venture is registered as the shareholder of Super TV, or the Transition Period, Golden Benefit covenants not to permit Super TV or any of its subsidiaries to, among other things, declare, set aside, make or pay any dividend or other distribution to shareholders (except for any dividend or other distribution already declared prior to the execution of the Share Transfer Agreement).

During the Covered Period, China Digital TV covenants not to make cash dividends out of the cash consideration (RMB2.4 billion), or the Cash Consideration, for an aggregate amount in excess of US\$3.33 per share. Otherwise, in respect of any excess amount of cash dividends out of the Cash Consideration, China Digital TV shall pay an equal amount to Tongda Venture as earnest money to secure its obligations under the Profit Compensation Agreement. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Covenants.

Although such restrictions do not apply to any cash dividends paid out of the revenues generated through our retained businesses, our retained businesses are significantly smaller than the CA, Screen Cross and video-on-demand businesses to be sold and may not be able to generate sufficient free cash for cash dividends. In addition, the dividend proposal in any given year will be subject to the availability of distributable profits or retained earnings and may be affected by, among other factors, the board of director s views on the potential future liquidity requirements, including for investments in production capacity, the funding of research and development programs and for acquisition opportunities that may arise from time to time; and by future changes in applicable income tax and corporate laws. Accordingly, it may be decided to propose not to pay a dividend or pay a lower dividend with respect to any given year, which could have a negative effect on the price of our ADSs.

### ***Our ability to use the sale proceeds is otherwise restricted due to the contingent compensation payments during the Covered Period.***

Under the terms of the Profit Compensation Agreement, in the event that net profit (before or after adjustment for non-recurring gains and losses, whichever is less) of Super TV in any of the fiscal years during the Covered Period is less than the profit target, Golden Benefit will be obligated to compensate Tongda Venture for the deficiencies by transferring its shares in Tongda Venture back to Tongda Venture and/or cash, based on a pre-determined formula. At the end of the Covered Period, if there is an impairment loss of Super TV and if the amount of such impairment loss is greater than the aggregate compensation already paid by Golden Benefit during the Covered Period, Golden Benefit shall be obligated to compensate Tongda Venture for such difference, in cash or by transferring its shares in Tongda Venture back to Tongda Venture. Compensation payable in aggregate under the profit compensation agreement shall be subject to a cap equal to the amount of the Consideration.

In order to prepare for such potential compensation payments, we may need to reserve a significant amount of cash, which may otherwise be applied to develop our retained businesses, pursue other business opportunities or otherwise maximize our profitability.

### ***Cinda Investment s exercise of the warrant may dilute the existing shareholders interest.***

Under the terms of the framework agreement, or the Framework Agreement, Cinda Investment has been granted by China Digital TV a warrant, exercisable within three months after the completion of the sale of Super TV, to subscribe for China Digital TV s new shares for an amount between US\$25 million and US\$30 million. Shares purchased under the warrant shall be subject to a lock-up during the Covered Period unless China Digital TV agrees otherwise.



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The exercise price of the warrant is US\$3.33 per share, which equals the weighted average trading price of the Company's ordinary shares (represented by ADSs) listed on the NYSE for the 20 trading days prior to June 12, 2014, the date on which the original framework agreement was approved by China Digital TV's board of directors. If Cinda Investment exercises the warrant to purchase new shares of China Digital TV, it will increase the number of the Company's outstanding shares, and dilute the equity interest of our existing shareholders. Based on an exercise price of US\$3.33 per share, up to 9 million shares will be issued upon the exercise of the warrant by Cinda Investment.

***For as long as we remain a public company, we will continue to incur the expenses of complying with public company reporting requirements.***

Our reporting obligations as a SEC registrant and NYSE-listed public company will not be affected as a result of completing the sale of Super TV. For as long as we remain as such, we have an obligation to continue to comply with the applicable reporting requirements of the Exchange Act, which include the filing with the SEC of periodic reports and other documents relating to our business, financial condition and other matters, even though compliance with such reporting requirements is economically burdensome.

***Tongda Venture may not be able to complete the Private Placement to fund the Consideration.***

Tongda Venture needs to complete the Private Placement to fund the Consideration. Completion of the Private Placement is subject to relevant regulatory approval. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Purchase Price. In addition, even if the relevant regulatory approvals are obtained, Tongda Venture may still not be able to complete the Private Placement for other reasons. Although completion of the Private Placement is not a condition precedent to the transaction, if the Private Placement by Tongda Venture cannot be completed for any reason, Tongda Venture may not have the financial ability to fund the Consideration and complete the transaction on time, or at all.

***Golden Benefit is obligated to compensate Tongda Venture for any net loss during the Transition Period.***

The Share Transfer Agreement does not provide for any adjustment to the Consideration. However, during the Transition Period, any net profit Super TV records will belong to Tongda Venture, and if Super TV has a net loss, Golden Benefit is obligated to make up for any difference in the amount of net assets of Super TV during the Transition Period. See Item 4. Information on the Company A. History and Development of the Company Capital Expenditures and Divestitures Covenants. As a result, Golden Benefit is obligated to compensate Tongda Venture for any net loss during the Transition Period.

***Information about Tongda Venture is provided by Tongda Venture and has not been independently verified by our Company.***

Information about Tongda Venture contained in this annual report is provided by Tongda Venture and has not been independently verified by our company, nor has our company made any representation as to the accuracy or reliability of such information. Such information should not be unduly relied upon, and our company and directors disclaim liability for any losses that might arise from any inaccuracy, omission or misstatement in such information.

***There are inherent uncertainties with respect to the final tax assessment to be made by PRC tax authorities, and we may be obligated to pay a greater amount of tax than we expect.***

Pursuant to applicable PRC tax laws and subject to the final assessment by PRC tax authorities, we are expected to pay PRC withholding tax at a rate of 10% on the proceeds from the sale of Super TV, or the Sale Proceeds, which

equals the Consideration minus the cost of the sale. As the Consideration is determined to be RMB3.2 billion and the cost of sale of Super TV equals the registered capital of Super TV, being US\$5 million (or RMB30.6 million), the Sale Proceeds should be RMB3.17 billion.

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Under the terms of the transaction agreements, the Consideration will be composed of Cash Consideration of RMB2.4 billion, and Consideration Shares of RMB800 million that Tongda Venture will issue to Golden Benefit at a price of RMB10.35 per share in the Private Placement. According to our PRC tax advisors, in practice, there are uncertainties regarding whether PRC tax authorities will determine the value of the Consideration Shares based on the issuance price fixed in the transaction agreements or the trading price of Tongda Venture's shares on the date of tax determination, or the Tax Assessment Date. If the trading price of Tongda Venture's shares on the Tax Assessment Date is higher than RMB10.35 per share and is used by the PRC tax authorities to determine the value of the Consideration Shares, we would be obligated to pay a greater amount of tax than we currently expect.

***Because our business will be smaller following the sale of Super TV, there is a possibility that our ADSs may be delisted from the NYSE if we fail to satisfy its continued listing criteria.***

Following the sale of Super TV, our business will be smaller, and we may fail to satisfy the continued listing criteria of the NYSE. In the event that we are unable to satisfy the continued listing criteria of the NYSE, our ADSs may be delisted from that market. In order to continue to be listed on the NYSE, we must meet the requirements as set forth in Sections 802.01A to 802.01C of the NYSE Listed Companies Manual, which require, among other things: (i) an average monthly trading volume of no less than 100,000 shares; (ii) an average global market capitalization over a consecutive 30 trading-day period of no less than US\$50,000,000 and, at the same time, stockholders' equity of no less than US\$50,000,000; and (iii) an average closing price of a security as reported on the consolidated tape of no less than US\$1.00 over a consecutive 30 trading-day period.

Any delisting of our ADSs from the NYSE could adversely affect our ability to attract new investors, decrease the liquidity of our outstanding ordinary shares, reduce our flexibility to raise additional capital, reduce the price at which our shares trade, and increase the transaction costs inherent in trading such shares with overall negative effects for our shareholders. In addition, delisting of our shares could deter broker-dealers from making a market in or otherwise seeking or generating interest in our shares, and might deter certain institutions and persons from investing in our securities at all. For these reasons and others, delisting could adversely affect the price of our shares and our business, financial condition and results of operations.

## **Risks Relating to the People's Republic of China**

***Our operations may be materially and adversely affected by changes in the economic, political and social conditions of the PRC.***

Substantially all of our non-cash assets are located in, and substantially all of our revenue is sourced from, the PRC. Accordingly, our business, financial condition, results of operations and prospects may be influenced to a significant degree by political, economic and social conditions in the PRC generally and by continued economic growth in the PRC as a whole.

The PRC economy differs from the economies of most developed countries in many respects, including the extent of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth over the past three decades, growth has been uneven across different regions and among various economic sectors. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our operating results and financial condition may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. We cannot predict the possible impact of any future economic policies of the PRC government on our business and operations.



The PRC government has implemented various measures since 2011 to control inflation, such as tightening bank lending policies. In addition, China's annual gross domestic product growth rate in 2014 was 7.4%, the slowest in 24 years. Continued implementation of these or similar measures, or a variety of other factors, may cause a continued slowdown in the PRC economy, which, in turn, could significantly reduce business activities in the PRC, including a slowing down or decline in investment in cable television networks, which, in turn, may result in a reduction of demand for our products and services and thus materially reduce our revenues and profitability.

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**Table of Contents*****Uncertainties in the interpretation and enforcement of PRC laws, rules and regulations could limit the legal protections available to you and us.***

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which legal decisions have limited value as precedents. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation over the past three decades has significantly increased the protections afforded to various forms of foreign or private-sector investment in the PRC. Super TV is a foreign-invested enterprise and is subject to laws, rules and regulations applicable to foreign investment in the PRC as well as laws, rules and regulations applicable to foreign-invested enterprises. These laws, rules and regulations change frequently, and their interpretation and enforcement involve uncertainties. For example, we may have to resort to administrative and court proceedings to enforce the legal protections that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than in more developed legal systems. These uncertainties may also impede our ability to enforce the contracts we have entered into, and materially impair our business and operations.

***The approval of the CSRC might be required in connection with our initial public offering under certain PRC regulation; failure to obtain this approval, if required, could have a material adverse effect on our business, financial condition, results of operations and reputation as well as the trading price of our ADSs.***

On August 8, 2006, six PRC regulatory agencies, including the MOFCOM, the State-owned Assets Supervision and Administration Commission, or the SASAC, the State Administration for Taxation, or the SAT, the State Administration for Industry and Commerce, or the SAIC, the CSRC and the State Administration of Foreign Exchange, or the SAFE, jointly adopted the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the M&A Rules, which became effective on September 8, 2006 and were amended on June 22, 2009. The M&A Rules, among other things, include provisions that purport to require that an offshore special purpose vehicle formed for the purpose of an overseas listing of securities in a PRC company obtain the approval of the CSRC prior to the listing and trading of such special purpose vehicle's securities on an overseas stock exchange.

We completed the initial listing and trading of our ADSs on the NYSE on October 11, 2007. We did not seek CSRC approval in connection with our initial public offering. Our PRC counsel, Han Kun, advised us that, based on their understanding of the current PRC laws, regulations and rules, because we completed our restructuring in 2004 in connection with an equity investment in our company by a private equity investor more than two years prior to the promulgation of the M&A Rules, we were not and are not required by the M&A Rules to apply to the CSRC for approval of our initial public offering unless we are clearly required to do so by any rules promulgated in the future. See Item 4. Information on the Company B. Business Overview Regulation Regulation of Overseas Listings. However, the application of the M&A Rules remains unclear. If the CSRC or another PRC regulatory agency subsequently determines that the CSRC's approval was required for our initial public offering, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our privileges in the PRC or take other actions that could have a material adverse effect on our business, financial condition, results of operations and prospects, as well as the trading price of our ADSs.

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***PRC regulations relating to offshore investment activities by PRC residents may increase the administrative burden we face and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by our shareholders who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose us and our PRC-resident shareholders to liability under PRC law.***

The SAFE has promulgated several regulations, including the *Notice on Issues Relating to the Administration of Foreign Exchange in Overseas Investment, Fund-Raising and Round-Trip Investment Activities of Domestic Residents via Offshore Special Purpose Vehicles*, or SAFE Notice 37, and its implementation rules and guidance, that require PRC residents (including PRC individuals and corporate entities) to register with and obtain approvals from relevant PRC government authorities in connection with their direct or indirect offshore investment activities. These regulations may apply to our shareholders who are PRC residents in connection with our prior and any future offshore acquisitions.

Under SAFE Notice 37, a special purpose vehicle refers to an offshore entity directly established or indirectly controlled by PRC residents for the purpose of seeking offshore equity financing or making offshore investment, using legitimate domestic or offshore assets or interests owned by such PRC residents, while round trip investment refers to the direct investment in China by such PRC residents through the special purpose vehicles, including, without limitation, establishing foreign-invested enterprises and using such foreign-invested enterprises to purchase or control onshore assets through contractual arrangements. SAFE Notice 37 requires that, before making a contribution into a special purpose vehicle, PRC residents are required to complete a foreign exchange registration with the competent local branches of SAFE for their overseas investments. In addition, PRC residents are required to update their previously filed registrations with respect to such special purpose vehicles to reflect any material change, such as any change of basic information (including change of such PRC residents, name and operation term), increases or decreases in investment amounts, transfers or exchanges of shares, and mergers or divisions. On February 28, 2015, the SAFE promulgated the *Notice on Further Simplifying and Improving Foreign Exchange Policy on Direct Investment*, or SAFE Notice 13, which will become effective on June 1, 2015. After SAFE Notice 13 becomes effective, instead of applying for approvals regarding foreign exchange registrations of foreign direct investment and overseas direct investment from the SAFE as required under current laws, entities and individuals will be required to apply for such foreign exchange registrations, including those required under SAFE Notice 37, from qualified banks. The qualified banks, under the supervision of the SAFE, will directly examine the applications and conduct the registration. If a PRC resident fails to make the required SAFE registration or update the previously filed registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion.

We have notified holders of our ordinary shares who we know to be PRC residents to register with the local branches of the SAFE and update their registrations as required by the relevant SAFE regulations described above. However, we cannot assure you that all of our shareholders who are PRC residents will comply with our request to make or obtain any registrations or approvals or update their previously filed registrations as required under these regulations or other related legislation. If any existing shareholder transfers any of our shares or ADSs to another PRC resident, it is unclear whether such new shareholder is also required to make the SAFE registration. Furthermore, as the interpretations and practice in implementing these SAFE regulations have been constantly evolving, it is unclear how these regulations, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. The failure or inability of our PRC resident shareholders to obtain any required approvals or make any required registrations may subject us to fines and legal sanctions, restrict our cross-border investment activities or obtaining of shareholders loans, and prevent us from being

able to make distributions or pay dividends, as a result of which our business as well as our ability to distribute profits to you could be materially and adversely affected.

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***We may be subject to fines and legal sanctions if we or our employees who are domestic individuals fail to comply with the PRC regulations relating to employee share options granted by overseas-listed companies to domestic individuals.***

In February 2012, the SAFE promulgated the *Notice relating to Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas-Listed Companies*, or SAFE Notice 7, which superseded the *Application Procedures of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plans or Stock Option Plans of Overseas-Listed Companies*, or SAFE Notice 78, promulgated by the SAFE in March 2007. SAFE Notice 7 is applicable to directors, supervisors, senior management personnel and other employees of an overseas-listed company incorporated in the PRC, PRC subsidiaries or branches of an overseas-listed company, and any PRC entities which are directly or indirectly controlled by an overseas-listed company, or, collectively, Domestic Companies, including PRC citizens (including Hong Kong, Macau and Taiwan) and foreign citizens who have resided in the PRC for one year or longer, or, collectively, Domestic Individuals. Under SAFE Notice 7, Domestic Individuals who participate in a stock incentive plan of an overseas-listed company are required, through a Domestic Company or a PRC entity designated by a Domestic Company, or the Domestic Agent, to register with the SAFE or its authorized local counterparts and complete certain other procedures. As we are an overseas-listed company, we and our employees who are Domestic Individuals and have been granted share options or any other share-related rights and benefits under our stock incentive plans are subject to SAFE Notice 7. We have registered ourselves and on behalf of our employees with the relevant local SAFE branch pursuant to SAFE Notice 7. However, there exist significant uncertainties in practice with respect to the interpretation and implementation of SAFE Notice 7 and we cannot assure you that we or our employees who are Domestic Individuals will be in full compliance with SAFE Notice 7. If the SAFE or other PRC government authorities determine that we or our employees who are Domestic Individuals fail to comply with the provisions of SAFE Notice 7, we or they may be subject to fines and legal sanctions. See Item 4. Information on the Company B. Business Overview Regulation Stock Incentive Plans.

***We may rely on dividends and other distributions on equity paid by our operating subsidiary to fund cash and financing requirements, and limitations on the ability of our operating subsidiary to pay dividends to us could materially restrict our ability to conduct our business.***

We, as a holding company, may rely on dividends and other distributions on equity paid by our operating subsidiary, Super TV, for our cash and financing requirements, including the funds necessary to pay dividends and other cash distributions to our shareholders, service any debt we may incur and pay our operating expenses. If Super TV incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us. Furthermore, relevant PRC laws, rules and regulations permit payments of dividends by Super TV only out of its retained earnings, if any, determined in accordance with PRC accounting standards and regulations.

Under applicable PRC laws, rules and regulations, Super TV is required to set aside 10% of its after-tax profits each year to fund a statutory reserve until the accumulated amount of such reserve has exceeded 50% of its registered capital. This reserve is not distributable as cash dividends to equity owners. As a result of these PRC laws, rules and regulations, Super TV is restricted in its ability to transfer a portion of its net assets to us in the form of dividends. Limitations on the ability of Super TV to pay dividends to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends, or otherwise fund and conduct our business.

***Restrictions on currency exchange may limit our ability to effectively utilize our revenues as well as the ability of our PRC subsidiaries to obtain debt or equity financing from financial institutions or investors outside the PRC, including us.***

A significant portion of our operating revenues have been denominated in Renminbi. The Renminbi is currently convertible under the current account, which includes dividends, trade and service-related foreign exchange transactions, but not under the capital account, which includes foreign direct investment and loans. Currently, Super TV may purchase foreign exchange for settlement of current account transactions, including purchase of imported computer chips and payment of dividends to us, without the approval of the SAFE by complying with certain procedural requirements. However, the relevant PRC government authorities may limit or eliminate our ability to purchase foreign currencies in the future for current account transactions. Since a significant amount of our future revenues will be denominated in Renminbi, any existing and future restrictions on currency exchange may limit our ability to utilize revenues generated in Renminbi to purchase computer chips from suppliers outside the PRC or fund our business activities outside the PRC denominated in foreign currencies or pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

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In addition, certain foreign exchange transactions under the capital account are still subject to limitations and require approvals from, or registration with, the SAFE and other relevant PRC government authorities. In particular, any loans to Super TV or its subsidiaries are subject to PRC regulations and approvals. For example, loans by us to Super TV, a foreign-invested enterprise, cannot exceed statutory limits and must be registered with the SAFE or its local counterpart.

This could affect the ability of Super TV to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us.

***Fluctuations in exchange rates could result in foreign currency exchange losses.***

As a significant portion of our operating revenues are denominated in Renminbi and the net proceeds from our initial public offering are denominated in U.S. dollars, fluctuations in exchange rates between U.S. dollars and Renminbi will affect the relative purchasing power of these proceeds and our balance sheet and earnings per share in U.S. dollars. Appreciation or depreciation in the value of the Renminbi relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business, financial condition or results of operations. Since July 2005, the Renminbi is no longer pegged solely to the U.S. dollar. Instead, the Renminbi is reported to be pegged against a basket of currencies, determined by the People's Bank of China, against which it can rise or fall by as much as 0.3% each day. This permitted floating range was increased to 0.5% in May 2007 and was further increased to 2.0% in March 2014. The Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the U.S. dollar. Fluctuations in the exchange rate will also affect the relative value of dividends, if any, payable on our ordinary shares in U.S. dollar terms and the value of any U.S. dollar-denominated investments we make in the future. In addition, since a significant portion of our operating revenues are denominated in Renminbi while approximately 28.5% of our cost of revenues is denominated in U.S. dollars, fluctuations in the exchange rate could also impact our financial condition and results of operations.

Very limited hedging transactions are available in the PRC to reduce our exposure to exchange rate fluctuations. We did not enter into any hedging transactions in 2012, 2013 or 2014. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of hedging transactions may be limited and we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency.

***The discontinuation of any of the preferential tax treatments or the financial incentives currently available to us in the PRC could materially and adversely affect our business, financial condition, results of operations and prospects.***

The PRC government has provided various incentives to our PRC subsidiaries. These incentives include reduced enterprise income tax rates, value-added tax refunds and tax holidays. For example, as high-and-new technology enterprises, each of Super TV and N-S Digital TV was entitled to a preferential income tax rate of 15% (against the standard income tax rate of 25%) since 2008. In October 2014, N-S Digital TV and Super TV successfully renewed their respective high-and-new technology enterprise certificates and qualified for a preferential tax rate of 15% for another three years from 2014 to 2016, and Cyber Cloud also obtained its high-and-new technology enterprise certificate and qualified for a preferential tax rate of 15% for three years from 2014 to 2016. In addition, Super TV was designated as a key software enterprise for the tax years from 2010 to 2014 by the relevant PRC government authorities and, as a result, was entitled to a preferential income tax rate of 10% in each of those years. Furthermore, for certain software-related products that are qualified as software products by PRC tax authorities, we received tax

refunds which effectively reduce the applicable value-added tax rate from 17% to 3%.



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Super TV, N-S Digital TV and Cyber Cloud must meet a number of financial and non-financial criteria in order to continue to qualify for the above tax incentives. For example, in order to be able to enjoy the preferential income tax rate of 15%, Super TV, N-S Digital TV and Cyber Cloud must be qualified as high-and-new technology enterprises strongly supported by the State under the *PRC Enterprise Income Tax Law*, or the 2008 EIT Law, which took effect on January 1, 2008. In addition, in order to continue to enjoy the preferential income tax rate of 10%, Super TV must reapply for and obtain the designation as a key software enterprise biennially. Moreover, the PRC government could determine at any time to eliminate or reduce the scale of such preferential tax policies. See Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives PRC.

Any increase in Super TV's or N-S Digital TV's enterprise income tax rate or discontinuation or reduction of any of the preferential tax treatments or financial incentives currently enjoyed by Super TV or N-S Digital TV could have a material adverse effect on our business, financial condition, results of operations and prospects.

***We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC.***

Pursuant to the 2008 EIT Law and Enterprise Income Tax Law Implementation Rules, or the Implementation Rules, enacted by the State Council on December 6, 2007 and which became effective on January 1, 2008, an enterprise established under the laws of a foreign country or region whose de facto management body is located within the PRC territory is considered a resident enterprise and will generally be subject to the enterprise income tax at the rate of 25% on its global income as well as PRC enterprise income tax reporting obligations. According to the Implementation Rules, de facto management body refers to a managing body that exercises, in substance, overall management and control over the production and business, personnel, accounting and assets of an enterprise. The SAT issued the Notice on Issues Relating to Determination of Chinese-Controlled Offshore Enterprises as PRC Resident Enterprises by Applying the De Facto Management Body Test, or SAT Notice 82, on April 22, 2009, which was amended in January 2014. SAT Notice 82 provides for certain specific criteria for determining whether the de facto management body of a Chinese-controlled offshore enterprise is located in the PRC. In addition, on July 27, 2011, the SAT issued the Administrative Measures of Enterprise Income Tax of Chinese-Controlled Offshore Resident Enterprises (Trial), or SAT Bulletin 45, which became effective on September 1, 2011, to provide guidance on the implementation of SAT Notice 82. SAT Bulletin 45 clarifies certain issues relating to: (i) the determination procedures of PRC resident enterprise status and (ii) tax registration and other related procedures for PRC resident enterprises. SAT Bulletin 45 also provides that if an offshore PRC resident enterprise presents a copy of the PRC tax resident determination certificate issued by the competent tax authorities to a payer of PRC-sourced dividends, interest, royalties and other income, such payer shall not withhold income tax on these payments to the offshore PRC resident enterprise. Although each of SAT Notice 82 and SAT Bulletin 45 provides that it only applies to offshore enterprises controlled by PRC enterprises, not those controlled by PRC individuals, like our company, it is generally believed that the determining criteria set forth therein very likely reflect the SAT's general position as to how the de facto management body test should be applied to determine the tax residency of all offshore enterprises, regardless of whether they are controlled by PRC enterprises or individuals. With reference to the criteria set forth in SAT Notice 82, we believe that we are not a PRC resident enterprise. However, if we were considered a PRC resident enterprise, although dividends we receive from our PRC operating subsidiary would be exempt from PRC withholding tax, we would be subject to the enterprise income tax at the rate of 25% on our global income as well as PRC enterprise income tax reporting obligations. In such case, our profitability and cash flow would be materially reduced as a result of our global income being taxed under the 2008 EIT Law.

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If we are considered as a non-resident enterprise under the 2008 EIT Law, we will not be subject to the enterprise income tax at the rate of 25% on our global income. In such case, however, dividends we receive from our PRC subsidiary will be subject to a PRC withholding tax, the standard rate of which is 10% and may be reduced by an applicable tax treaty, under the 2008 EIT Law. According to the *Arrangement for Avoidance of Double Taxation on Income and Prevention of Tax Evasion* entered into between the PRC and Hong Kong in August 2006, as amended, dividends paid by a PRC foreign-invested enterprise to its shareholder in Hong Kong are generally subject to a 5% PRC withholding tax, subject to satisfaction of certain conditions and requirements, compared to the standard 10% PRC withholding tax under the 2008 EIT Law. However, on October 27, 2009, the SAT issued the *Notice on How to Recognize Beneficial Owners under Relevant Tax Treaties*, or SAT Notice 601, which provides that only the enterprises with active operations may be recognized as beneficial owners under relevant tax treaties that are entitled to enjoy the corresponding tax benefits. SAT Notice 601 further provides that those enterprises that are established solely for the purposes of benefiting from favorable tax treatment under the relevant tax treaties should not be recognized as beneficial owners and therefore may not enjoy favorable tax treatment. On June 29, 2012, the SAT issued the *Announcement of the SAT Regarding Recognition of Beneficial Owners under Tax Treaties*, or the SAT Announcement 30, which provides that a comprehensive analysis based on all the factors listed in SAT Notice 601 should be made to determine the beneficial owner status. We indirectly hold the 100% interest in Super TV, our PRC subsidiary, through Golden Benefit, a wholly-owned subsidiary incorporated in Hong Kong. As a result, to the extent we are considered as a non-resident enterprise and Golden Benefit is not recognized as a qualified beneficial owner under the relevant tax treaty, dividends we receive from our PRC subsidiary will be subject to the standard rate of 10%. For example, as a result of our decision in 2012 to distribute the undistributed retained earnings of our PRC subsidiary without a set schedule, we accrued a US\$4.8 million deferred tax liability related to withholding tax on the undistributed earnings of Super TV generated after January 1, 2008. In 2013, we accrued an additional deferred tax liability of US\$3.4 million related to withholding tax on the undistributed earnings of Super TV generated after January 1, 2008, resulting in a deferred tax liability balance of US\$8.2 million as of December 31, 2013. In 2014, we accrued deferred tax liability of US\$3.4 million and transferred US\$7.9 million to current income tax payable for retained earnings declared to be distributed by Super TV, resulting in a deferred tax liability balance of US\$3.7 million as of December 31, 2014. Such withholding tax increased our tax burden and reduced the amount of cash available to our company.

***Dividends payable by us to our non-PRC shareholders and ADS holders, and gains on the sales of our ordinary shares or ADSs, may be subject to withholding taxes under PRC tax laws, which may materially reduce the value of your investment.***

The 2008 EIT Law and the Implementation Rules, both of which became effective on January 1, 2008, provide that an income tax rate of 10% (which may be reduced by the relevant tax treaties between the PRC and other jurisdictions) will generally be applicable to dividends payable to non-resident enterprises, which do not have an establishment or place of business in the PRC or whose establishment or place of business in the PRC has no connection with the dividends, to the extent such dividends are derived from sources within the PRC and paid out of distributable profits accumulated on or after January 1, 2008. In addition, any gain realized on the transfer of shares by non-resident enterprises is also subject to the 10% income tax if such gain is regarded as income derived from sources within the PRC, unless the applicable tax treaties provide for an alternative withholding arrangement. Furthermore, dividends payable to non-PRC individual investors and any gain realized on the transfer of our ADSs or ordinary shares by such non-PRC individual investors may be subject to PRC income tax at a rate of 20% (which may be reduced or exempted by the relevant tax treaties between the PRC and other jurisdictions).

If we are considered as a PRC resident enterprise, our dividends payable to our non-PRC shareholders and ADS holders, and any gain realized from the transfer of our ordinary shares or ADSs, would be treated as income derived from sources within the PRC and would as a result be subject to PRC tax. If dividends payable to our non-PRC

shareholders and ADS holders are subject to PRC tax, or if non-PRC shareholders and ADS holders are required to pay PRC tax on the transfer of our ordinary shares or ADSs, the value of your investment in our ordinary shares or ADSs may be materially reduced.

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***We face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises by their non-PRC holding companies. Enhanced scrutiny over acquisition transactions by the PRC tax authorities may have a negative impact on potential acquisitions we may pursue in the future.***

Pursuant to the *Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises*, or Circular 698, issued by the State Administration of Taxation, which became effective retroactively as of January 1, 2008, where a non-resident enterprise investor transfers equity interests in a PRC resident enterprise indirectly by way of disposing of equity interests in an overseas holding company, the non-resident enterprise investor, being the transferor, may be subject to PRC enterprise income tax, if the indirect transfer is considered to be an abusive use of company structure without reasonable commercial purposes. As a result, gains derived from such indirect transfer may be subject to PRC withholding tax at the rate of up to 10%. In addition, the PRC resident enterprise may be required to provide necessary assistance to support the enforcement of Circular 698.

On February 3, 2015, the State Administration of Tax issued a *Public Notice Regarding Certain Corporate Income Tax Matters on Indirect Transfer of Properties by Non-Tax Resident Enterprises*, or Public Notice 7. Public Notice 7 has introduced a new tax regime that is significantly different from that under Circular 698. Public Notice 7 extends its tax jurisdiction to not only indirect transfers set forth under Circular 698 but also transactions involving transfer of other taxable assets, through the offshore transfer of a foreign intermediate holding company. In addition, Public Notice 7 provides clearer criteria than Circular 698 on how to assess reasonable commercial purposes and has introduced safe harbors for internal group restructurings and the purchase and sale of equity through a public securities market. Public Notice 7 also brings challenges to both the foreign transferor and transferee (or other person who is obligated to pay for the transfer) of the taxable assets. Where a non-resident enterprise conducts an indirect transfer by transferring the taxable assets indirectly by disposing of the equity interests of an overseas holding company, the non-resident enterprise being the transferor, or the transferee, or the PRC entity which directly owned the taxable assets may report to the relevant tax authority such indirect transfer. Using a substance over form principle, the PRC tax authority may disregard the existence of the overseas holding company if it lacks a reasonable commercial purpose and was established for the purpose of reducing, avoiding or deferring PRC tax. As a result, gains derived from such indirect transfer may be subject to PRC enterprise income tax, and the transferee or other person who is obligated to pay for the transfer is obligated to withhold the applicable taxes, currently at a rate of 10% for the transfer of equity interests in a PRC resident enterprise. Both the transferor and the transferee may be subject to penalties under PRC tax laws if the transferee fails to withhold the taxes and the transferor fails to pay the taxes.

We face uncertainties on the reporting and consequences on future private equity financing transactions, share exchange or other transactions involving the transfer of shares in our company by investors that are non-PRC resident enterprises, or sale or purchase of shares in other non-PRC resident companies or other taxable assets by us. We and our non-resident enterprises may be subject to filing obligations or being taxed if we and our non-resident enterprises are transferors in such transactions, and may be subject to withholding obligations if we and our non-resident enterprises are transferees in such transactions, under Circular 698 and Public Notice 7. For the transfer of shares in our company by investors that are non-PRC resident enterprises, our PRC subsidiaries may be requested to assist in the filing under Circular 698 and Public Notice 7. As a result, we may be required to expend valuable resources to comply with Circular 698 and Public Notice 7 or to request the relevant transferors from whom we purchase taxable assets to comply with these circulars, or to establish that we and our non-resident enterprises should not be taxed under these circulars, which may have a material adverse effect on our financial condition and results of operations.

The PRC tax authorities have the discretion under Circular 698 and Public Notice 7 to make adjustments to the taxable capital gains based on the difference between the fair value of the taxable assets transferred and the cost of investment. If we are considered a non-resident enterprise under the 2008 EIT Law and if the PRC tax authorities make adjustments to the taxable income of the transactions under Circular 698 and Public Notice 7, our income tax costs

associated with such potential acquisitions will be increased, which may have an adverse effect on our financial condition and results of operations.

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***The M&A Rules and other recent PRC laws, rules and regulations have established more complex procedures for acquisitions conducted by foreign investors, which could make it more difficult for us to pursue growth through acquisitions.***

The M&A Rules established certain procedures and requirements that could make mergers and acquisitions by foreign investors in China more time-consuming and complex. In addition, PRC national security review rules, which became effective on September 1, 2011, subject acquisitions by foreign investors of PRC companies that conduct business in military-related or certain other industries that are crucial to national security to a security review before the consummation of any such acquisition. Furthermore, the PRC Antitrust Law, which became effective on August 1, 2008, requires, among other things, that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor acquires control of a PRC domestic enterprise or a foreign company with substantial PRC operations, if certain thresholds set forth in the *Provisions on Thresholds for Prior Notification of Concentrations of Undertakings* issued by the State Council on August 3, 2008 are triggered.

We may grow our business in part by pursuing potential strategic acquisitions that are complementary to our business and operations. Complying with the requirements of these PRC laws, rules and regulations to complete such acquisitions could be time-consuming, and any required approval procedures, including obtaining approvals from the MOFCOM, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market position.

***Natural disasters and health hazards in the PRC may severely disrupt our business and operations and may have a material adverse effect on our financial condition and results of operations.***

From time to time, certain parts of China have experienced devastating natural disasters and health hazards causing tens of thousands of deaths and widespread injuries. In addition, parts of Mainland China, in particular its southern, central and eastern regions, have in the past experienced what was reportedly the most severe winter weather in the country in half a century, which resulted in significant and extensive damage to factories, power lines, homes, automobiles, crops and other properties, blackouts, transportation and communications disruptions and other losses in the affected areas. Moreover, certain countries and regions, including China, have encountered incidents of the H5N1 strain of bird flu, or avian flu, as well as severe acute respiratory syndrome, or SARS, and the outbreak of influenza (H7N9). We are unable to predict the effect, if any, that any future natural disasters and health and public security hazards may have on our business. Any future natural disasters and health and public security hazards may, among other things, significantly disrupt our ability to adequately staff our business, and may generally disrupt our operations. Furthermore, such natural disasters and health and public security hazards may severely restrict the level of business activity in affected areas, which may, in turn, materially and adversely affect our business and prospects. As a result, any natural disasters or health hazards in China may have a material adverse effect on our financial condition and results of operations.

***The implementation of the PRC Labor Contract Law may increase our operating expenses and adversely affect our business and results of operations.***

The PRC Labor Contract Law, as amended, and its implementation rules formalize workers' rights concerning overtime hours, pensions, layoffs, employment contracts and the role of trade unions and provide for specific standards and procedure for the termination of an employment contract. In addition, the Labor Contract Law requires the payment of a statutory severance pay upon the termination of an employment contract in most cases, including in cases of the expiration of a fixed-term employment contract. As there has been little guidance as to how the Labor Contract Law will be interpreted and enforced by the relevant PRC authorities, there remains substantial uncertainty as to its potential impact on our business and results of operations. The implementation of the Labor Contract Law

may increase our operating expenses, in particular our personnel expenses and labor service expenses. In the event that we decide to significantly reduce the number of our employees or otherwise change our employment or labor practices, the Labor Contract Law may also limit our ability to effect these changes in a manner that we believe to be cost-effective or desirable, which could materially and adversely affect our business, financial condition and results of operations.

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***If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, with respect to requests for the production of documents, we may not be able to timely file future financial statements in compliance with the requirements of the Exchange Act.***

Starting in 2011, the Chinese affiliates of the big four accounting firms (including our independent registered public accounting firm) were affected by a conflict between U.S. and Chinese law. Specifically, for certain U.S. listed companies operating and audited in mainland China, the SEC and the PCAOB sought to obtain from the Chinese firms access to their audit work papers and related documents. The firms were, however, advised and directed that under PRC laws they could not respond directly to the U.S. regulators on those requests, and that requests by foreign regulators for access to such papers in China had to be channeled through the CSRC.

In late 2012, this impasse led the SEC to commence administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act against the Chinese accounting firms (including our independent registered public accounting firm). A first instance trial of the proceedings in July 2013 in the SEC's internal administrative court resulted in an adverse judgment against the firms. The administrative law judge proposed penalties on the firms, including a temporary suspension of their right to practice before the SEC, although that proposed penalty did not take effect pending review by the Commissioners of the SEC. On February 6, 2015, before a review by the Commissioner had taken place, the firms reached a settlement with the SEC. Under the settlement, the SEC accepts that future requests by the SEC for the production of documents will normally be made to the CSRC. The firms will receive matching Section 106 requests, and are required to abide by a detailed set of procedures with respect to such requests, which in substance require them to facilitate production through the CSRC. If they fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. Remedies for any future noncompliance could include, as appropriate, an automatic six-month bar on a single firm's performance of certain audit work, commencement of a new proceeding against a firm, or in extreme cases, the resumption of the current proceeding against all four firms.

In the event that the SEC restarts the administrative proceedings, depending upon the final outcome, listed companies in the United States with major PRC operations may find it difficult or impossible to retain auditors in respect of their operations in the PRC, which could result in financial statements being determined not to be in compliance with the requirements of the Exchange Act, including possible delisting. Moreover, any negative news about any such future proceedings against these audit firms may cause investor uncertainty regarding China-based, United States-listed companies and the market price of our ADSs may be adversely affected.

If our independent registered public accounting firm were denied, even temporarily, the ability to practice before the SEC and we were unable to find another registered public accounting firm to audit and issue an opinion on our financial statements in a timely manner, our financial statements could be determined not to be in compliance with the requirements of the Exchange Act. Such a determination could ultimately lead to the delisting of our ordinary shares from the NYSE or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

***The audit reports included in this annual report are prepared by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, you are deprived of the benefits of such inspection.***

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the SEC, as auditors of companies that are traded publicly in the United States and a firm registered with the United States Public Company Accounting Oversight Board, or the PCAOB, is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and



professional standards. Because our auditors are located in the PRC, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, our auditors are not currently inspected by the PCAOB.

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Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

***Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of the draft PRC Foreign Investment Law and how it may impact the viability of our current corporate structure, corporate governance and business operations.***

The MOFCOM published a discussion draft of the proposed Foreign Investment Law in January 2015, or draft Foreign Investment Law, aiming to, upon its enactment, replace the trio of existing laws regulating foreign investment in China, namely, the *Sino-foreign Equity Joint Venture Enterprise Law*, the *Sino-foreign Cooperative Joint Venture Enterprise Law* and the *Wholly Foreign-invested Enterprise Law*, together with their implementation rules and ancillary regulations. The draft Foreign Investment Law embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. The MOFCOM is currently soliciting comments on this draft and substantial uncertainties exist with respect to its enactment timetable, interpretation and implementation. The draft Foreign Investment Law, if enacted as proposed, may materially impact the viability of our current corporate structure, corporate governance and business operations in many aspects.

Among other things, the draft Foreign Investment Law expands the definition of foreign investment and introduces the principle of "actual control" in determining whether a company should be treated as a foreign-invested enterprise, or an FIE. According to the definition set forth in the draft Foreign Investment Law, FIEs shall refer to enterprises established in China pursuant to PRC laws that are solely or partially invested by foreign investors. The draft Foreign Investment Law specifically provides that entities established in China (without direct foreign share ownership) but "controlled" by foreign investors, via contracts or trust, for example, will be treated as FIEs. Once an entity falls within the definition of FIE, it may be subject to foreign investment restrictions or prohibitions set forth in a "negative list" to be separately issued by the State Council at a later date. If the underlying business of an FIE is subject to foreign investment restrictions, it needs to go through a market entry clearance process carried out by the MOFCOM before the FIE can be established. If the underlying business of the FIE is subject to foreign investment prohibitions, it may not enter such business in China. However, an FIE, during the market entry clearance process, may apply in writing to be treated as a PRC domestic enterprise if its foreign investor(s) is/are "controlled" by PRC government authorities and its affiliates and/or PRC citizens. In this connection, "control" is broadly defined in the draft law to cover the following summarized categories: (i) holding 50% of more of the voting rights of the subject entity; (ii) holding less than 50% of the voting rights of the subject entity but having the power to secure at least 50% of the seats on the board or other equivalent decision-making bodies, or having the voting power to exert material influence on the board, the shareholders' meeting or other equivalent decision-making bodies; or (iii) having the power to exert decisive influence, via contractual or trust arrangements, over the subject entity's operations, financial matters or other key aspects of business operations. The draft also emphasizes the security review requirements, whereby all foreign investments concerning national security must be reviewed and approved in accordance with the security review procedure. If the enacted version of the Foreign Investment Law and the final "negative list" mandate further actions, such as a market entry clearance or certain restructuring of our corporate structure and operations, we face substantial uncertainties as

to whether these actions can be timely completed, or at all, and our business and financial condition may be materially and adversely affected.

The draft Foreign Investment Law, if enacted as proposed, may also materially impact our corporate governance practice and increase our compliance costs. For instance, the draft imposes stringent ad hoc and periodic information reporting requirements on foreign investors and applicable FIEs. In addition to investment implementation reports and investment amendment reports, which are required for each investment and alteration of investment specifics, an annual report is mandatory, and large foreign investors meeting certain criteria are required to report on a quarterly basis. Any company found to be non-compliant with these information reporting obligations may potentially be subject to fines and/or administrative or criminal liabilities, and the persons directly responsible may be subject to criminal liabilities.

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*The trading price of our ADSs has been and may continue to be volatile, which could result in substantial losses to you.*

The trading price of our ADSs has been volatile and subject to wide fluctuations. Since October 5, 2007, the closing prices of our ADSs on the NYSE have ranged from US\$1.68 to US\$51.08 per ADS and the last reported sale price on April 27, 2015 was US\$4.24. Our ADSs may continue to fluctuate in response to various factors beyond our control. The financial markets in general, and the market prices for many other PRC companies listed on stock exchanges in the United States in particular, have experienced extreme volatility. These broad market and industry factors may significantly affect the market price and volatility of our ADSs, regardless of our actual operating performance.

In addition to market and industry factors, the price and trading volume for our ADSs may be highly volatile for specific business reasons. In particular, factors such as variations in our revenues, earnings and cash flow, announcements of new investments and cooperation arrangements, acquisitions or disposition could cause the market price for our ADSs to change substantially. Any of these factors may result in large and sudden changes in the volume and trading price of our ADSs. In the past, following periods of volatility in the market price of a company's securities, shareholders have often instituted securities class action litigation against that company. If we were involved in a class action suit, it could divert the attention of senior management, and, if adversely determined, have a material adverse effect on our financial condition and results of operations.

*The sale or availability for sale of substantial amounts of our ADSs could adversely affect their trading price and could materially impair our future ability to raise capital through offerings of our ADSs.*

Sales of substantial amounts of our ADSs in the public market, or the perception that these sales could occur, could adversely affect the market price of our ADSs and could materially impair our future ability to raise capital through offerings of our ADSs.

As of March 31, 2015, we had 59,770,311 ordinary shares outstanding (excluding 752,781 ordinary shares that were issued and held for our account in preparation for the exercise of share options by option holders under our employee stock incentive plans), including 39,277,950 ordinary shares represented by 39,277,950 ADSs (excluding the 752,781 ADSs that were held for our account in preparation for exercise of share options by option holders under our employee stock incentive plans). All ADSs are freely transferable without restriction or additional registration under the Securities Act. The remaining ordinary shares outstanding have been available for sale, subject to volume and other restrictions that may be applicable under Rule 144 and Rule 701 under the Securities Act. In addition, we have filed registration statements on Form S-8 to register the ordinary shares to be issued to the share option holders under our employee stock incentive plans. The ordinary shares to be received by such share option holders who are not affiliated with us may be resold freely to the public market. We cannot predict what effect, if any, market sales of securities held by our significant shareholders or any other shareholder or the availability of these securities for future sale will have on the market price of our ADSs.

*Your interest in our ADSs will be diluted as a result of our stock incentive plans or other share option grants.*

As of March 31, 2015, options to purchase an aggregate of 4,471,431 ordinary shares had been granted and were outstanding under the 2005 Stock Incentive Plan, the 2008 Stock Incentive Plan, the 2010 Stock Incentive Plan and the 2012 Stock Incentive Plan. For a description of these plans, see Item 6. Directors, Senior Management and Employees B. Compensation of Directors and Senior Officers Share Options. The exercise of those options would

result in a reduction in the percentage of ownership of the holders of ordinary shares and of ADSs, and therefore would result in a dilution in the earnings per ordinary share and per ADS.

***You may face difficulties in protecting your interest, and your ability to protect your rights through the United States federal courts may be limited, because we are incorporated under Cayman Islands law.***

Our corporate affairs are governed by our Second Amended and Restated Memorandum and Articles of Association, the Cayman Islands Companies Act and the common law of the Cayman Islands. The rights of shareholders to take action against the directors and actions by minority shareholders are to a large extent governed by the common law of the Cayman Islands. Cayman Islands law in this area may not be as established and may differ from provisions under statutes or judicial precedent in existence in the United States. As a result, our public shareholders may face different considerations in protecting their interests in actions against our management or directors than would shareholders of a corporation incorporated in a jurisdiction within the United States.

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The rights of shareholders and the responsibilities of management and members of the board of directors under Cayman Islands law, such as in the areas of fiduciary duties, are different from those applicable to a company incorporated in a jurisdiction of the United States. For example, the Cayman Islands courts are unlikely:

to recognize or enforce against us judgments of courts of the United States based on the civil liability provisions of United States federal securities laws; and

in original actions brought in the Cayman Islands, to impose liabilities against us based on the civil liability provisions of United States federal securities laws that are penal in nature.

As a result, our public shareholders may have more difficulty in protecting their interests in connection with actions taken by our management or members of our board of directors than they would as public shareholders of a company incorporated in the United States.

### ***Certain judgments obtained against us by our shareholders may not be enforceable.***

We are a Cayman Islands company and substantially all of our assets are located outside the United States. Substantially all of our current operations are conducted in the PRC. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the United States in the event that you believe that your rights have been infringed under the United States federal securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of the PRC may render you unable to enforce a judgment against our assets or the assets of our directors and officers.

### ***Your voting rights as a holder of our ADSs are limited by the terms of the deposit agreement.***

You may exercise your voting rights with respect to the ordinary shares underlying your ADSs only in accordance with the provisions of the deposit agreement. Upon receipt of voting instructions from you in the manner set forth in the deposit agreement, the depository for our ADSs will endeavor to vote your underlying ordinary shares in accordance with these instructions. Under our Second Amended and Restated Memorandum and Articles of Association and Cayman Islands law, the minimum notice period required for convening a general meeting is 15 days. When a general meeting is convened, you may not receive sufficient notice of a shareholders' meeting to permit you to withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter at the meeting. In addition, the depository and its agents may not be able to send voting instructions to you or carry out your voting instructions in a timely manner. We will make all reasonable efforts to cause the depository to extend voting rights to you in a timely manner, but you may not receive the voting materials in time to ensure that you can instruct the depository to vote your shares. Furthermore, the depository and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast or for the effect of any such vote. As a result, you may not be able to exercise your right to vote and you may lack recourse if your ordinary shares are not voted as you requested.

***The depository for our ADSs will give us a discretionary proxy to vote our ordinary shares underlying your ADSs if you do not vote at shareholders' meetings, except in limited circumstances, which could adversely affect your interests.***

Under the deposit agreement for our ADSs, the depositary will give us a discretionary proxy to vote our ordinary shares underlying your ADSs at shareholders' meetings if you do not vote, unless:

we have failed to timely provide the depositary with our notice of meeting and related voting materials;

we have instructed the depositary that we do not wish a discretionary proxy to be given;

we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;

a matter to be voted on at the meeting would have a material adverse impact on shareholders; or

voting at the meeting is made on a show of hands.

The effect of this discretionary proxy is that you cannot prevent our ordinary shares underlying your ADSs from being voted, absent the situations described above, and it may make it more difficult for shareholders to influence the management of our company.

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***You may not receive distributions on our ordinary shares or any value for them if it is illegal or impractical to make them available to you.***

The depositary of our ADSs has agreed to pay you the cash dividends or other distributions it or the custodian for our ADSs receives on our ordinary shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of our ordinary shares that your ADSs represent. However, the depositary is not responsible if it is unlawful or impractical to make a distribution available to any holders of ADSs. For example, it would be unlawful to make a distribution to a holder of ADSs if it consists of securities that require registration under the Securities Act but that are not properly registered or distributed pursuant to an applicable exemption from registration. The depositary is not responsible for making a distribution available to any holders of ADSs if any government approval or registration required for such distribution cannot be obtained after reasonable efforts made by the depositary. We have no obligation to take any other action to permit the distribution of our ADSs, ordinary shares, rights or anything else to holders of our ADSs. This means that you may not receive the distributions we make on our ordinary shares or any value for them if it is illegal or impractical for us to make them available to you. These restrictions may have a material and adverse effect on the value of your ADSs.

***You may not be able to participate in rights offerings and may experience dilution of your holdings.***

We may, from time to time, distribute rights to our shareholders, including rights to acquire securities. Under the deposit agreement, the depositary will not distribute rights to holders of ADSs unless the distribution and sale of rights and the securities to which these rights relate are either exempt from registration under the Securities Act with respect to all holders of ADSs, or are registered under the provisions of the Securities Act. The depositary may, but is not required to, attempt to sell these undistributed rights to third parties, and may allow the rights to lapse. We may be unable to establish an exemption from registration under the Securities Act, and we are under no obligation to file a registration statement with respect to these rights or underlying securities or to endeavor to have a registration statement declared effective. Accordingly, holders of ADSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

***You may be subject to limitations on transfer of your ADSs.***

Your ADSs represented by ADRs are transferable on the books of the depositary. However, the depositary may close its books at any time or from time to time when it deems expedient in connection with the performance of its duties. The depositary may close its books from time to time for a number of reasons, including in connection with corporate events such as a rights offering, during which time the depositary needs to maintain an exact number of ADS holders on its books for a specified period. The depositary may also close its books in emergencies, and on weekends and public holidays. The depositary may refuse to deliver, transfer or register transfers of our ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary thinks it is advisable to do so because of any requirement of law or any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

## **Item 4. Information on the Company**

### **A. History and Development of the Company**

Our holding company, China Digital TV Holding Co., Ltd., was incorporated as an exempted limited liability company on April 19, 2007 under the laws of the Cayman Islands. We are headquartered in Beijing, China, and



provide CA systems to the PRC's digital television market. We conduct substantially all of our business through our operating subsidiary in the PRC, Super TV, and through N-S Digital TV, a PRC company that we controlled through contractual arrangements until June 2014 and a subsidiary of Super TV thereafter. See Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions.

Our principal executive office is located at Jingmeng High-Tech Building B, 4th Floor, No. 5 Shangdi East Road, Haidian District, Beijing 100085, PRC. Our telephone number is (8610) 6297 1199. Information contained on our website does not constitute a part of this annual report. Our agent for service of process is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011, U.S.A.

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N-T Information Engineering was established as a limited liability company under the PRC law by Tsinghua Enterprise Group, a company affiliated with Tsinghua University, and Hong Kong-based Tsinghua Novel Hi-Tech Investment Holding Ltd. in July 1998, and initially focused on developing, producing and selling digital data broadcasting equipment for cable television operators. In December 2002, N-T Information Engineering completed its acquisition of the CA systems-related assets of Tsinghua Tongfang Co., Ltd., or Tsinghua Tongfang. In March 2004, China Digital TV Technology Co., Ltd., or CDTV BVI, was incorporated as a holding company in the British Virgin Islands, or BVI. Following the establishment of CDTV BVI, we restructured our operations, in connection with an investment by SAIF, by establishing Super TV, a limited liability company under the PRC law and a wholly-owned subsidiary of CDTV BVI, on May 31, 2004. On the same day, N-T Information Engineering and Li Yang, a PRC citizen then employed by SAIF, established N-S Digital TV. In June 2004, N-S Digital TV acquired from N-T Information Engineering its smart card and CA systems business and, in August 2006, N-S Digital TV acquired from N-T Information Engineering its set-top box design business. In April 2007, a new holding company, China Digital TV Holding Co., Ltd., or CDTV Holding, was established in the Cayman Islands. In May 2007, CDTV BVI executed a 40-for-1 share split of its ordinary shares and Series A preferred shares. Following this share split, the shareholders of CDTV BVI exchanged all of their shares of CDTV BVI for shares of CDTV Holding in proportion to their percentage interest in CDTV BVI, as a result of which CDTV BVI became a wholly-owned subsidiary of CDTV Holding. In August 2007, with our consent, Ms. Yang transferred her entire equity interest in N-S Digital TV to Wei Gao, a PRC citizen employed by an affiliated company of SAIF.

In October 2007, we completed the initial public offering of our ADSs representing our ordinary shares and listed the ADSs on the NYSE.

In order to benefit from certain beneficial tax arrangements between the PRC and Hong Kong, in December 2007, CDTV BVI acquired Golden Benefit, a company incorporated in Hong Kong, for a nominal consideration, and transferred its 100% equity interest in Super TV to Golden Benefit. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC and Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives PRC.

Since December 2007, new entities have been established or acquired in the PRC to offer new solutions and products, including N-S Media Investment, Cyber Cloud, Joysee, Super Movie, Beijing Shibo Movie Technology Co., Ltd., or Shibo Movie and Beijing Xinsi Yijia Technology Co., Ltd., or Xinsi Yijia. Super Movie later dissolved in November 2013.

In June 2008, Ms. Gao transferred all of her equity interests in N-S Digital TV to Junming Wu, who is a PRC citizen and is currently our employee. In November 2008, N-T Information Engineering transferred all of its equity interest in N-S Digital TV to Lei Zhang and Shizhou Shen, both of whom are PRC citizens and are currently our employees. In July 2011, Junming Wu transferred all of his equity interests in N-S Digital TV to Tianxing Wang, who is a PRC citizen and is currently our employee. In addition, in July 2011, Tianxing Wang and Lei Zhang, who are PRC citizens and are currently our employees, and Wenjun Wang, who is a PRC citizen and was then our employee, each contributed cash to increase the registered capital of N-S Digital TV to RMB150 million using the loan proceeds from Super TV. As a result of these transactions, Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang in aggregate owned all of the equity interest of N-S Digital TV.

N-S Digital Technology Co., Ltd., or N-S Digital Technology, and N-S Investment Holdings Co., Ltd., or N-S Investment Holdings, were incorporated in the PRC as wholly-owned subsidiaries of our company in April and July 2010, respectively. In March 2011, N-S Digital Technology was dissolved. In June 2014, N-S Investment Holdings

was renamed Beijing N-S Information Technology Co., Ltd., or N-S Information Technology, and Super TV transferred its equity interest in N-S Information Technology to China Super Media Holdings Limited, or CSM Holdings.

In June 2014, we conducted an internal reorganization in preparation of our sale of Super TV, as a result of which we obtained legal ownership of N-S Digital TV, the variable interest entity that we controlled through contractual agreements in China, or VIE structure, and adjusted our senior management team. Specifically, we terminated the series of contractual agreements underlying the VIE structure between the nominee shareholders of N-S Digital TV, namely Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang, and Super TV, and transferred the 100% equity interest of N-S Digital TV held by these nominee shareholders to Super TV. As a result, N-S Digital TV became an indirectly wholly-owned subsidiary of the Company.

### ***Our Investments and Acquisitions***

In August 2006, N-S Digital TV entered into an asset transfer agreement to purchase from N-T Information Engineering its set-top box design business for an initial purchase price of RMB29.4 million (US\$3.8 million), subject to certain post-closing downward adjustments. As an adjustment to the initial purchase price, N-T Information Engineering refunded RMB12.1 million (US\$1.5 million) to N-S Digital TV in April 2007.

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In August 2006, N-S Digital TV entered into an equity transfer agreement to purchase from N-T Information Engineering its 51% equity interest in Foshan Nanhai Guokai Digital TV Technology Co., Ltd., or Guokai, for a cash consideration of RMB2.4 million (US\$0.3 million). The parties entered into a new agreement in March 2007 to reduce the consideration to RMB2.3 million (US\$0.3 million). Guokai is a company primarily engaged in the research, development and sale of digital TV-related systems, software and products. A Japanese multinational company holds the remaining 49% equity interest in Guokai. This transaction was completed on July 27, 2007. In June 2013, Guokai was dissolved.

In March 2007, N-S Digital TV and Jiangsu Qingda Technology Co. Ltd., or Jiangsu Qingda, one of our customers, entered into an agreement to set up a joint venture in Nanjing of Jiangsu Province mainly engaging in digital television technology development and services, Nanjing Qingda Yongxin Culture & Media Co. Ltd., or Qingda Yongxin. N-S Digital TV contributed cash of RMB0.8 million (US\$0.1 million), representing 40% of equity interest in the joint venture. Jiangsu Qingda contributed cash of RMB1.2 million (US\$0.2 million) representing 60% of equity interest in the joint venture. N-S Digital TV had an option to purchase up to an additional 30% of the equity interest of Qingda Yongxin, which expired in 2010 without being exercised.

In June 2008, N-S Digital TV and Xitao Lai, a PRC citizen, established Dongguan SuperTV Video Info Co., Ltd., or Dongguan SuperTV, a joint venture in Dongguan, Guangdong Province, mainly to provide value-added services to television viewers. N-S Digital TV and Mr. Lai each contributed cash of RMB5.0 million (US\$0.7 million), representing 50% of equity interest in the joint venture. In September 2008, N-S Digital TV exercised an option to purchase an additional 10% equity interest in the joint venture from Mr. Lai. In July 2009, N-S Digital TV sold its 20% equity interest in Dongguan SuperTV to a new investor, Guangdong Jiakai Digital Technology Co., Ltd., or Guangdong Jiakai. In August 2010, N-S Digital TV entered into an equity transfer agreement with Guangdong Jiakai to repurchase the 20% equity interest in Dongguan SuperTV from Guangdong Jiakai. After those transactions, the equity interest of Dongguan SuperTV held by N-S Digital TV increased to 60% and N-S Digital TV became entitled to 70% of shareholders' voting rights and appointing three out of the five members of the board of directors of Dongguan SuperTV. In November 2011, Dongguan SuperTV transferred all of its high-definition interactive television services-related assets to the Dongguan branch of the Guangdong Broadcasting TV Network Co., Ltd. In December 2011, N-S Digital TV transferred its entire equity interest in Dongguan SuperTV to a third party for total consideration of RMB6.6 million (US\$1.0 million).

In August 2008, we acquired from N-T Information Engineering all of its intellectual property rights relating to digital watermarking and image tracing technologies, including one issued patent and five then pending patent applications in the PRC. As of the date of this annual report, these five pending patents have all been issued to us. For details of these acquisitions, see Item 4. Information on the Company B. Business Overview Intellectual Property.

On January 4, 2010, we entered into a share purchase agreement with OpenV China Holdings Company, or OpenV, a PRC online video company, and several other parties to make a strategic investment in OpenV. Pursuant to the share purchase agreement and related transaction documents, we acquired an 11.5% equity interest (subject to adjustment based on, among other things, OpenV's performance) in OpenV for a consideration of US\$5.0 million and received a warrant to purchase ordinary shares of OpenV of up to US\$4.5 million. As part of this investment transaction, we also agreed to extend to OpenV a US\$2.5 million interest-free convertible loan, which could be converted into ordinary shares of OpenV, subject to certain closing conditions. The Company did not purchase additional ordinary shares of OpenV pursuant to the warrant, which has expired, and the interest-free convertible loan was not extended to OpenV due to OpenV's performance in 2010. In 2010, we wrote off our entire investment in OpenV because we had doubts on OpenV's ability to continue as a going concern. As of December 31, 2013, we understood that OpenV's normal online video services had not been restored. On October 11, 2012, we entered into a share redemption agreement with OpenV, pursuant to which OpenV repurchased 460,080 of its shares from us for US\$0.82 million. We continue to

hold 2,345,267 shares of OpenV after the share repurchase.

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In February 2010, N-S Digital TV acquired from Beijing Shi Xun Hu Lian Technology Co., Ltd., or Beijing Shi Xun, and another shareholder of Guangdong Digital Media Technology Research & Development Institute Co., Ltd., or Guangdong R&D, their entire equity interest in Guangdong R&D for RMB3.0 million (US\$0.4 million) and became the sole shareholder of Guangdong R&D. We decided to discontinue the business of Guangdong R&D and dissolved Guangdong R&D in April 2013.

In May 2010, we entered into a share subscription agreement with 3DiJoy Corp., or 3DiJoy, a company specializing in the research and development of interactive and motion-sensing gaming products, and several other parties to make a strategic investment in 3DiJoy. Pursuant to the share subscription agreement, we acquired an aggregate of 4,953,798 series C convertible preferred shares of 3DiJoy, representing a 24% equity interest, for an aggregate subscription price of US\$6.0 million. In 2012, we accrued a full impairment charge of US\$4.5 million related to our investment in 3DiJoy based on the fair value of 3DiJoy we estimated with the assistance of a third party valuation firm, as we had doubts regarding 3DiJoy's ability to operate as a going concern given that it had been experiencing financial difficulties.

In May 2010, Super TV acquired an aggregate 34.45% equity interest in Guangzhou Rujia Network Technology Co., Ltd., or Guangzhou Rujia, through both purchase of existing shares from a shareholder of Rujia and contribution to its capital increase, for total consideration of RMB16.5 million (US\$2.5 million).

In August 2010, N-S Digital TV entered into an equity transfer agreement with Guangzhou Rujia to transfer all of its equity interest in Guangdong SuperTV, a wholly-owned subsidiary of N-S Media Investment, for a consideration of RMB30.3 million (US\$4.6 million).

In December 2010, Super TV and Beijing Yuewu Yuntian Software Technology Ltd., or Yuewu Yuntian, agreed to establish Cyber Cloud in Beijing, which mainly engages in research and development of cloud computing technology-based digital video delivery solutions. Super TV and Yuewu Yuntian contributed cash of RMB45.0 million (US\$6.8 million) and RMB5.0 million (US\$0.8 million), representing 90% and 10% of the equity interest in Cyber Cloud, respectively. Cyber Cloud was formally established on January 19, 2011. Pursuant to a series of agreements dated April 30, 2014, Cyber Cloud acquired a 100% equity interest in Xinsi Yijia from Yuewu Yuntian and Beijing Holch Capital Investment Center, or Holch Capital, and in exchange, Yuewu Yuntian and Holch Capital obtained certain noncontrolling interests in Cyber Cloud. Moreover, Super TV transferred its remaining equity interest in Cyber Cloud to CSM Holdings. As a result of these transactions, CSM Holdings, Yuewu Yuntian and Holch Capital held 75%, 15% and 10% of the equity interest in Cyber Cloud, respectively. Xinsi Yijia became a wholly-owned subsidiary of Cyber Cloud. Beijing Dingyuan Technology Co., Ltd., or Dingyuan, is controlled by Xinsi Yijia through a series of contractual arrangements. Dingyuan is immaterial from a financial perspective.

In April 2011, Super TV and Beijing Ying Zhi Cheng Technology Co., Ltd., or Ying Zhi Cheng Technology, an entity that is held mainly by employees of Joysee, agreed to establish Joysee in Beijing, which mainly engages in the research and development of advanced digital television terminals. Super TV and Ying Zhi Cheng Technology contributed cash of RMB27.0 million (US\$4.2 million) and RMB3.0 million (US\$0.5 million), representing 90% and 10% of the equity interest in Joysee, respectively. Pursuant to an agreement, dated May 24, 2011, among Super TV, N-S Digital TV and Ying Zhi Cheng Technology, N-S Digital TV contributed RMB6.0 million (US\$0.9 million) in cash, representing a 16.7% equity interest in Joysee. Pursuant to an agreement, dated June 13, 2011, among Super TV, N-S Digital TV, Ying Zhi Cheng Technology and Intel Semiconductor (Dalian) Ltd., or Intel, a wholly-owned subsidiary of Intel Corporation in the PRC, Intel contributed RMB33.0 million (US\$5.1 million) in cash, representing a 37.5% equity interest in Joysee. Pursuant to an equity transfer agreement, dated June 13, 2011, between N-S Digital TV and Intel, Intel transferred 7.5% of its equity investment in Joysee to N-S Digital TV for a nominal consideration. As a result of these transactions, Super TV, N-S Digital TV, Ying Zhi Cheng Technology and Intel each holds a

46.9%, 17.9%, 5.2% and 30% equity interest in Joysee, respectively. In June 2014, Super TV and N-S Digital TV transferred their equity interest in Joysee to N-S Information Technology and Ying Zhi Cheng Technology, respectively. As a result of these transactions, N-S Information Technology, Ying Zhi Cheng Technology and Intel held 46.9%, 23.1% and 30% of the equity interests in Joysee, respectively. According to the article of association of Joysee, N-S Information Technology is entitled to recommend for appointment three out of the five members to the board of directors of Joysee. As a result, we are considered to have the ability to control Joysee.

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In June 2011, Super TV and Beijing AirMedia Advertising Co., Ltd., or AirMedia, entered into a framework cooperation agreement for the establishment of two joint ventures, Shibo Movie and Beijing Xinghe Union Media Co., Ltd., or Xinghe Union, in the PRC, each of which mainly engages in movie-related content sourcing and distribution services. In December 2011, Super TV, N-S Digital TV and AirMedia entered into a supplemental agreement, pursuant to which Super TV transferred its rights and obligations under the framework cooperation agreement to N-S Digital TV. N-S Digital TV and AirMedia each contributed in cash RMB5.0 million (US\$0.8 million), representing 50% of the equity interest in Shibo Movie, and cash of RMB5.0 million (US\$0.8 million), representing 50% of the equity interest in Xinghe Union. Shibo Movie and Xinghe Union were formally established on February 15, 2012 and March 13, 2012, respectively. On September 29, 2013, N-S Digital TV and AirMedia entered into a share swap agreement, pursuant to which N-S Digital TV transferred its equity interest in Xinghe Union to AirMedia, in exchange for AirMedia's equity interest in Shibo Movie. Upon completion of the registration update of Shibo Movie with the relevant PRC authorities in February 2014, Shibo Movie became wholly-owned by N-S Digital TV. In June 2014, N-S Digital TV transferred its equity interest in Shibo Movie to N-S Information Technology.

In August 2011, Super TV and Beijing Chaoying Weichuang Technology Ltd. agreed to establish Super Movie, which mainly engages in video program delivery services. Super TV and Beijing Chaoying Weichuang Technology Ltd. contributed cash in the amount of RMB13.5 million (US\$2.1 million) and RMB1.5 million (US\$0.2 million), respectively, representing 90% and 10% of the equity interest in Super Movie, respectively. Super Movie was formally established on September 23, 2011. We decided to discontinue the business of Super Movie and dissolved Super Movie in November 2013.

***Capital Expenditures and Divestitures***

See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Capital Expenditures for information concerning our principal capital expenditures for the previous three years and those currently in progress.

On October 9, 2014, we entered into a share transfer agreement (as amended by a supplementary agreement dated October 27, 2014, the Share Transfer Agreement) with CDTV BVI, Golden Benefit, Cinda Investment and Tongda Venture, pursuant to which Tongda Venture will acquire a 100% equity interest in Super TV. In connection with the planned sale of Super TV, we entered into certain ancillary agreements to complete the transactions contemplated thereby, including granting Cinda Investment, the immediate parent of Tongda Ventures, a warrant to purchase our new shares of between US\$25 million and US\$30 million. The sale of Super TV and related transactions have been approved by the respective board of directors and shareholders of us and Tongda Venture, and is pending approval from PRC regulatory authorities.

***Cinda Investment and Tongda Venture.*** Cinda Investment is a wholly-owned subsidiary of China Cinda Asset Management Co., Ltd., or China Cinda (one of the major asset management firms in China), and also the flagship subsidiary of China Cinda's investment and asset management business. With registered capital of RMB2 billion, Cinda Investment is an integrated investment company incorporating alternative asset management, investment and operations in capital markets, real estate, commercial property and hotels. As China Cinda's dedicated investment platform, Cinda Investment specializes in asset management, particularly the management of non-performing assets, with a focus on the real estate and financial sectors. The registered office of Cinda Investment is at No. 1 Building, No. 9 Naoshikou Street, Xicheng District, Beijing, PRC.



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Tongda Venture was established in 1991 and is listed on the Shanghai Stock Exchange (Ticker: 600647). Cinda Investment is currently the largest and controlling shareholder of Tongda Venture. Tongda Venture currently develops and manages real estate properties in China, and its business covers high-and-new technology investment, industrial investment and asset management, agricultural development, operation and domestic trade, and food production and sales. The registered office of Tongda Venture is at 24/F, Yinqiao Plaza, No. 58 Jinxin Road, Pudong New District, Shanghai, PRC.

***The Transaction Agreements and the Sale of Super TV.*** Pursuant to the terms of the Share Transfer Agreement, as well as certain ancillary agreements in connection therewith (the Ancillary Agreements), which consist of a profit compensation agreement dated October 9, 2014 (as amended and supplemented by a supplementary agreement dated October 27, 2014, the Profit Compensation Agreement), a share subscription agreement (the Share Subscription Agreement) dated October 9, 2014, and a framework agreement dated June 13, 2014 (as amended and supplemented by a supplementary agreement dated October 9, 2014, the Framework Agreement) among all or some of the parties to the Share Transfer Agreement (together with the Ancillary Agreements, the Transaction Agreements; the transactions contemplated under the Transaction Agreements, the Transaction), we have agreed to sell the Company's CA, Screen Cross and video-on-demand businesses, through the sale of 100% equity interest in our indirectly wholly-owned subsidiary, Super TV, to Tongda Venture (the sale of Super TV).

***Purchase Price.*** In consideration of the sale of Super TV pursuant to the Share Transfer Agreement, we will receive a total consideration of RMB3.2 billion, or the Consideration, consisting of:

77,294,685 shares of Tongda Venture to be issued to Golden Benefit, or the Consideration Shares, at a per share price of RMB10.35, with the aggregate value of RMB800 million; and

RMB2.4 billion in cash, or the Cash Consideration.

Golden Benefit is obligated to compensate Tongda Venture for any net loss of Super TV during the period from the valuation date, or June 30, 2014, to the closing date, or the date on which Tongda Venture is registered as the shareholder of Super TV, or the Transition Period. In addition, Golden Benefit is obligated to pay certain compensation amounts under certain situations pursuant to the Profit Compensation Agreement.

To fund the Consideration, Tongda Venture will effect a private placement of its new shares, or the Private Placement. As part of the Private Placement, the Consideration Shares will be issued pursuant to the Share Subscription Agreement and, upon receipt of the Consideration Shares, Golden Benefit is expected to hold approximately 17.24% of the share capital of Tongda Venture. These Consideration Shares will be subject to a 36-month lock-up.

The issuance of the Consideration Shares is subject to the following conditions precedent: (i) the approval by the shareholders and the board of directors of Tongda Venture of the Private Placement; (ii) the internal approval by Golden Benefit pursuant to its organizational documents for its subscription of the A-shares issued in the Private Placement; (iii) the approval of the relevant authorities of the Private Placement; (iv) the approval by the MOFCOM of Golden Benefit's investment in Tongda Venture; (v) the approval by the CSRC of the Private Placement; (vi) the waiver from the CSRC with respect to any tender offer obligation of Golden Benefit that may be triggered by the Private Placement; (vii) the execution of the Share Subscription Agreement by Tongda Venture and Golden Benefit; and (viii) the taking effect of the Framework Agreement, the Share Transfer Agreement, and the Profit Compensation Agreement.

Golden Benefit is expected to pay PRC withholding tax at a rate of 10% on the Consideration, subject to the final assessment by PRC tax authorities under applicable tax laws and regulations in China.

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The Cash Consideration will be settled according to the following schedule: (i) within five business days upon receiving the funds raised from the Private Placement and the satisfaction of certain tax declaration conditions, Tongda Venture will declare to PRC tax authorities the payment of the applicable PRC withholding tax on behalf of Golden Benefit; (ii) subject to compliance with any applicable PRC regulations on tax and foreign exchange and within fifteen business days upon paying the aforesaid PRC withholding tax, Tongda Venture will pay no less than 35% of the Cash Consideration to Golden Benefit; and (iii) within five business days upon the registration of Tongda Venture as the shareholder of Super TV and the satisfaction of certain foreign exchange conditions, Tongda Venture will pay the remainder of the Cash Consideration, deducted by the applicable PRC withholding tax.

***Profit Compensation Scheme.*** Under the terms of the Profit Compensation Agreement, in the event that the net profit (before or after adjustment for non-recurring gains and losses, whichever is less) of Super TV in 2014, 2015 and 2016 is less than the profit target (being RMB190.10 million, RMB283.67 million and RMB340.66 million, respectively), Golden Benefit will be obligated to compensate Tongda Venture for the deficiency by transferring its shares in Tongda Venture back to Tongda Venture and/or cash, based on a pre-determined formula.

The formula for compensation in cash is as follows:  $\text{Compensation Payable of Current Period} = (\text{Cumulative Projected Net Profits of Super TV at the End of Current Period} - \text{Cumulative Realized Net Profits (before or after adjustment for non-recurring gains and losses, whichever is less) at the End of Current Period}) \div \text{Sum of Projected Net Profits of Super TV within the Covered Period} \times \text{Consideration} - \text{Compensation Already Paid within the Covered Period}$ . Where the compensation payable calculated for each year in the Covered Period per the said formula is negative, no compensation is payable, and the shares and cash already paid in compensation will not be returned or refunded.

The formula for compensation in shares is as follows:  $\text{Number of Compensation Shares of Current Period} = \text{Compensation Payable of Current Period} \div \text{Private Placement Offer Price}$ .

At the end of the Covered Period, if there is an impairment loss of Super TV and if the amount of such impairment loss is greater than the aggregate compensation already paid by Golden Benefit during the Covered Period, Golden Benefit shall be obligated to compensate Tongda Venture for such difference in cash or by transferring its shares in Tongda Venture back to Tongda Venture.

Compensation payable in aggregate under the Profit Compensation Agreement shall be subject to a cap equal to the amount of the Consideration.

We provide a joint and several guarantee of Golden Benefit's obligations under the Profit Compensation Agreement. In the event that all Consideration Shares held by Golden Benefit have been used in compensating Tongda Venture and Golden Benefit fails to make adequate cash compensation or at all, we will make up for any deficiency.

***Use of Proceeds from the Sale of Super TV.*** Net proceeds from the sale of Super TV may be used in connection with cash dividend payment, development of new technologies in emerging fields, and investment in operations and other businesses operations. If we decide to pay cash dividends out of the proceeds from the sale of Super TV during the Covered Period, we may not pay in aggregate more than US\$3.33 per share, unless a surety has been placed with Tongda Venture pursuant to the Transaction Agreements. Our board of directors has not made any decision as to whether to pay a cash dividend, and such decision will be based on what the board determines is in the best interest of CDTV Holding and its shareholders (subject to compliance with Cayman Islands and PRC laws), and the timing of the payment of a cash dividend may vary depending on a number of factors, including any contingent liabilities such as the potential compensation under the Profit Compensation Agreement or other unforeseen matters. If we elect to pay a cash dividend, prior to making such cash dividend, we will announce, at least ten days in advance, the record date for

such distribution. Only holders of our ordinary shares (the Shares ) or ADSs on the record date for a cash dividend will be entitled to receive a cash dividend. Please note that if we elect to pay a cash dividend, the record date for such cash dividend will be after the completion of the sale of Super TV and is different from the record date for determining which holders of the Shares are entitled to vote on the matters described in the proxy statement in relation to the sale of Super TV furnished on Form 6-K filed with the SEC on November 10, 2014, or the Proxy Statement.

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***Directors and Senior Management following the Sale of Super TV.*** The board of directors and senior management of Super TV will remain unchanged following the sale of Super TV and within the Covered Period, namely, 2014, 2015 and 2016.

Upon the consummation of the sale of Super TV, Tongda Venture's board of directors will be increased from six members to nine members, including three independent directors. Golden Benefit will be entitled to recommend for appointment two directors, and Cinda Investment has agreed to vote in favor of the director candidates recommended by Golden Benefit and their appointment as members of the Venture and Strategy Committee of Tongda Venture's board of directors. Cinda Investment has also agreed that one or two professional managers, who will be either recommended by Golden Benefit or identified in a process in line with market practice, will be employed to serve as senior executives of Tongda Venture and to oversee the business related to Super TV.

***When the Sale of Super TV is Expected to be Completed.*** We expect to complete the sale of Super TV as soon as practicable after all of the closing conditions in the Share Transfer Agreement have been satisfied or waived. We and Tongda Venture are working toward satisfying the conditions to closing and completing the sale of Super TV as soon as reasonably practicable. However, there can be no assurance that the sale of Super TV will be completed at all or, if completed, when it will be completed.

If the sale of Super TV shall not have been consummated by December 31, 2015, unless all parties agree to extend such deadline, the Share Transfer Agreement will be automatically terminated.

***Representations and Warranties.*** Golden Benefit's representations and warranties in the Share Transfer Agreement relate to, among other things:

corporate matters of Golden Benefit, including due organization, qualification and the absence of insolvency proceedings;

due authorization of Golden Benefit and the absence of violation of or conflict with its organizational documents, agreements or applicable laws;

ownership of Golden Benefit in Super TV;

corporate matters of Super TV and its subsidiaries, including due organization, qualification and the absence of insolvency proceedings;

assets and businesses of Super TV and its subsidiaries;

intellectual property owned by Super TV and its subsidiaries and the absence of infringement of third-party intellectual property;

capital expenditure commitments by Super TV and its subsidiaries;

the absence of bank borrowings and other liabilities of Super TV and its subsidiaries other than provided in Super TV's financial statement and the valuation report;

Super TV's financial statements;

labor and employment matters in respect of Super TV and its subsidiaries;

litigation or legal proceedings in respect of Super TV and its subsidiaries;

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compliance with laws and issuance of permits to Super TV and its subsidiaries;

tax matters in respect of Super TV and its subsidiaries; and

non-competition matters.

The representations and warranties made by Golden Benefit were made as of the date of the Share Transfer Agreement and shall be true and correct in all material respects as of the date of the consummation of the sale of Super TV. Certain of the representations and warranties made by Golden Benefit are qualified by materiality or material adverse change standard.

Tongda Venture's representations and warranties in the Share Transfer Agreement relate to, among other things:

corporate matters of Tongda Venture, including due organization, qualification and the absence of insolvency proceedings;

due authorization of Tongda Venture and the absence of violation of or conflict with its organizational documents, agreements or applicable laws; and

financial capability to fund the Transaction.

***Covenants.*** (i) *Net Profit/Loss during the Transition Period.* During the Transition Period, if Super TV has net profit (after adjustment for non-recurring gains and losses), then, upon completion of the sale of Super TV, such profit shall belong to Tongda Venture; if Super TV has net loss, Golden Benefit is required to make up for any difference in the amount of net assets of Super TV during the Transition Period.

Upon the completion of the sale of Super TV, an audit will be conducted to determine the net profit/loss of Super TV during the Transition Period.

(ii) *Conduct of Business Pending the Sale of Super TV.* Golden Benefit has agreed that, subject to certain exceptions, prior to the closing of the sale of Super TV, it will cause Super TV and its subsidiaries to (i) conduct the respective businesses of Super TV and its subsidiaries in the ordinary course of business in a manner consistent with past practices and (ii) use commercially reasonable efforts to preserve the business operations, organization and goodwill of Super TV and its subsidiaries, and their relationships with customers and suppliers. Golden Benefit will provide information reasonably requested by Tongda Venture regarding Super TV and its subsidiaries.

Additionally, Golden Benefit has agreed that, subject to certain exceptions, prior to the closing of the sale of Super TV, it will not permit Super TV or any of its subsidiaries to, other than in the ordinary course of business:

make any investment, or any acquisition or disposal of material assets;

permit any material adverse change in their respective financial condition or indebtedness;

waive or assign to any other parties any material right (including creditor's rights or security interest);

enter into any material contracts, and modify, amend or terminate any existing material contracts (except the implementation of contracts entered into prior to the execution of the Share Transfer Agreement);

provide loans to any other parties or guarantee any indebtedness;



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incur any indebtedness or other obligations, or waive any related rights;

increase or decrease their respective registered capital;

declare, set aside, make or pay any dividend or other distribution to shareholders (except for any dividend or other distribution already declared prior to the execution of the Share Transfer Agreement); or

take any other actions that may have a material adverse effect on Tongda Venture's financial consolidation of Super TV and its subsidiaries in accordance with the Share Transfer Agreement.

In addition, Golden Benefit agreed to promptly notify Tongda Venture of any event or occurrence with respect to Super TV and any of its subsidiaries that would reasonably be expected to have a material adverse effect on the Transaction.

*(iii) Covenants by CDTV Holding.* CDTV Holding guarantees the performance of Golden Benefit's obligations under the Share Transfer Agreement and the Profit Compensation Agreement.

During the Covered Period, CDTV Holding covenants not to make cash dividends out of the Cash Consideration for an aggregate amount in excess of US\$3.33 per share. Otherwise, in respect of any excess amount of cash dividends out of the Cash Consideration, CDTV Holding shall pay an equal amount to Tongda Venture as surety to secure the potential compensation payments under the Profit Compensation Agreement.

*(iv) Covenants by Cinda Investment.* As the controlling shareholder of Tongda Venture, Cinda Investment agrees to vote in favor of the Transaction and the appointment of the directors recommended by Golden Benefit to the board of directors of Tongda Venture following the sale of Super TV. Cinda Investment would also use its best efforts to cause Tongda Venture to make timely and full payment of the Consideration.

*(v) Covenants by Tongda Venture.* Subject to applicable PRC laws and regulatory requirements for listed companies, Tongda Venture agrees that it would provide certain information (including its audited and unaudited financial statements filed with the Shanghai Stock Exchange) for inclusion in CDTV Holding's disclosure documents and communications with shareholders (including proxy statements) to CDTV Holding in its ongoing compliance with U.S. securities laws.

***Conditions to Closing.*** The obligations of the parties to consummate the Transaction are subject to the satisfaction or waiver of the following closing conditions:

the approval by the shareholders and the board of directors of Tongda Venture of the Private Placement;

the approval by the shareholders and the board of directors of CDTV Holding of the Transaction;

the completion by Cinda Investment of applicable approval process with respect to the Private Placement;

the approval by the MOFCOM of Golden Benefit's investment in Tongda Venture;

the approval by the CSRC of the Private Placement;

the approval by the relevant MOFCOM authority of the Transaction in respect of Super TV.

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***Event of Default.*** Where the purpose of the Share Transfer Agreement is frustrated due to any party's non-performance or improper performance of any of its obligations hereunder, any non-breaching party may terminate that agreement, and if the breaching party causes any loss to other parties, it shall fully indemnify such loss.

Where any loss is caused to Golden Benefit due to any breach of Article 5 (in relation to corporate governance) of the Share Transfer Agreement by Cinda Investment and/or Tongda Venture, the breaching party or parties shall fully indemnify such loss.

***Termination of the Share Transfer Agreement.*** If the sale of Super TV shall not have been consummated by December 31, 2015, unless all parties agree to extend such deadline, the Share Transfer Agreement will be automatically terminated.

Where a force majeure event and its effect last for 30 days or longer and cause a party to be unable to continue performing its obligations under the Share Transfer Agreement, any party has the right to terminate the Share Transfer Agreement.

***Accounting Treatment.*** As a result of the sale of Super TV, the assets and liabilities of Super TV will be removed from our consolidated balance sheet, and a gain or loss that equals the difference between the fair value of the Consideration received and the book value of our ownership interest in Super TV will be recorded in respect of the sale of Super TV.

***Material U.S. Federal Income Tax Consequences.*** If Super TV was classified as a PFIC for U.S. federal income tax purposes at any time during the holding period of a U.S. holder of ADSs or shares that is treated as owning shares in a PFIC, the sale of Super TV may cause such U.S. taxable investors to be subject to tax under the indirect disposition rules of the PFIC regime regardless of whether he or she receives any distributions in connection with the sale. Specifically, if that indirect disposition is treated as being made at a gain for U.S. federal income tax purposes, the U.S. holder would be subject to the excess distribution regime with respect to that gain even if we make no distribution to the U.S. holder with respect to the sale of Super TV.

Under these rules, if you are a U.S. holder:

    this gain would be allocated ratably over your holding period for the ADSs,

    the amount allocated to the taxable year in which we sell Super TV and years before Super TV was classified as a PFIC with respect to you, if there are any such years, will be taxed as ordinary income,

    the amount allocated to each other prior year will be taxed at the highest tax rate in effect for that year, and

    the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such other prior year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC. Even if you made a mark-to-market election with respect to your ADSs, this election generally would not apply to

your indirect interest in Super TV.

Under the PFIC rules, if we make distributions in any single taxable year that are greater than 125% of the average annual distributions received by you in respect of the ADSs during the three preceding taxable years or, if shorter, your holding period for the ADSs, the excess would generally be subject to the same tax rules described above (i.e., the amount would be allocated ratably over your holding period for the ADSs and subject to U.S. tax in the manner described above).

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U.S. holders should consult their own tax advisors about the application of the PFIC rules to the sale of Super TV, any distributions we make in connection with such sale, the interaction of the excess distribution rules as they apply to indirect dispositions with their application to actual distributions and any special U.S. tax filing requirements that may arise under the PFIC rules or otherwise as a result of these transactions.

***Effects on CDTV Holding if the Sale of Super TV is Completed and Nature of CDTV Holding's Business Following the Sale of Super TV.*** If the sale of Super TV is completed, we will no longer conduct our CA, Screen Cross and video-on-demand businesses. Instead, we will focus on our remaining businesses and interests, which are Cyber Cloud and our 17.24% equity interest in Tongda Venture, and also on development of new technologies in emerging fields and investments in other businesses. The assets of CDTV Holding that are currently used in connection with Cyber Cloud will not be transferred to Tongda Venture as part of the Transaction.

Following the sale of Super TV, we expect Cyber Cloud to continue to operate in our headquarters in Beijing, China.

Our reporting obligations as a SEC-registered public company will not be affected as a result of completing the sale of Super TV. However, following the sale of Super TV, our business will be smaller, and therefore we may fail to satisfy the continued listing standards of the NYSE. In the event that we are unable to satisfy the continued listing standards of the NYSE, our ADSs may be delisted from that market. See Item 3. Key Information D. Risk Factors Risks Relating to the Planned Sale of Super TV Because our business will be smaller following the sale of Super TV, there is a possibility that our ADSs may be delisted from the NYSE if we fail to satisfy its continued listing criteria.

We also intend to continue to evaluate and potentially explore other available strategic options. We will continue to work to maximize shareholder interests with a goal of returning value to our shareholders. The sale of Super TV will not alter the rights, privileges or nature of the issued and outstanding shares of our Company. A shareholder who owns our shares or ADSs immediately prior to the closing of the sale of Super TV will continue to hold the same number of shares or ADSs immediately following the closing. Our reporting obligations as a SEC-registered public company will not be affected as a result of completing the Transaction.

The transactions contemplated by the Transaction Agreements are not a first step in a going private transaction under Rule 13e-3 promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act.

***Effects on CDTV Holding if the Sale of Super TV is Not Completed.*** If any of the closing conditions set forth in the Share Transfer Agreement are not satisfied or waived, including if Tongda Venture fails to complete the Private Placement or we are unable to obtain regulatory clearance (including with limitation by the CSRC and the MOFCOM), we will continue to conduct our CA, Screen Cross and video-on-demand businesses, and we may consider and evaluate other strategic opportunities. In such a circumstance, there can be no assurances that our continued operation of our CA, Screen Cross and video-on-demand businesses or any alternative strategic opportunities will result in the same or greater value to our shareholders as the sale of Super TV.

**B. Business Overview**  
**Overview**

We are the leading provider of CA systems to the PRC's digital television market. Our CA systems, which consist of smart cards, head-end software for television network operators and terminal-end software for set-top box manufacturers, enable digital television network operators in the PRC to control the distribution of content and value-added services to their subscribers and block unauthorized access to their networks. As of December 31, 2014,

we had installed CA systems at 436 digital television network operators in 31 of the 32 provinces, autonomous regions and centrally administered municipalities in the PRC. We were the leading vendor of smart cards for CA systems in terms of smart cards shipped in the PRC in 2014, with a market share of approximately 51.20%, according to Researchdtv. We derive a substantial majority of our revenues from sales of our smart cards, which accounted for 88.5% and 80.9% of our total revenues in 2013 and 2014, respectively. We expect that the sales of our smart cards will continue to constitute the majority of our revenues in the near future. In addition, we sell advanced digital television application software such as electronic program guides, or EPGs, and subscriber management systems, or SMSs, to digital television network operators. We are also developing and commercializing certain new solutions and products, including value-added digital television services, cloud computing technology-based digital video delivery solutions and advanced digital television terminals. Furthermore, we have been installing CA systems outside the PRC since 2010, including countries such as Myanmar, India and Venezuela.

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PRC television network operators are in the process of migrating from analog to digital transmissions. We are a primary beneficiary of this transition because CA systems are an essential component of any pay-television platform. We sell our CA systems and digital television application software to PRC television network operators, including cable, mobile, satellite and terrestrial television network operators, enterprises that maintain private cable television networks within their facilities and media operators.

Our top five customers in terms of revenues in 2014 were Jiangsu Qingda, Sichuan Cable TV Network Co., Ltd., Guangdong Broadcasting TV Network Co., Ltd., Jiangxi Broadcasting TV Network Co., Ltd. and Fujian Broadcasting TV Network Co., Ltd., which in aggregate contributed 26.9% of our total revenue in 2014.

We were founded in 2004 by Dr. Zengxiang Lu and Jianhua Zhu, who had worked together since 2001 at N-T Information Engineering, one of the PRC's earliest CA systems vendors. We purchased N-T Information Engineering's CA systems business in 2004 and continued to build upon the strong reputation that business had achieved. We sold 15.3 million, 17.0 million and 15.6 million smart cards in 2012, 2013 and 2014, respectively, and our net revenues were US\$88.7 million, US\$87.2 million and US\$81.5 million in 2012, 2013 and 2014, respectively. Our net income was US\$5.5 million, US\$22.6 million and US\$19.2 million in 2012, 2013 and 2014, respectively.

## **Our Products and Services**

Our core products and services include the following:

end-to-end CA systems, including smart cards, head-end software and terminal-end software;

other digital television application systems for television network operators; and

other products.

### ***CA Systems***

Our CA systems consist of: software that is installed at the premises of the television network operator, or the head end; software that is installed in a set-top box at the subscriber's end, or the terminal end; and smart cards that are inserted into the set-top boxes. At both the head end and the terminal end, our CA systems are designed to interface easily with the software and hardware of as many other vendors as possible. This gives our customers maximum flexibility in selecting the components of their digital transmission systems, and allows us to cooperate with the other vendors in promoting each other's products to the network operators.

Our CA systems give cable television network operators the flexibility to charge subscribers on a per-channel or per-view basis, and to restrict viewers from making copies of the programs they watch. Our CA systems also support or offer the following functions:

***Video on demand.*** Video on demand is a system that allows subscribers to select and watch video on demand and provides subscribers with a large subset of personal-video-reorder functions, such as pause, fast forward, slow forward and jump to previous/future frame. Television network operators

need to have two-way transmission capacity in order to apply such systems, which either stream content through a set-top box for viewing in real time, or download the content to subscribers' local storage devices for viewing at any time.



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***Near video-on-demand.*** Television network operators who do not yet have two-way transmission capacity, which is necessary for full-blown video on demand, can broadcast the same program repeatedly at short intervals, typically of 10 to 20 minutes, giving subscribers many choices of time to start watching the program.

***Push video-on-demand.*** Television network operators who do not yet have two-way transmission capacity can record programs onto subscribers' local storage devices based on subscribers' instructions, giving subscribers the flexibility to watch the programs at a time of their own choice.

***Personal video recorder.*** A personal video recorder, or digital video recorder, is a device that records video in a digital format to a disk drive or other memory medium within the device. Access to the contents, such as television programs, recorded in the personal video recorder is controlled by the CA system module and the smart card installed in the personal video recorder.

***Parental control.*** Parents can use the set-top box to set viewing controls by creating a password that must be entered to watch television or to watch certain programs, and can block access to the system at certain hours.

***Location control.*** Television network operators can authorize each smart card and set-top box to function only on the premises of the subscriber in whose name the smart card and set-top box are registered, preventing subscribers from providing their smart cards and set-top boxes to others.

***E-wallets.*** Information about pre-payment by subscribers for programs or services can be recorded on their smart cards. As subscribers order programs or services, the fees are deducted from the amounts recorded on their smart cards.

***Messaging.*** Network operators can communicate with their subscribers by transmitting electronic messages about bill status, rate changes and new programs and services to their subscribers' televisions. Network operators also can allow other vendors, such as water or electricity companies, to send billing or other service messages via this messaging platform.

***Upgrades.*** CA systems upgrades can be accomplished by transmitting software over the transmission network to the terminal end.

We guarantee the security of the encryption technologies of our CA systems during the periods generally ranging from one to three years after sale. In the event of a security problem, we undertake to attempt to resolve the problem by taking steps such as resetting the encryption code or adding additional layers of encryption. If these or other system modifications do not resolve the problem, we undertake to replace our smart cards. Upon expiration of the applicable period, the customer bears some portion or all of the cost. To date, we have not encountered any material problems with the security of our CA systems.

**Smart Cards.** Our smart cards are manufactured by third-party manufacturers based on our blueprints, and then are encoded by us on our premises with security codes unique to each customer. We forward the chips to smart card manufacturers in the PRC, which embed the chips in plastic cards. When we receive the cards from the smart card manufacturers, we program each one with a unique security code so that it can communicate with the CA systems of its intended network. We currently have enough equipment and trained staff to encode 100,000 smart cards on our premises during an eight-hour shift. An additional layer of security code is added at the customer's premises using software that we install as part of our CA systems.

Our customers generally wait until after they have purchased, installed and tested our head-end CA systems software before placing purchase orders for smart cards. We may offer discounts for large smart card orders. We sold 15.3 million, 17.0 million and 15.6 million smart cards in 2012, 2013 and 2014, respectively.

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Our smart cards are manufactured to meet the ISO-7816 standard for card readability. We guarantee the quality of our smart cards for periods generally ranging from one to three years and if any of our cards are found to have defects during the applicable warranty period, we replace them for free. To date, we have not experienced a material rate of smart card failure.

**Head-End Software.** Our head-end software includes: an entitlement management message generator, which notifies the smart card whether the subscriber is entitled to view a program or not; an entitlement control message generator, which sends messages that the set-top box uses to unscramble the digital television signal; and encryption software, which encrypts the outgoing messages.

Our head-end software also includes simulcrypton software that allows network operators to install parallel CA systems from multiple vendors and transmit their programs to some subscribers using one CA system's security codes and to other subscribers using another CA system's security codes. Many of the cable television network operators in the PRC who use digital transmission have installed two or more CA systems sourced from different vendors in order to reduce dependency on a single vendor. Moreover, in 2003, the SAPPRT issued a policy requiring digital cable television network operators who install non-PRC CA systems to also install a domestic CA system. Our simulcrypton software and open-interface technology enable us to work with operators to install parallel CA systems, and we have integrated our CA systems with those of DVN Holdings Ltd., Sumavision Technologies Co., Ltd., Irdeto Access BV and NDS Group, among others.

As of December 31, 2014, our CA systems had been installed at 436 digital television network operators.

We generally install, customize, test and commission our CA systems over a period of months and train our customers staff to operate it. Our prices vary according to the size and complexity of each customer's network, as well as market conditions. Generally, the contract price is payable in installments with the respective installments due on issuance of a preliminary acceptance, issuance of a final acceptance or within a certain period thereafter, or, in the case of a single acceptance, due prior, on and/or after the issuance of the acceptance.

**Terminal-End Software.** We license our CA systems terminal-end software to whichever set-top box manufacturer has been chosen by our customer to produce set-top boxes compatible with our CA systems. More than 150 set-top box manufacturers in the PRC have installed our technology in their set-top boxes.

Once our customer has selected one or more set-top box manufacturers, the selected manufacturers enter into contracts with us to license our terminal-end software for use in their manufacturing processes so that their set-top boxes can be used on the planned network. The manufacturers agree to pay us a one-time license fee, including fees for testing and certifying their set-top boxes, and royalties for each box they manufacture using our software. We have also entered into agreements with certain television network operators who purchase our CA systems pursuant to which the operators agree to pay us royalties for each set-top box deployed on their networks that uses our CA systems terminal-end software.

## ***Other Digital Television Application Systems for Television Network Operators***

Our other digital television application systems for television network operators primarily include SMSs, EPGs, Screen Cross and Cyber Cloud Platform.

**Subscriber Management Systems.** We produce SMS software, which can be used by television network operators to reduce the cost and improve the efficiency of their subscriber management. Our SMS software is compatible with the CA systems of other vendors, and we sell it on a stand-alone basis as well as packaged with our CA systems. Our

SMS software performs the following functions:

maintains and updates a database of subscriber information;

processes subscriber orders for new services;

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maintains billing, payment and authorization records and sends e-mail bills and receipts to subscribers; and

processes subscriber requests to repair or replace defective or lost set-top boxes or smart cards.

As of December 31, 2014, our SMS software had been installed by 124 television network operators. Our prices vary according to the size and complexity of each customer's network, as well as market conditions.

***Electronic Program Guides.*** An EPG is an on-screen guide to the programs and services available to subscribers. Our EPG is a software application that is installed at the head end of a CA system and can be controlled by a remote control. Viewers can use the guide to obtain program schedules as well as information about specific programs, such as plot descriptions and the names of the cast.

As of December 31, 2014, our EPG software had been installed by 247 television network operators. Our EPG software may be sold together with our CA systems, but it is also compatible with the CA systems of other vendors. When we sell our EPGs packaged with our CA systems, we provide the same maintenance terms as for the CA systems. Our prices vary according to the size and complexity of each customer's network, as well as market conditions.

***Screen Cross.*** A Screen Cross is a digital television broadcast system developed for mobile devices. It transmits digital television programs through channels in the digital television broadcast system to the Screen Cross gateway, then to mobile devices through wireless local area network, or WLAN. As of December 31, 2014, 17 television network operators from 14 provinces in China had purchased head-end and terminal-end Screen Cross products.

***Cyber Cloud Platform.*** Our Cyber Cloud Platform provides cloud computing technology-based digital video delivery solutions to television network operators. The working principle of this service is that end users' requests are processed on centralized servers known as the cloud, with content and solutions delivered through the network in the form of audio and video streams that are decoded and presented by the terminal to the end users.

Our Cyber Cloud Platform enables television network operators to use their two-way set-top boxes that have already been installed to run a large number of value-added applications, such as video games, 3D games, educational applications, and business service applications, which are accessible on smart phones, tablet computers, personal computers, Internet TVs and other devices.

As of December 31, 2014, we have entered into cooperation agreements with over 20 well-known television network operators.

## ***Other Products***

We sell other products sourced from third party suppliers, such as surface mounted device chips.

***Surface mounted device chips.*** Surface mounted device chips are of similar function as smart cards, except that surface mounted device chips are not embedded in plastic cards. Surface mounted device chips may be packed in different forms and are widely used in different kinds of terminals. We sold 1.8 million, 0.3 million and 1.0 million surface mounted device chips in 2012, 2013 and 2014, respectively.

## **Technical Support and Services**

We offer system integration services for television network operators who are digitalizing and installing our CA systems. As system integrators, we purchase additional hardware and software from third parties and integrate it with our CA systems software. If our customers install multiple CA systems from more than one vendor, we integrate these systems with our own so that all the hardware and software operate as a seamless whole.

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As of December 31, 2014, we had a total of 52 technicians and engineers located in Beijing and two other cities available 24 hours a day to respond to customer requests for information and assistance. Our two regional service centers are strategically located in eastern (Hangzhou) and southern (Nanhai) China. Each service center maintains a 24-hour telephone hotline. Upon receiving a call for assistance, our technical support employees first attempt to identify and resolve the problem over the telephone or by accessing the software remotely, and then arrange a site visit if necessary. In addition, each customer is assigned a project manager who oversees the initial software installation and remains primarily responsible for ensuring that after-sale requests for assistance are handled promptly.

## **Sales and Marketing**

As of December 31, 2014, we had 153 full-time sales personnel. We maintain regular contact with our customer base through contacts at industry forums and sales visits, and use these opportunities to educate them about digital television systems. We actively monitor which operators are moving towards digitalization, and when we learn that a particular operator is planning to launch a digital network, we target that operator for more frequent contact by our sales and technical personnel. We compensate our sales personnel by means of base salaries and performance bonuses.

We also cooperate informally with other providers of digital television software and hardware with whom we do not compete, such as set-top box manufacturers, to promote each other's products to our respective customers, and thereby benefit from each other's marketing efforts.

Jiangsu Qingda, a Nanjing-based company, is our exclusive distributor for CA systems and smart cards in Jiangsu Province in eastern China. Jiangsu Qingda also provides after-sales technical support and maintenance services for our customers in Jiangsu Province. We entered into a 13-year distribution contract with Jiangsu Qingda effective January 1, 2007. We account for revenues contributed by Jiangsu Qingda in the same way as revenues from our customers who are television network operators. Jiangsu Qingda was our largest contributor to revenues in 2012, 2013 and 2014. In addition to Jiangsu Qingda, we also engage fee-based sales agents to assist us in selling and maintaining our CA systems and smart cards in designated regions or to designated customers. Such sales agents also provide certain related services, including gathering market intelligence regarding potential customers and pricing information in the relevant market.

## **Customers**

Our primary customers are cable television network operators. We sell our products and services to networks of all sizes. Our top five customers in 2014 were Jiangsu Qingda, Sichuan Cable TV Network Co., Ltd., Guangdong Broadcasting TV Network Co., Ltd., Jiangxi Broadcasting TV Network Co., Ltd. and Fujian Broadcasting TV Network Co., Ltd., which contributed 6.4%, 5.7%, 5.6%, 5.0% and 4.2%, respectively, to our total revenues for the year.

We have also sold our CA systems to:

satellite and terrestrial television network operators, including the China Central Satellite Television Transmission Center;

a commercial satellite transmission platform, namely China Dbstar Co., Ltd.;

large enterprises that maintain private cable television networks within their facilities, including the Beijing Capital International Airport and Daqing Oilfield Company Limited, a wholly-owned subsidiary of PetroChina Company Limited;

media operators who use CA systems to encrypt their programs for distribution to television operators, including China DTV Media Inc., Ltd. and Huacheng Digital Movie & TV Co., Ltd.; and

a mobile television operator, namely China Broadcasting (Group) Co., Ltd. (formerly known as China Satellite Mobile Broadcasting Corporation or China Broadcasting Co., Ltd.).



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We currently derive, and we expect to continue to derive, a significant portion of our revenues each period from a limited number of large customers, although the particular customers may vary from period to period. As digital cable television systems are at the developing stage in the PRC, the largest shipments of smart cards are to operators who are launching new digital transmission systems and need to purchase in bulk for their established networks. We may face certain risks from this concentration of revenues. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We depend, and expect to continue to depend, on a limited number of customers for a significant portion of our revenues in any single period. If one customer defers or cancels its orders or chooses our competitors' products or services, our revenues and net income could decline significantly.

As most cable television network operators in the PRC are state-owned, they are required to follow a public bidding process for major purchases. As a result, the majority of our CA systems sales are made pursuant to a formal bid process. In such cases, the network operator generally submits its CA systems requirements to a state-owned bidding company, which posts a request for bids on its website and specifies the necessary financial and technical qualifications of bidders. We are generally required to accompany our bid with a cash deposit, which generally is from US\$300 to US\$117,000 and which is refundable in full if we fail to win the sales contract. If we succeed in winning the contract, some network operators require that we leave our deposit in their account until we have installed and tested our software and the network operator has signed a certificate of acceptance. The time from when a request for bids is posted until a winner is selected is usually one to two months.

Our customers also include set-top box manufacturers, to whom we license terminal-end software for our CA systems. More than 150 set-top box manufacturers in the PRC, including Shenzhen Jiuzhou Electric Co., Ltd., Shenzhen Skyworth Digital Technology Co., Ltd., Shenzhen Coship Electronics Co., Ltd., Sichuan Changhong Network Technology Co., Ltd. and Huawei Technologies Co., Ltd., have installed our terminal-end software in their set-top boxes.

## **Suppliers**

Before 2006, we bought most of our computer chips for our smart cards from STM. In order to maintain a secure supply of computer chips, beginning in 2006 we have purchased a significant portion of our computer chips from Infineon, initially indirectly through AdvanIDe Pte. Ltd. (formerly known as ACG Identification Technologies Asia Pte. Ltd.), an agent of Infineon, and since February 2009, directly from Infineon.

STM and Infineon produce chips that use our card operating system and deliver them to Beijing by air freight. We do not have long-term contracts with any of our computer chip suppliers, but place orders according to our customers' demands. We pay based upon the prevailing market price at the time of order.

The time required from placing a new chip order with the fabricators to shipping finished smart cards to our customers may be as long as 15 weeks. To ensure that we are able to meet our customers' demands, we plan at all times to have enough chips and smart cards on order or in inventory to meet our demand for an average 15-week period.

We have arrangements with a number of smart-card manufacturers, including China Electronics, the China Sciences Group and Beijing Sanyou Hengrui Technology Co., Ltd., to embed the computer chips into plastic cards. We currently maintain a one-year contract with each of the manufacturers that guarantees us a volume-based price discount for each purchase order and requires the manufacturer to fulfill our orders in accordance with an agreed schedule. Our contracts with the manufacturers require them to meet the ISO-7816 standard for card readability. In addition, we believe that there are numerous alternative smart-card manufacturers from whom we would be able to obtain smart cards if any of our current suppliers were unable to meet our needs.

For more information about risks relating to our relationships with our suppliers, see Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We generally do not have long-term contracts with suppliers of computer chips or the companies that manufacture our smart cards. If any of our computer chip suppliers or smart-card manufacturers is unable to fulfill our orders in time or at all, we may be unable to deliver smart cards to our customers.

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### **Competition**

We face competition in the CA systems market from both international and domestic companies. We compete on the basis of:

customer service and technical support;

brand name, track record and market recognition;

encryption management and other technologies, including our smart cards;

the number of set-top box manufacturers with whom we cooperate; and

price.

Our main international competitors in the CA systems business are Irdeto Access B.V. and NDS Limited. These companies have longer operating histories and substantially greater financial, technical and other resources than we do, which may enable them to respond more quickly than we could to technological or commercial changes in our industry. In addition, several of these companies entered the PRC market before us, but have to date been less successful in capturing market share. Historically, these companies have generally focused on sales to the television network operators in the PRC's largest cities. To the extent that our international competitors may begin targeting small and mid-size television network operators, we believe that we can continue to compete successfully because of our local knowledge and relationships and our more extensive customer support and service network.

Our main domestic competitors are DVN Holdings Ltd. and Sumavision Technologies Co., Ltd., both of which are non-state-owned companies operating mainly in the PRC. They may offer their CA systems at a lower price or with a longer credit term than we do. However, we believe that we have more advanced technology than they do, and that our strong technology and leading market position will enable us to continue to compete successfully against these companies.

According to Researchdtv, we were the leader in the PRC CA systems market in 2013 and 2014. According to Researchdtv, in 2014, we had an approximately 51.20% market share based on the number of smart cards shipped, followed by DVN Holdings Ltd. with approximately 17.58% market share, Sumavision Technologies Co., Ltd. with approximately 11.51% market share, Irdeto Access B.V. with approximately 7.68% market share, NDS Limited with approximately 6.12% market share and others accounting for the remaining 5.91%. For more information about risks relating to our competitors, see Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry We face intense competition, which could reduce our market share and harm our financial performance.

### **Research and Development**

Our success to date has in large part resulted from our strong research and development capabilities. As of December 31, 2014, our research and development team consisted of 362 employees, compared to 419 as of December 31, 2013 and 439 as of December 31, 2012. Our research and development expenses increased from

US\$17.4 million in 2012 to US\$19.3 million in 2013, and decreased to US\$17.3 million in 2014.

Our business and the market in which we operate are characterized by rapid technological change, evolving industry standards and frequent product enhancements. As digital broadcasting becomes more popular in the PRC, television network operators are likely to seek more sophisticated CA technology that offers them greater reliability, flexibility and functionality in delivering protected content or value-added services to viewers. As methods of distributing information and entertainment evolve, CA technology also needs to evolve to provide content protection for distribution platforms other than television. Our continued success will depend, in part, on our ability to develop and market products and services that respond to technological changes and evolving market demand or industry standards in a timely and cost-effective manner.

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Many of our current research and development staff are graduates of the PRC's top science and engineering universities, including Tsinghua University, and have extensive experience in digital television and encryption technologies. Our research team played a leading role in drafting the PRC industry standards for CA systems, EPGs and other key industry standards. We are active in the China Digital Rights Management Forum, which aims to develop a PRC standard for digital rights management.

Our research and development personnel focus our research on: (1) actively seeking ways to improve the security and reliability of our CA systems, as well as to prevent content theft at other stages of the television network operators chain of transmission; (2) adapting our CA systems for use on new television platforms, such as satellite television, mobile television, IPTV and Internet TV; (3) enhancing our CA systems to support applications such as video-on-demand, near video-on-demand, push video-on-demand and personal video recorders; (4) developing new value-added services that will enhance operator revenues; (5) enhancing Screen Cross to extend television services to mobile phones, tablet computers and other devices, with content protection; (6) developing a new line of products and technologies, including digital rights management products that allow content providers to control the way their content is distributed and reproduced, such as advanced digital television terminals; (7) applying cloud computing to television applications; and (8) developing our CA systems for use outside the PRC.

## **Intellectual Property**

We develop all of our software internally, and our proprietary intellectual property is critical to our success. We rely primarily on a combination of patent, trademark and copyright laws, trade secrets, licenses and employee and third-party confidentiality agreements to safeguard our intellectual property. We generally enter into confidentiality and non-disclosure agreements with our employees, customers and suppliers.

As of December 31, 2014, we had a total of 93 patents issued and 77 pending patent applications in the PRC. Our issued patents and pending patent applications relate primarily to digital transmission technologies, encryption and decryption technologies, technologies relating to the production of set-top boxes and smart cards and technologies relating to value-added services. We have also completed copyright registration of 109 software programs relating to digital television in the PRC.

In August 2008, we acquired from N-T Information Engineering all intellectual property rights relating to the digital watermarking and image tracing technologies, including one issued patent and five then pending patent applications in the PRC. Four of these pending patent applications relate to the digital watermarking technology, while the remaining pending patent application and the issued patent relate to the image tracing technology. As of the date of this annual report, these five pending patents have all been issued to us. The digital watermarking technology is aimed to enhance cable television operators' counterfeit tracking and broadcasting restriction capabilities and can also be used to provide anti-piracy and TV rating services. The image tracing technology is used for remote control of personal computers, set-top boxes and televisions as well as gaming consoles.

When we license our intellectual property to third parties, we generally receive a combination of license fees and royalties. We mainly license our terminal-end software to the set-top box manufacturers.

We have a non-exclusive license to use the English and Chinese names for "NOVEL-TONGFANG" and a graphic logo, free of charge, pursuant to an agreement with N-T Information Engineering. N-T Information Engineering has registered these names and the logo as trademarks. Our term of use is from June 1, 2004 until such trademark registrations expire at various dates in 2023. In November 2007, we ceased using "NOVEL-TONGFANG" in N-S Digital TV's name by changing the name from Beijing Novel-Tongfang Digital TV Technology Co., Ltd. to Beijing Novel-Super Digital TV Technology Co., Ltd. In January 2008, we ceased using the English and Chinese names for

NOVEL-TONGFANG as trademarks for our products and we intend not to use such trademarks in the future. We started to use the English and Chinese names for NOVEL SUPERTV in combination with the graphic logo we licensed from N-T Information Engineering as the trademarks for our products. In December 2008, we acquired for free the licensed graphic logo from N-T Information Engineering. In 2010, we completed the registration of the trademarks of the English and Chinese names for NOVEL SUPERTV, as well as the trademark for a combination of Chinese and English names for NOVEL SUPERTV and the graphic logo.

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As of December 31, 2014, we owned 63 trademarks, 53 of which are registered trademarks and 10 of which are in the process of being registered. We have 23 registered domain names, five of which were filed with the Ministry of Industry and Information Technology, or MIIT, including novel-supertv.com and chinadtv.cn.

**Insurance**

In 2014, we purchased short-term export credit insurance policies to cover the credit risks we bear in collecting proceeds from certain customers located in overseas markets. Other than these insurance policies, we do not maintain any business insurance or key-man insurance. Insurance companies in the PRC offer limited business insurance products and, to our knowledge, offer limited business liability insurance. While business disruption insurance is available to a limited extent in the PRC, we have determined that the risks of disruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. As a result, we do not have any business liability, disruption or litigation insurance coverage for our operations in the PRC. We also generally do not maintain property insurance, except for insurance that covers the company automobiles.

**Employees**

We had 778, 722 and 680 full-time employees as of December 31, 2012, 2013 and 2014, respectively. We have no part-time employees. Substantially all of our employees are located in the PRC. The table below shows the number of employees categorized by business area and as a percentage of our workforce as of December 31, 2012, 2013 and 2014:

	As of December 31, 2012		As of December 31, 2013		As of December 31, 2014	
	Number	%	Number	%	Number	%
Research and development	439	56.4%	419	58.0%	362	53.2%
Technical service	58	7.4	51	7.1	53	7.8
Sales and marketing	168	21.6	145	20.1	153	22.5
General and administration	83	10.7	78	10.8	82	12.1
Smart card production	30	3.9	29	4.0	30	4.4
Total	778	100.0%	722	100.0%	680	100.0%

As required by applicable PRC regulations, we participate in various employee benefit plans that are organized by municipal and provincial governments, including housing, pension, medical and unemployment benefit plans. We are required under PRC law to make contributions to the employee benefit plans at specified percentages of the salaries, bonuses and certain allowances of our employees, up to a maximum amount specified by the local government from time to time. Members of the retirement plan are entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The total contributions made to employee benefit plans in 2012, 2013 and 2014 were approximately US\$5.0 million, US\$5.7 million and US\$5.8 million, respectively.

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Our employees are not represented by any collective bargaining agreements or labor unions. We believe that we maintain a good working relationship with our employees and we have not experienced any significant labor disputes.

We typically enter into a standard confidentiality agreement with our employees. We also enter into an agreement with each of our employees giving us full rights to any inventions developed by such persons during the course of their employment by us. In addition, we enter into a non-competition agreement with each of our executive officers and key research and development personnel. These agreements include a covenant that prohibits each of them from engaging in any activities that directly or indirectly compete with our business during, and for one year after, the period of their employment with us.

## **Regulation**

We operate substantially all of our business in the PRC and various aspects of our business activities are subject to the laws, rules and regulations of the PRC, including laws, rules and regulations relating to the encryption industry, the cable television industry and the software industry. These laws, rules and regulations require us to obtain certain licenses and certificates for our encryption products. In addition, certain laws, rules and regulations of the PRC also affect the rights of our shareholders to receive dividends and other distributions from us. This section summarizes the principal regulations relevant to our lines of business.

### ***Regulation of Encryption Industry***

Encryption software is an essential component of our CA systems. The development, production and sale of commercial encryption products in the PRC is regulated by the PRC National Encryption Administrative Bureau, or the Encryption Bureau, and its authorized local branches. The principal regulations governing the encryption business in the PRC are the *Administrative Regulation for Commercial Cryptogram* promulgated by the State Council in 1999 and a series of rules issued by the Encryption Bureau thereunder.

A company generally is only allowed to produce and/or sell encryption products that have adopted the algorithms designated by the Encryption Bureau and such products shall also be certified by the Encryption Bureau. The Encryption Bureau did not initially designate algorithms for CA systems until 2007, and a final and official designation still remains pending. As a result, like many other vendors of CA systems in the PRC, N-S Digital TV has been making and selling CA systems using algorithms other than those initially designated by the Encryption Bureau. Based on our consultation with the Encryption Bureau, we have no reason to believe, given that N-S Digital TV commenced its CA systems business when the initially designated algorithms were not yet available, that the Encryption Bureau would impose any sanctions against N-S Digital TV for not using initially designated algorithms in the past. In addition, since the Encryption Bureau did not initially designate any algorithms for CA systems until 2007 with a final and official designation pending, and algorithms for CA systems other than those initially designated by the Encryption Bureau have been widely used and accepted in the market, the PRC government has allowed vendors of CA systems a transition period, of a duration yet to be determined at its sole discretion, during which such vendors, including N-S Digital TV, may continue to produce and sell CA systems without using government-designated algorithms. The PRC government may require vendors of CA systems to adopt the algorithms to be finally and officially designated by the authority at the expiration of such transition period or at any time during the transition period.

In addition, a company engaging in the encryption-related business is subject to certain licensing requirements. For example, a company engaging in the production of commercial encryption products must obtain a production license from the Encryption Bureau, and a company engaging in the sale and distribution of commercial encryption products must obtain a sales license. In addition, a company engaging in research and development of commercial encryption



systems, protocols, algorithms or technical standards shall obtain a license for research and development from the Encryption Bureau. To obtain such licenses, a company must meet requirements established by the Encryption Bureau, among other things, with respect to its technological capabilities, its equipment, its production and quality control processes, the level of security of its algorithms and the qualifications of its employees. Furthermore, both importing and exporting products or equipment containing encryption technologies are subject to the prior approval of the Encryption Bureau.

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In the opinion of Han Kun, our PRC counsel, the business of N-S Digital TV does not require a license for research and development. N-S Digital TV has engaged in the production and sale of encryption products since its establishment in May 2004, but it did not obtain the license for the production of encryption products until June 2006, which was renewed in May 2009 and June 2012, and the license for the sale of encryption products until September 2008, which was renewed in September 2011 and September 2014. For risks relating to the potential legal penalties against N-S Digital TV for its operations prior to its obtaining the production and sales licenses, see Item 3. Key Information D. Risk Factors Risk Relating to Our Business and Industry N-S Digital TV may be deemed not to be in full compliance with certain legal regulatory requirements relating to the production, sale and export of encryption products, and the relevant PRC government authorities could require N-S Digital TV to cease such activities and impose administrative penalties including fines, which could have a material adverse effect on our business, financial condition and results of operations.

Furthermore, the *Administrative Regulation for Commercial Cryptogram and the Provisions on the Administration of the Use of Commercial Encryption Products*, which became effective in October 1999 and May 2007, respectively, allow users to use only encryption products that are certified by the encryption authority and purchased from vendors who hold an encryption product sales license. Our CA systems that we currently produce and sell have not been certified by the Encryption Bureau because we have not adopted the government-designated algorithms for those CA systems. We believe that because, in practice, the PRC government has allowed a transition period, of a duration yet to be determined at its sole discretion, for us to adopt the algorithms to be finally and officially designated by the authority, it is unlikely that the government will enforce the above-mentioned regulatory requirements with respect to the use or purchase of our CA systems during that transition period. See also Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry Enforcement of certain PRC regulatory requirements regarding the use of encryption products may prevent prospective customers from purchasing our CA systems.

Although foreign-invested enterprises incorporated in the PRC, such as our subsidiary, Super TV, are not expressly prohibited from conducting encryption-related business, they may have difficulties obtaining the licenses or permits required for conducting such business from the Encryption Bureau due to the Encryption Bureau's generally restrictive approach towards foreign participation in the PRC encryption industry. In light of the above, at the time of the Company's initial public offering, we established and controlled, through contractual arrangements, N-S Digital TV to conduct our CA system business, and obtained the license for the production and sales of commercial encryption products required for our business. In order to consummate the sale of Super TV to Tongda Venture and meet the CSRC's approval requirements that, among other things, require that the assets of a China-listed company generally be held and owned by it or its subsidiaries while the contractual arrangements may not be accepted, our contractual arrangements with N-S Digital TV and its nominee shareholders were terminated, and the 100% equity interest in N-S Digital TV formerly held by the nominee shareholders was transferred to Super TV in June 2014. As a result, N-S Digital TV has become Super TV's subsidiary, a subsidiary of a foreign-invested company. If the Encryption Bureau determines that the ownership structure of N-S Digital TV is contrary to its generally restrictive approach towards foreign participation in the PRC encryption industry, it may reconsider N-S Digital TV's eligibility to hold the license to produce and sell commercial encryption products. The Encryption Bureau may revoke, or refuse to renew, N-S Digital TV's licenses to produce and sell commercial encryption products, or refuse to grant any other encryption-related license that may be required for our business in the future. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry The structure for operating our business may result in the relevant PRC government regulators revoking or refusing to renew N-S Digital TV's licenses for the production and sale of commercial encryption products, or refusing to issue any other license required to engage in an encryption-related business and Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry N-S Digital TV may be deemed not to be in full compliance with certain legal regulatory requirements relating to the production, sale and export of encryption products, and the relevant PRC government authorities could require N-S Digital TV to cease such activities and impose administrative penalties including fines, which could have a material adverse effect on our

business, financial condition and results of operations.

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### *Regulation of the Cable Television Industry*

The PRC cable television industry, in which most of our customers operate, is subject to extensive government regulation and control. All PRC cable television network operators are directly or indirectly owned or controlled by provincial or local governments, and their business decisions and strategies are significantly affected by government budgets and spending plans. In April 2005, the PRC State Council issued a notice to allow domestic private investors to invest in PRC companies engaged in the operation and infrastructure development of cable networks, subject to a 49% ownership cap. Foreign ownership of cable television networks and stations, however, is still prohibited.

Cable television network operators are subject to the laws, rules and regulations promulgated from time to time by the State Council, the SAPPRFT and other ministries and government departments. These regulations include the *Administrative Regulations for Television Broadcasting* promulgated by the State Council in 1997, the *Interim Measures regarding the Management of Cable TV* promulgated by a predecessor government agency of the SAPPRFT in 1990 and amended in January 2011, and the *Measures Concerning Network Access Certification of Broadcasting and Television Equipment*, which became effective on August 1, 2004. Under these laws, rules and regulations:

the establishment of a television station or cable television network requires the approval of the SAPPRFT or its relevant local branch;

the establishment of a digital pay-television channel requires the approval of the SAPPRFT;

basic cable television subscription rates are set by local governments and may not be increased without a public hearing;

cable television networks must be designed, constructed and installed by institutions or companies that meet the qualifications set by the SAPPRFT;

each province and municipality, respectively, can have only one provincial or municipal cable television network; and

various restrictions on television programming must be complied with, including a requirement that television operators shall procure programs only from licensed production companies.

According to the relevant regulations of the SAPPRFT, cable television network operators may not use any network equipment or system unless the SAPPRFT has issued a network access certificate with respect to such equipment or system. In determining whether to issue such a certificate, the SAPPRFT reviews the quality assurance system of the relevant manufacturer or vendor and the results of tests of the equipment or systems. A network access certificate has a term of three years and is subject to annual review by the SAPPRFT or its local branches. N-S Digital TV has obtained network access certificates for our CA systems and SMS products.

According to a policy introduced by the SAPPRFT in 2003 and the *Policies to Encourage the Development of Digital TV Industry* jointly promulgated by SAPPRFT and other government authorities in January 2008, any cable network

operator that uses a non-PRC CA system should use such non-PRC CA system together with a PRC CA system when transmitting broadcasting signals. To satisfy this requirement, a cable network operator that uses a non-PRC CA system must install a parallel PRC CA system. Under these policies, vendors of non-PRC CA systems may sell only to cable network operators that have already installed a PRC CA system or who are willing to purchase a parallel PRC CA system. This may result in a competitive disadvantage for vendors of non-PRC CA systems relative to vendors of PRC CA systems. Such policies do not expressly indicate whether the CA systems produced by a foreign-invested company incorporated in the PRC, such as our subsidiary, Super TV, fall into the category of non-PRC CA systems. In light of this ambiguity, at the time of the Company's initial public offering, we had established N-S Digital TV, which was wholly owned by PRC citizens, to produce and sell our CA systems. In June 2014, our contractual arrangements with N-S Digital TV and its shareholders were terminated, and the 100% equity interest in N-S Digital TV was transferred to Super TV. There are substantial uncertainties regarding the interpretation and application of the above-described PRC government policies and relevant PRC laws, rules and regulations. Accordingly, the PRC government may determine that N-S Digital TV is a vendor of non-PRC CA systems because N-S Digital TV is a wholly-owned subsidiary of Super TV, a foreign-invested enterprise, and cable network operators may cancel their orders for our CA systems to avoid being required to install a parallel PRC CA system, and we may also lose potential customers who are not willing, or have no plan, to install a parallel PRC CA system for economic or other reasons. As a result, our business, financial condition and results of operations could be materially and adversely affected. See Item 3. Key Information D. Risk Factors Risks Relating to Our Business and Industry If the PRC government determines that N-S Digital TV is a vendor of non-PRC CA systems by virtue of it being a subsidiary of a foreign-invested company, we could face difficulty selling our CA systems in the PRC.

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### ***Software Products Registration***

On March 5, 2009, the MIIT issued the *Measures Concerning Software Products Administration*, or Software Measures, which became effective on April 10, 2009 and superseded the prior measures issued in 2000, to regulate software products and promote the development of the software industry in the PRC.

In order to manufacture software products, a software producer must possess the copyright of such software or have obtained a license from a legitimate copyright owner or licensor in connection with such software. Software producers must censor the content of their software products. Software developers or producers are allowed to sell or license their registered software products independently or through agents. Software products developed in the PRC may be registered with the local provincial government authorities in charge of the information industry and filed with the MIIT. If no objection is raised within seven business days from the date of the public announcement made by the MIIT after its receipt of the filing, the software products shall be granted registration certificates. Each registration certificate is valid for five years and may be renewed upon expiration. Registered software products may be qualified for certain tax and other preferential treatments under the industrial policies. The MIIT and other relevant departments may carry out supervision and inspection over the development, production, operation and importing and exporting of software products in the PRC. As of December 31, 2014, we had 36 registered software products.

### ***Tax***

See Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives PRC.

### ***Foreign Currency Exchange***

Foreign currency exchange in the PRC is primarily governed by the following regulations:

*Foreign Exchange Administration Rules* (1996), as amended in 2008; and

*Regulations of Settlement, Sale and Payment of Foreign Exchange* (1996).

Under the *Foreign Exchange Administration Rules*, the Renminbi is freely convertible for current account items, including the distribution of dividends, payment of interest, trade and service-related foreign exchange transactions. Conversion of Renminbi for capital account items, such as direct investment, loans, securities investment and repatriation of investment, however, is still generally subject to the approval or verification of the SAFE.

Under the *Regulations of Settlement, Sale and Payment of Foreign Exchange*, foreign-invested enterprises may only buy, sell or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents and, in the case of capital account item transactions, obtaining approval from the SAFE. Capital investments by foreign-invested enterprises outside the PRC are also subject to limitations, which include approvals by the MOFCOM, the SAFE and the National Development and Reform Commission.

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On February 28, 2015, the SAFE promulgated the *Notice on Further Simplifying and Improving Foreign Exchange Policy on Direct Investment*, or SAFE Notice 13, which will become effective on June 1, 2015. After SAFE Notice 13 becomes effective, instead of applying for approvals regarding foreign exchange registrations of foreign direct investment and overseas direct investment from the SAFE as required under current laws, entities and individuals will be required to apply for such foreign exchange registrations from qualified banks. The qualified banks, under the supervision of the SAFE, will directly examine the applications and conduct the registration.

### ***Stock Incentive Plans***

On December 25, 2006, the People's Bank of China issued the *Administrative Measures on Individual Foreign Exchange Control*, and on January 5, 2007, the SAFE issued the *Implementation Rules of the Administrative Measures on Individual Foreign Exchange Control*, both of which became effective on February 1, 2007. Under these regulations, all foreign exchange matters involved in employee share ownership plans, share option plans and other equity incentive plans participated in by PRC individuals are to be transacted upon the approval of the SAFE or its authorized branches.

On February 15, 2012, the SAFE promulgated SAFE Notice 7, which superseded SAFE Notice 78. Under SAFE Notice 7, Domestic Individuals who are granted stock options or any other stock-related rights and benefits under a stock incentive plan by an overseas-listed company are required, through a Domestic Agent, to register with the SAFE or its authorized local counterparts and complete certain other procedures. The Domestic Agent is required to submit information relating to a stock incentive plan with the authorized local counterparts of the SAFE within three business days of each quarter and complete foreign exchange cancellation procedures within 20 business days after the termination of a stock incentive plan.

### ***Dividend Distribution***

The principal regulations governing distribution of dividends paid by wholly foreign-owned enterprises include:

*Wholly Foreign-Owned Enterprise Law* (1986), as amended in 2000 and 2014; and

*Wholly Foreign-Owned Enterprise Law Implementation Rules* (1990), as amended in 2001 and 2014. Under these regulations, wholly foreign-owned enterprises in the PRC may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, according to the *PRC Company Law*, wholly foreign-owned enterprises in the PRC, like other PRC companies, are required to set aside to fund a statutory reserve each year at least 10% of their after-tax profit, based on PRC accounting standards, until the cumulative total of such reserve reaches 50% of its registered capital. This reserve is not distributable as cash dividends to equity owners.

### ***Regulation of Foreign Exchange in Certain Onshore and Offshore Transactions***

In July 2014, the SAFE issued SAFE Notice 37, to replace the *Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents Engaging in Financing and Roundtrip Investments via Overseas Special Purpose Vehicles*, or SAFE Notice 75. SAFE Notice 37 provides that PRC residents, whether natural or legal persons, must register with the relevant local SAFE branch in connection with establishing or taking control of an offshore entity established for the purpose of overseas equity financing involving legitimate onshore or offshore assets or

equity interests held by them. The term "PRC legal person residents" as used in the SAFE regulations refers to those entities with legal person status or other economic organizations established within the territory of the PRC. The term "PRC natural person residents" as used in the SAFE regulations includes all PRC citizens and all other natural persons, including foreigners, who habitually reside in the PRC for economic benefit.



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PRC residents are also required to complete amended registrations or filing with the local SAFE branch after any material change in the shareholding or capital of the offshore entity, such as changes of basic information, increase or decrease in investment amount, share transfers or exchanges, and mergers or divisions. On February 28, 2015, the SAFE promulgated the *Notice on Further Simplifying and Improving Foreign Exchange Policy on Direct Investment*, or SAFE Notice 13, which will become effective on June 1, 2015. After SAFE Notice 13 becomes effective, instead of applying for approvals regarding foreign exchange registrations of foreign direct investment and overseas direct investment from the SAFE as required under current laws, entities and individuals will be required to apply for such foreign exchange registrations, including those required under SAFE Notice 37, from qualified banks. The qualified banks, under the supervision of the SAFE, will directly examine the applications and conduct the registration.

The registration and filing procedures under the SAFE regulations are prerequisites for other approval and registration procedures necessary for capital inflow from the offshore entity, such as inbound investments or shareholders loans, or capital outflow to the offshore entity, such as the payment of profits or dividends, liquidating distributions, equity sale proceeds, or the return of funds upon a capital reduction.

***Regulation of Overseas Listings***

On August 8, 2006, six PRC regulatory agencies, including the MOFCOM, the SASAC, the SAT, the SAIC, the CSRC and the SAFE, jointly adopted the M&A Rules, which became effective on September 8, 2006 and were amended on June 22, 2009. The M&A Rules, among other things, include provisions that purport to require that an offshore special purpose vehicle formed for the purpose of an overseas listing of securities in a PRC company and controlled directly or indirectly by PRC companies or individuals obtain the approval of the CSRC prior to the listing and trading of such special purpose vehicle's securities on an overseas stock exchange.

We completed the initial listing and trading of our ADSs on the NYSE on October 11, 2007. We did not seek CSRC approval in connection with our initial public offering, as we were advised by our PRC counsel that, based on their understanding of the current PRC laws, regulations and rules, because we completed our restructuring before September 8, 2006, the effective date of the M&A Rules, we were not required by the M&A Rules to apply to the CSRC for approval of the listing and trading of our ADSs on a U.S. stock exchange, unless we were clearly required to do so by any rules promulgated in the future. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China The approval of the CSRC might be required in connection with our initial public offering under certain PRC regulation; failure to obtain this approval, if required, could have a material adverse effect on our business, financial condition, results of operations and reputation as well as the trading price of our ADSs.

***Regulations on PRC Foreign Investment***

The MOFCOM published the draft Foreign Investment Law in January 2015, aiming to, upon its enactment, replace the trio of existing laws regulating foreign investment in China, namely, the *Sino-foreign Equity Joint Venture Enterprise Law*, the *Sino-foreign Cooperative Joint Venture Enterprise Law* and the *Wholly Foreign-invested Enterprise Law*, together with their implementation rules and ancillary regulations. The draft Foreign Investment Law embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. The MOFCOM is currently soliciting comments on this draft and substantial uncertainties exist with respect to its enactment timetable, interpretation and implementation. The draft Foreign Investment Law, if enacted as proposed, may materially impact the viability of our current corporate structure, corporate governance and business operations in many aspects.



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Among other things, the draft Foreign Investment Law expands the definition of foreign investment and introduces the principle of actual control in determining whether a company should be treated as a foreign-invested enterprise, or an FIE. According to the definition set forth in the draft Foreign Investment Law, FIEs shall refer to enterprises established in China pursuant to PRC laws that are solely or partially invested by foreign investors. The draft Foreign Investment Law specifically provides that entities established in China (without direct foreign share ownership) but controlled by foreign investors, via contracts or trust, for example, will be treated as FIEs. Once an entity falls within the definition of FIE, it may be subject to foreign investment restrictions or prohibitions set forth in a negative list to be separately issued by the State Council at a later date. If the underlying business of an FIE is subject to foreign investment restrictions, it needs to go through a market entry clearance process carried out by the MOFCOM before the FIE can be established. If the underlying business of the FIE is subject to foreign investment prohibitions, it may not enter such business in China. However, an FIE, during the market entry clearance process, may apply in writing to be treated as a PRC domestic enterprise if its foreign investor(s) is/are controlled by PRC government authorities and its affiliates and/or PRC citizens. In this connection, control is broadly defined in the draft law to cover the following summarized categories: (i) holding 50% of more of the voting rights of the subject entity; (ii) holding less than 50% of the voting rights of the subject entity but having the power to secure at least 50% of the seats on the board or other equivalent decision-making bodies, or having the voting power to exert material influence on the board, the shareholders meeting or other equivalent decision-making bodies; or (iii) having the power to exert decisive influence, via contractual or trust arrangements, over the subject entity's operations, financial matters or other key aspects of business operations.

The draft also emphasizes the security review requirements, whereby all foreign investments concerning national security must be reviewed and approved in accordance with the security review procedure. In addition, the draft imposes stringent ad hoc and periodic information reporting requirements on foreign investors and applicable FIEs. In addition to investment implementation reports and investment amendment reports, which are required for each investment and alteration of investment specifics, an annual report is mandatory, and large foreign investors meeting certain criteria are required to report on a quarterly basis. Any company found to be non-compliant with these information reporting obligations may potentially be subject to fines and/or administrative or criminal liabilities, and the persons directly responsible may be subject to criminal liabilities.

The draft is now open for public review and comments. It is still uncertain when the draft would be signed into law and whether the final version would have any substantial changes from the draft. When the Foreign Investment Law becomes effective, the trio of existing laws regulating foreign investment in China, namely, the *Sino-foreign Equity Joint Venture Enterprise Law*, the *Sino-foreign Cooperative Joint Venture Enterprise Law* and the *Wholly Foreign-invested Enterprise Law*, together with their implementation rules and ancillary regulations, will be abolished.

**C. Organizational Structure**

We are a Cayman Islands holding company and conduct substantially all of our business through our operating subsidiaries in the PRC. We own 100% of the equity interest of CDTV BVI, a BVI holding company, that directly owns 100% of the equity interest of Golden Benefit and CSM Holdings, each a Hong Kong holding company. Golden Benefit directly owns 100% of the equity interest of Super TV, which owns 100% of the equity interest in N-S Digital TV. CSM Holdings directly owns a 100% and 75% equity interest in N-S Information Technology and Cyber Cloud, respectively. N-S Information Technology holds a 46.9%, 100% and 100% equity interest in Joysee, N-S Media Investment and Shibo Movie, respectively. And Cyber Cloud holds a 100% equity interest in Xinsi Yijia.



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The following diagram illustrates our corporate structure as of the date of this annual report:

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N-T Information Engineering was established by Tsinghua Enterprise Group, a company affiliated with Tsinghua University, and Hong Kong-based Tsinghua Novel Hi-Tech Investment Holding Ltd. in July 1998, and initially focused on developing, producing and selling digital data broadcasting equipment for cable television operators. In December 2002, N-T Information Engineering completed its acquisition of the CA systems-related assets of Tsinghua Tongfang. In March 2004, CDTV BVI was incorporated as a holding company in the BVI. Following the establishment of CDTV BVI, we restructured our operations in connection with an investment by SAIF. As part of this restructuring, we established Super TV, a wholly-owned subsidiary of CDTV BVI, on May 31, 2004. On the same day, N-S Digital TV was also established. In June 2004, N-S Digital TV acquired from N-T Information Engineering its smart card and CA systems business and, in August 2006, N-S Digital TV acquired from N-T Information Engineering its set-top box design business. In April 2007, a new holding company, CDTV Holding, was established in the Cayman Islands. In May 2007, CDTV BVI executed a 40-for-1 share split of its ordinary shares and Series A preferred shares. Following this share split, the shareholders of CDTV BVI exchanged all of their shares of CDTV BVI for shares of CDTV Holding in proportion to their percentage interest in CDTV BVI. As a result, CDTV BVI became a wholly-owned subsidiary of CDTV Holding. As a result of a series of transactions over the years, Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang in aggregate owned all of the equity interest of N-S Digital TV.

In order to benefit from the tax arrangement between the PRC and Hong Kong, in December 2007, CDTV BVI acquired Golden Benefit, a company incorporated in Hong Kong, for a nominal consideration, and transferred its 100% equity interest in Super TV to Golden Benefit. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC and Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives Tax Arrangement between the PRC and Hong Kong.

In December 2007, Super TV established a wholly-owned subsidiary, N-S Media Investment, and transferred the equity interest of N-S Media Investment to N-S Information Technology in June 2014. In February 2008, CDTV BVI established a wholly-owned subsidiary, CSM Holdings, in Hong Kong. In July 2010, we established N-S Investment Holdings, a wholly-owned subsidiary of Super TV, in the PRC. In June 2014, N-S Investment Holdings was renamed N-S Information Technology, and Super TV transferred its 100% equity interest in N-S Information Technology to CSM Holdings.

In January 2011, we established Cyber Cloud, a subsidiary in which Super TV holds a 90% equity interest, in the PRC. Pursuant to a series of agreements dated April 30, 2014, Cyber Cloud acquired 100% equity interest in Xinsi Yijia from Yuewu Yuntian and Holch Capital, and in exchange, Yuewu Yuntian and Holch Capital obtained certain noncontrolling interests in Cyber Cloud. Moreover, Super TV transferred its remaining equity interest in Cyber Cloud to CSM Holdings. As a result of these transactions, CSM Holdings, Yuewu Yuntian and Holch Capital held 75%, 15% and 10% of the equity interest in Cyber Cloud, respectively. Dingyuan is controlled by Xinsi Yijia through a series of contractual arrangements. Joysee was established in May 2011, and as a result of a series of equity transactions, N-S Information Technology owns a 46.9% equity interest in Joysee. In September 2011, we established Super Movie, a subsidiary in the PRC in which Super TV holds a 90% equity interest. Super Movie was later dissolved in November 2013. Shibo Movie was established in February 2012 as a joint venture of Super TV and became wholly owned by N-S Information Technology upon completion of a series of equity transactions in June 2014. See Item 4. Information on the Company A. History and Development of the Company Our Investments and Acquisitions.

Any cable network operator who uses a non-PRC CA system is required under a policy promulgated by the SAPPRFT to install a parallel PRC CA system. Under this policy, vendors of non-PRC CA systems may sell only to cable network operators who have already installed a PRC CA system or are willing to purchase a parallel PRC CA system.

This may result in a competitive disadvantage for vendors of non-PRC CA systems relative to vendors of PRC CA systems. Such policy does not expressly indicate whether the CA systems produced by a foreign-invested company incorporated in the PRC, such as our subsidiary Super TV, fall into the category of non-PRC CA systems. In light of this ambiguity, we established N-S Digital TV in May 2004, which was incorporated in the PRC and wholly owned by PRC citizens, to produce and sell our CA systems to avoid our CA systems being deemed as non-PRC CA systems. We conduct a significant portion of our operations through N-S Digital TV. Prior to June 2014, we did not directly or indirectly have any equity interest in N-S Digital TV, but Super TV, our wholly-owned subsidiary in the PRC, had entered into a series of contractual arrangements with N-S Digital TV and its shareholders. As a result of these contractual arrangements, we were considered the primary beneficiary of N-S Digital TV and, accordingly, we consolidated N-S Digital TV's results of operations in our financial statements.

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Super TV mainly engages in supplying software products relating to smart cards to N-S Digital TV, providing technical support and related services to N-S Digital TV, and developing technology for use by N-S Digital TV. Specifically, Super TV and N-S Digital TV had entered into the following contracts:

a products and software purchase agreement, pursuant to which N-S Digital TV purchased from Super TV all software products relating to smart cards required for N-S Digital TV's CA systems;

a technical support and related services agreement, pursuant to which Super TV exclusively provided N-S Digital TV and/or its customers with technical support, technical training, personnel services in connection with N-S Digital TV's marketing activities and services relating to the maintenance and optimization for the products and software of N-S Digital TV's customers at N-S Digital TV's request;

a technology license agreement, pursuant to which N-S Digital TV granted Super TV, free of charge, an exclusive license to use certain software copyrights, patents, unpatentable technologies and technical secrets relating to the digital television business that was transferred from N-T Information Engineering to N-S Digital TV; and

a technology development agreement, pursuant to which N-S Digital TV engaged Super TV to develop all technology required by N-S Digital TV or its customers.

In addition, Super TV had entered into the following agreements with N-S Digital TV and its shareholders that provided us with the ability to control N-S Digital TV, which were subsequently terminated on June 20, 2014:

Equity Transfer Option Agreement, pursuant to which the shareholders of N-S Digital TV had jointly granted Super TV or its designated party an exclusive and irrevocable option to purchase all of their equity interests in N-S Digital TV at any time, and, without Super TV's prior written consent, the shareholders of N-S Digital TV were not permitted to: (1) transfer or pledge their equity interests in N-S Digital TV; (2) cause N-S Digital TV to issue new shares; (3) receive any dividends, loan interest or other benefits from N-S Digital TV; or (4) make any material adjustment or change to N-S Digital TV's business or operations;

Business Operating Agreement, pursuant to which N-S Digital TV and its shareholders agreed to: (1) accept the policies and guidelines furnished by Super TV with respect to the hiring and dismissal of employees, the operational management and financial system of N-S Digital TV; (2) appoint the candidates recommended by Super TV as directors of N-S Digital TV and appoint the senior management personnel of Super TV as the general manager, chief financial officer and other senior officers of N-S Digital TV based on Super TV's recommendations; (3) replace or remove a director or senior management personnel of N-S Digital TV upon Super TV's request; and (4) seek a guarantee from Super TV first when any guarantee is required to secure performance by N-S Digital TV of any contract or working capital loans borrowed by N-S Digital TV;



loan agreements, pursuant to which each shareholder of N-S Digital TV had obtained loans from Super TV to fund its contribution to N-S Digital TV's registered capital and had agreed to: (1) not repay the loan prior to the termination date of the relevant loan agreement, unless so requested by Super TV; and (2) only repay the loan by (i) transferring all its equity interests in N-S Digital TV to Super TV or any third party designated by Super TV and (ii) paying Super TV with the entire proceeds obtained by it from such transfer;

powers of attorney, pursuant to which each shareholder of N-S Digital TV had irrevocably appointed Super TV or one of its directors as their attorneys-in-fact to exercise all its voting rights as shareholders of N-S Digital TV; and

share pledge agreements, pursuant to which each shareholder of N-S Digital TV had pledged all of its respective equity interests in N-S Digital TV to Super TV to secure the performance of its and N-S Digital TV's obligations under certain contractual arrangements between N-S Digital TV and/or its shareholders and Super TV.

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For a more detailed description of these contractual agreements, see Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Super TV and N-S Digital TV Arrangements and Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions Shareholder Rights and Corporate Governance.

### **D. Property, Plants and Equipment**

We currently maintain our headquarters and most of our operations at Jingmeng High-Tech Building B, 4th Floor, No. 5 Shangdi East Road, Haidian District, Beijing 100085, PRC, where we lease 7,747 square meters of office space pursuant to seven short-term lease agreements with the same landlord for separate portions of the total space. The seven lease agreements are: (1) a lease agreement of N-S Digital TV with respect to an aggregate area of 1,138 square meters for its operational use; (2) a lease agreement of Super TV with respect to an aggregate area of 1,984 square meters for its operational use and an aggregate area of 140 square meters for storage; (3) a lease agreement of N-S Information Technology with respect to an area of 2,655 square meters for its operational use; (4) a lease agreement of N-S Information Technology with respect to an area of 480 square meters for its operational use; (5) a lease agreement of Cyber Cloud with respect to an area of 878 square meters for its operational use; (6) a lease agreement of Xinsi Yijia with respect to an area of 236 square meters for its operational use; and (7) a lease agreement of Dingyuan with respect to an area of 236 square meters for its operational use. All the lease agreements expired in April 2015. We intend to continue leasing the forgoing space and are currently in the process of finalizing the relevant leasing arrangements with the landlord. In addition, the manufacturing department of N-S Digital TV is located at Building 4, 2nd Floor, No. 7 Yuexiu Road, Haidian District, Beijing. N-S Digital TV has entered into a lease agreement with another landlord with respect to an aggregate area of 618 square meters for its manufacturing use. That lease agreement will expire in 2016.

In addition, we lease office space for service and support centers in Hangzhou and Nanhai. We routinely review our needs for office space in light of the development of our operations. We believe that the office space that we currently lease is sufficient for our current and immediately foreseeable needs. We may lease additional space if needed in the future.

### **Item 4A. Unresolved Staff Comments**

On September 17, 2014, we received a comment letter from the SEC relating to our annual report on Form 20-F for the fiscal year ended December 31, 2013. On October 27, 2014, we submitted a response letter to the SEC.

On December 10, 2014 and February 5, 2015, we received comment letters from the SEC relating to issues with respect to our planned sale of Super TV and investment in Tongda Venture as described in the Proxy Statement. We submitted response letters to the SEC on January 8, 2015 and March 18, 2015, respectively. On April 11, 2015, we received follow-up verbal comments from the SEC on these matters, and we submitted a supplemental response letter to the SEC on April 16, 2015.

As of the date of the filing of this annual report on Form 20-F, we are working on responding to the latest comment letter received from the SEC on April 22, 2015 concerning these matters. We will continue to cooperate with the SEC to resolve any remaining comments.

### **Item 5. Operating and Financial Review and Prospects**

The following discussion and analysis should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report. Our audited consolidated financial statements have been prepared in accordance with U.S. GAAP. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information provided in Item 3. Key Information D. Risk Factors.

In light of the uncertainties in completing the planned sale of Super TV, the discussion below has been presented without regard to that pending transaction. Following the planned sale of Super TV (which operates our CA, Screen Cross and video-on-demand businesses) to Tongda Venture, our retained businesses (other than the approximately 17.24% equity interest in Tongda Venture) will primarily consist of Cyber Cloud, which mainly engages in the research and development of cloud computing technology-based digital video delivery solutions.

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**Table of Contents****A. Operating Results****Overview**

We are the leading provider of CA systems to the PRC digital television market. Our CA systems, which consist of smart cards, head-end software for television network operators and terminal-end software for set-top box manufacturers, enable digital television network operators in the PRC to control the distribution of content and value-added services to their subscribers and block unauthorized access to their networks. In addition, we sell advanced digital television application software, such as EPGs and SMSs, to digital television network operators.

We sell our CA systems and digital television application software to PRC television network operators, including cable, satellite and terrestrial television network operators and enterprises that maintain private cable television networks within their facilities. We currently derive, and we expect to continue to derive, a significant portion of our revenues during any given period from a limited number of customers, primarily cable television network operators who are launching new digital transmission systems, although the particular customers may vary from period to period.

As of December 31, 2014, we had installed CA systems at 436 digital television network operators in 31 of the 32 provinces, autonomous regions and centrally administered municipalities in the PRC. We have also been installing CA systems outside the PRC since 2010, including countries such as Myanmar, India and Venezuela. We derive a substantial majority of our revenues from sales of our smart cards, which accounted for 83.3%, 88.5% and 80.9% of our total revenues in 2012, 2013 and 2014, respectively. We sold 15.3 million, 17.0 million and 15.6 million smart cards in 2012, 2013 and 2014, respectively, and our net revenues were US\$88.7 million, US\$87.2 million and US\$81.5 million in 2012, 2013 and 2014, respectively. Our net income was US\$5.5 million, US\$22.6 million and US\$19.2 million in 2012, 2013 and 2014, respectively.

Among the most significant factors affecting our business, financial condition and results of operations are:

***Progress of continued digitalization and growth of digital television network operators' subscriber base in the PRC.*** On the one hand, our continued success depends on the pace at which PRC television network operators continue to switch from analog to digital transmission as well as further growth in our customers' subscriber base. If the PRC government postpones its target date for digitalization, or our customers fail to roll out analog-to-digital conversion or attract subscribers to digital television, we may be unable to sustain or grow our revenues. On the other hand, as digitalization progresses, the number of cable TV operators who have not switched to digital transmission and thus are potential customers of our CA systems and smart cards is decreasing.

***Pricing.*** The business in which we operate is subject to intense competition, particularly with respect to pricing of our products and services. Our customers generally expect to receive volume-based discounts from us, and we may be required to reduce prices for large purchases or if competition intensifies.

***Purchasing patterns of our customers.*** Our customers generally purchase smart cards from us based on the number of digital television subscribers they expect to add in the immediate near term, resulting in significant fluctuations in our revenues from period to period due to the uncertainty of both the

timing and the amount of such customer orders.

***Ability to respond effectively to technological and commercial changes.*** Our business and the market in which we operate are characterized by rapid commercial and technological change, evolving industry standards and frequent product enhancements. Our continued success will depend, in part, on our ability to continue developing and marketing products and services that respond to technological changes and evolving market demand or industry standards in a timely and cost-effective manner.

***Cost structure.*** Our profitability also depends on the cost structure of our operations, including, among other things, the costs of computer chips sourced from third-party suppliers and personnel costs.

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In addition to the factors discussed above, our reported results are also affected by the fluctuations in the value of the Renminbi against the U.S. dollar, as our reporting currency is the U.S. dollar while the functional currency of our subsidiaries and variable interest entities in China, which operate substantially all of our business, is the Renminbi. In 2012 and 2013, the Renminbi appreciated against the U.S. dollar by approximately 1.0% and 2.8%, respectively, and in 2014, the Renminbi depreciated against the U.S. dollar by approximately 2.5%. The appreciation of the Renminbi against the U.S. dollar contributed to the increase in our net income reported in U.S. dollar terms in 2012 and 2013, respectively, and the depreciation of the Renminbi against the U.S. dollar contributed to the decrease in our net income reported in U.S. dollar terms in 2014. For additional information relating to the fluctuations in the value of the Renminbi against the U.S. dollar, see Item 3. Key Information A. Selected Financial Data Exchange Rate Information, Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China Fluctuations in exchange rates could result in foreign currency exchange losses and Item 11. Quantitative and Qualitative Disclosures About Market Risks Foreign Currency Risk.

Our business is managed as a single operating segment. Our management reviews our consolidated results of operations prepared in accordance with U.S. GAAP when making decisions about allocating our resources and assessing our performance.

## **Revenues**

We derive revenues primarily from the following two sources:

**Products.** We currently derive a substantial majority of our revenues from sales of smart cards and other products to digital television network operators. Smart cards are an essential part of our CA systems. Our customers purchase our smart cards for distribution to and use by their subscribers in their set-top boxes. Revenues from the sales of our smart cards account for substantially all of our revenues from the sales of our products. In addition, we also sell small quantities of other products, such as surface mounted device chips and Screen Cross.

**Services.** We derive revenues from providing head-end system integration services and head-end system development services to digital television network operators, collecting licensing fees and/or royalty income from set-top box manufacturers and digital television operators. Our head-end system integration services involve providing head-end software, hardware and related system integration services to our customers. Head-end software mainly consists of software for CA systems, SMSs and EPGs. Our head-end system development services involve the development of customized digital television-related software applications for our customers. In addition, we provide set-top box manufacturers with our CA system terminal-end software that enables them to manufacture set-top boxes compatible with our CA systems, and receive one-time licensing fees as well as royalties from such set-top box manufacturers.

In certain circumstances, we receive royalties from digital television network operators who purchase smart cards for use with set-top boxes that were manufactured using our CA system terminal-end software, in lieu of collecting royalties from the relevant set-top boxes manufacturers. We include such royalty income as part of the revenue from sales of the related smart cards.

Revenues from the sales of our products and services accounted for 88.6% and 11.4%, respectively, of our total revenues in 2014 compared to 93.8% and 6.2%, respectively, of our total revenues in 2013. Our revenues also include

certain refunds of value-added taxes from PRC tax authorities that we previously paid with respect to some of our software products. See Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives PRC Value-Added Tax and Business Tax below for more information.

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Our net revenues represent total revenues less PRC business tax and related surcharges. See Item 5. Operating and Financial Review and Prospects A. Operating Results Taxes and Incentives PRC Value-Added Tax and Business Tax below for more information.

**Cost of Revenues**

Cost of revenues primarily includes: costs of raw materials, such as computer chips manufactured by third-party suppliers and used in our smart cards and other products; personnel costs directly relating to provision of our services; warranty costs relating to our smart card sales; depreciation and amortization costs; share-based compensation allocated to the production and processing of our smart cards and other products; fees paid to our sales agents; and other miscellaneous costs. These costs are allocated to our two types of revenue-generating activities as their respective cost of revenues. Cost of revenues related to the sales of our products and to the sales of our services accounted for 76.0% and 24.0%, respectively, of our total cost of revenues in 2014 compared to 78.5% and 21.5%, respectively, of our total cost of revenues in 2013. As a percentage of our net revenues, cost of revenues decreased from 24.9% in 2013 to 22.4% in 2014.

**Gross Profit and Gross Margin**

Gross profit is equal to net revenues less cost of revenues. Gross margin is equal to gross profit divided by net revenues. Our gross margin was 76.5%, 75.1% and 77.6% in 2012, 2013 and 2014, respectively. The increase in our gross margin from 2013 to 2014 was mainly due to a decrease in cost of revenues relating to inventory write-downs with respect to surface mounted chips, video-on-demand and other products.

The average unit cost of our smart cards in U.S. dollar terms decreased by approximately 14.5% from 2012 to 2013 and increased slightly by 1.3% from 2013 to 2014.

**Operating Expenses**

Our operating expenses consist of research and development expenses, selling and marketing expenses and general and administrative expenses. Each of these components of our operating expenses includes a portion of our total share-based compensation expenses, which are generally allocated according to the functions of those individuals who received share-based awards.

**Research and Development Expenses.** Research and development expenses consist primarily of costs associated with the design, development and testing of our products and technologies. Among other things, these costs include compensation and benefits for our research and development staff, rental for our office premises used for research and development activities, depreciation expenses related to equipment used in research and development activities, expenditures for purchases of supplies and other relevant costs. Compensation and benefits for our research and development staff accounted for the majority of our research and development expenses. Research and development expenses as a percentage of our net revenues were 22.1% and 21.2% in 2013 and 2014, respectively.

**Selling and Marketing Expenses.** Selling and marketing expenses consist primarily of compensation and benefits for our sales and marketing staff, expenses for promotional, advertising, travel and entertainment activities, marketing-related consulting fees, expenditures for purchases of supplies and amortization of intangible assets. Selling and marketing expenses as a percentage of our net revenues were 17.2% and 17.0% in 2013 and 2014, respectively.

**General and Administrative Expenses.** General and administrative expenses consist primarily of compensation and benefits for our general management, finance and administrative staff, professional advisory fees, depreciation and



amortization with respect to equipment used for general corporate purposes, rental costs for our office premises used by general management, finance and administrative staff, and other expenses incurred in connection with general corporate purposes. General and administrative expenses as a percentage of our net revenues were 11.4% and 13.4% in 2013 and 2014, respectively.

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**Share-Based Compensation Expenses.** We account for share-based compensation expenses based on the fair value of share option grants at the date of grant.

We adopted our 2005, 2008, 2010 and 2012 Stock Incentive Plans in February 2005, September 2007, November 2010 and May 2012, respectively, and options to purchase an aggregate of 4,471,431 ordinary shares have been granted and were outstanding under the plans as of March 31, 2015. We incurred share-based compensation expenses of US\$2.6 million, US\$2.3 million and US\$1.7 million in 2012, 2013 and 2014, respectively. For additional information regarding our share-based compensation expenses, see Note 20 to our consolidated financial statements included elsewhere in this annual report.

The table below shows the allocation of share-based compensation charges to cost of revenues and our operating expense line items for the periods indicated:

Share-Based Compensation Related to:	For the years ended December 31,		
	2012	2013	2014
	(In thousands)		
Cost of revenues	US\$ 5	US\$ 41	US\$ 12
Research and development expenses	552	380	98
Selling and marketing expenses	356	492	130
General and administrative expenses	1,701	1,358	1,459
<b>Total</b>	<b>US\$ 2,614</b>	<b>US\$ 2,271</b>	<b>US\$ 1,699</b>

**Income from Operations**

Income from operations represents gross profit less operating expenses.

**Non-operating Income/(Expenses)**

Non-operating income/(expenses) includes interest income/(expense), gain from foreign currency forward contracts, impairment loss on long-term investments and other income/(expense), each as presented in our consolidated statements of comprehensive income. Our interest income was US\$6.3 million, US\$1.9 million and US\$1.3 million in 2012, 2013 and 2014, respectively. We had interest expense of US\$0.7 million, nil and nil in 2012, 2013 and 2014, respectively. We recorded a loss from foreign currency forward contracts of US\$0.7 million in 2012. Our impairment loss on long-term investments was US\$4.5 million, nil and nil in 2012, 2013 and 2014, respectively. We also had other income of US\$0.5 million, US\$0.5 million and US\$3.1 million in 2012, 2013 and 2014, respectively.

**Critical Accounting Policies**

We prepare our financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect our reporting of, among other things, assets and liabilities, contingent assets and liabilities and revenues and expenses. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experiences and other factors that we believe to be relevant under the circumstances. Since our financial reporting process inherently relies on the use of estimates and assumptions, our actual results could differ from what we expect. This is especially true with some accounting policies that require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding

of our consolidated financial statements because they involve the greatest reliance on our management's judgment.

***Revenue Recognition***

We derive revenues primarily from two sources: (1) sales of products, including smart cards and other products sourced from third-party suppliers, such as surface mounted device chips; and (2) provision of services, including head-end system integration services, head-end system development services and CA system terminal-end software that generate licensing income and royalty income.

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For sales of our products, we recognize revenue when the products are delivered to and received by customers.

Our head-end integration services primarily involve provision of our head-end software, third-party hardware and software, related installation and integration services, training and post-contract customer support, or PCS, including telephone support and bug-fixing. Our head-end system development services involve the development of customized digital television technology-related software applications. Head-end software offered by us includes CA systems head-end software, SMS software and EPG software.

We sign head-end system integration contracts with cable television network operators to install and integrate our software with third-party hardware and software. Once the service is substantially completed, customers will issue a preliminary acceptance, while a final acceptance is usually issued six months to one year after the issuance of preliminary acceptance if no major technical problems are discovered. In the majority of our head-end system integration contracts, we offer free PCS for one year, beginning from preliminary acceptance by customers. Based on historical information, we believe that a final acceptance is not a significant event because essentially all the services we were obligated to provide have been delivered and all technical problems, if any, have been detected at the point of the preliminary acceptance by the customer and the cost of additional work between a preliminary acceptance and a final acceptance has historically been insignificant.

With respect to the contracts in which we offer free PCS for one year or less, we recognize revenue when all installation and integration services are completed, which is generally indicated by obtaining the preliminary acceptances from customers. With respect to contracts in which we offer free PCS for more than one year, although the costs incurred during the PCS term have historically been insignificant, we defer the revenue and ratably recognize it over the PCS term. Where we offer PCS for an unspecified period, we ratably recognize the relevant revenue over the estimated useful life of our CA systems, which we determined to be five years.

With respect to our head-end system development services, we use the completed-contract method to recognize revenue when the software application development is finished and accepted by customers, as we currently do not have a reliable mechanism to measure the progress toward completion of the service.

We receive licensing fees from set-top box manufacturers who license our CA systems terminal-end software, and we are also entitled to receive royalties from them based on the quantity of set-top boxes manufactured under such licenses. Royalty income is recognized upon receipt of sales reports from the set-top box manufacturers and when payment is received, while licensing income is recognized upon the issuance of certificates to the set-top box manufacturers by us.

## ***Goodwill***

The excess of the purchase price over the fair value of net assets acquired is recorded on the consolidated balance sheet as goodwill. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the stock prices, business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. Estimating fair value is performed by utilizing various valuation techniques, with a primary technique being a discounted cash flow which requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long term rate of growth for the Company's business, estimation of the useful life over which cash flows will occur, and determination of the Company's weighted average cost of capital.

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In the evaluation of the goodwill for impairment, the Group may first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, goodwill is then tested following a two-step process. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. The Group has determined to perform the annual impairment test on December 31 of each year. The Group did not incur any impairment loss on goodwill for the years ended December 31, 2012, 2013 or 2014.

***Allowance for Doubtful Accounts***

We perform ongoing credit evaluations of our customers and generally do not require collateral on accounts receivable. We maintain an allowance for doubtful accounts primarily based upon the aging analysis of the receivables and factors surrounding the credit risk of specific customers.

***Consolidation of Variable Interest Entity***

Historically, we had conducted substantially all of our business through our operating subsidiary, Super TV, and our variable interest entity, N-S Digital TV, which was wholly owned by PRC citizens until the end of June 2014.

Since the establishment of N-S Digital TV, we had designed the structure such that Super TV was the primary beneficiary of N-S Digital TV:

(a) the nominee shareholders of N-S Digital TV lacked direct or indirect ability to make decisions regarding the activities of N-S Digital TV that could have a significant impact on the economic performance of N-S Digital TV. All of the voting rights of N-S Digital TV's nominee shareholders had been transferred to Super TV such that Super TV had effective control over N-S Digital TV; and

(b) the nominee shareholders of N-S Digital TV did not have the right to receive the expected residual returns of N-S Digital TV, while such right had been transferred to Super TV such that Super TV was the primary beneficiary of N-S Digital TV.

In order to achieve such purpose, we had entered into a series of contractual agreements with N-S Digital TV and/or its nominee shareholders, including technical support and related services agreement, technology license agreement, technology development agreement, products and software purchase agreement, Equity Transfer Option Agreement, Business Operating Agreement, loan agreements, share pledge agreements and powers of attorney. Through those contractual arrangements, Super TV had the right to: (i) exercise 100% of the voting rights of N-S Digital TV's shareholders and (ii) nominate the members of N-S Digital TV's board of directors and senior management. As a result, Super TV had the power to direct the activities of N-S Digital TV that most significantly impact N-S Digital TV's economic performance, including the power, pursuant to the articles of association of N-S Digital TV, to: (i) approve the operating strategy and investment plan of N-S Digital TV; (ii) elect the members of N-S Digital TV's board of directors and approve their compensation; and (iii) review and approve N-S Digital TV's annual budget and

earnings distribution plan. In addition, Super TV had an exclusive and irrevocable option to purchase all of N-S Digital TV's shareholders' equity interests in N-S Digital TV at any time. We believe we had substantive kick-out rights pursuant to the terms of the Equity Transfer Option Agreement, and that the terms of the Equity Transfer Option Agreement were exercisable and legally enforceable under existing PRC laws, rules and regulations. As a result, we believe the rights of the shareholders of N-S Digital TV effectively accrued to us. Furthermore, the fees we received from N-S Digital TV under these contractual arrangements were determined by Super TV and may be adjusted by Super TV. For a description of these contractual arrangements, see Item 7. Major Shareholders and Related Party Transactions B. Related Party Transactions.

We had evaluated the VIE structure and concluded that through these contractual arrangements, we had the ability to effectively control N-S Digital TV and its subsidiaries as well as to receive substantially all the economic benefits of those entities. As a result, we were considered the primary beneficiary of N-S Digital TV, and N-S Digital TV and its subsidiaries were our variable interest entities under U.S. GAAP and we consolidated their financial results and assets and liabilities in our consolidated financial statements. As a result of a restructuring in June 2014, these contractual arrangements were terminated and N-S Digital TV became an indirectly wholly-owned subsidiary of ours.

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### ***Income Taxes***

Deferred income taxes are provided using the asset and liability method. Under this method, deferred income taxes are recognized based on net operating losses available for carry-forwards and significant temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis using enacted tax rates in effect for the years in which the differences are expected to reverse. Deferred tax assets and liabilities are classified as current or non-current based upon the classification of the related asset or liability in the financial statements or the expected timing of their reversal if they do not relate to a specific asset or liability. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax assets will not be realized.

Income taxes are provided for in accordance with the laws, rules and regulations applicable to the relevant companies as enacted by the relevant tax authorities. The impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more likely than not to be sustained upon audit of the relevant tax authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

### ***Inventories***

Inventories are stated at the lower of cost or market value. Cost is determined using the weighted average method. Inventories are written down for provisions for obsolescence to net realizable value based upon estimates of future demand, technology developments, and market conditions.

### **Recently Issued Accounting Pronouncements Not Yet Adopted**

See Note 2(dd) to our consolidated financial statements included elsewhere in this annual report for recently issued accounting standards that we believe may have implications on our consolidated financial statements for future periods.

### **Taxes and Incentives**

#### ***Cayman Islands, British Virgin Islands and Hong Kong***

Our company, as an exempted company incorporated in the Cayman Islands, and CDTV BVI, our wholly-owned subsidiary incorporated in BVI, are not subject to any income or capital gains tax under the current laws of the Cayman Islands and BVI. Golden Benefit and CSM Holdings, our indirectly wholly-owned subsidiaries incorporated in Hong Kong, were subject to 16.5% Hong Kong profits tax in 2012, 2013 and 2014 on their activities conducted in Hong Kong.

#### ***PRC***

Our subsidiaries, our variable interest entity and the subsidiaries of our variable interest entity operating in the PRC are subject to PRC taxes as described below:

***Enterprise Income Tax.*** Prior to January 1, 2008, the effective date of the 2008 EIT Law, both domestic and foreign-invested enterprises were generally subject to an enterprise income tax rate of 33% in the PRC under the relevant tax laws then effective. Effective from January 1, 2008, the 2008 EIT Law imposes a tax rate of 25% on all enterprises, including foreign-invested enterprises, and terminates many of the tax exemptions, reductions and



preferential treatments available under previous tax laws and regulations. However, under the 2008 EIT Law, enterprises that were established before March 16, 2007 and already enjoy preferential tax treatments will continue to enjoy them (1) in the case of certain preferential tax rates that are specified by tax legislation, for a transition period of five years from January 1, 2008 or (2) in the case of tax exemption or reduction for a specified term, until the expiration of such term.

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Each of N-S Digital TV and Super TV was entitled to income tax exemption during the three years from 2004 through 2006, and a 50% reduction of income tax during the subsequent three years from 2007 through 2009. In addition, under the 2008 EIT Law, high-and-new technology enterprises strongly supported by the State are entitled to a preferential tax rate of 15%. In December 2008, N-S Digital TV and Super TV successfully obtained their respective high-and-new technology enterprise certificates under the 2008 EIT Law and were therefore recognized as high-and-new technology enterprises strongly supported by the State and qualified for a preferential tax rate of 15% in each of 2008, 2009 and 2010. In October 2011, N-S Digital TV and Super TV successfully renewed their respective high-and-new technology enterprise certificates and qualified for a preferential tax rate of 15% for another three years from 2011 to 2013. In 2010, Super TV was designated as a key software enterprise by the relevant PRC government authorities and, as a result, qualified for a preferential tax rate of 10% for that year. In March 2013, Super TV's re-application for the key software enterprise designation for the year of 2011 and 2012 was approved by the relevant PRC government authorities. As a result, Super TV would qualify for the 10% preferential tax rate for 2011 and 2012 retroactively. In December 2013, Super TV continued to be designated as a key software enterprise and enjoyed the preferential tax rate of 10% in 2013 and 2014. In October 2014, N-S Digital TV and Super TV successfully renewed their respective high-and-new technology enterprise certificates and qualified for a preferential tax rate of 15% for another three years from 2014 to 2016. In October 2014, Cyber Cloud also obtained its high-and-new technology enterprise certificate and qualified for a preferential tax rate of 15% for three years from 2014 to 2016.

Each of N-S Media Investment, N-S Information Technology, Guangdong R&D, Joysee, Super Movie, Shibo Movie and Xinsi Yijia was subject to an enterprise income tax rate of 25% in each of 2012, 2013 and 2014. Dingyuan has been subject to the statutory tax rate of 25% since its establishment in 2013.

In addition, under the 2008 EIT Law, an enterprise established under the laws of a foreign country or region whose de facto management body is located within the PRC territory is considered a resident enterprise and will generally be subject to the enterprise income tax at the rate of 25% on its global income as well as PRC enterprise income tax reporting obligations. According to the Implementation Rules, de facto management body refers to a managing body that exercises, in substance, overall management and control over the production and business, personnel, accounting and assets of an enterprise. SAT Notice 82 provides for certain specific criteria for determining whether the de facto management body of a Chinese-controlled offshore enterprise is located in the PRC. In addition, SAT Bulletin 45, which became effective on September 1, 2011, provides guidance on the implementation of SAT Notice 82. SAT Bulletin 45 clarifies certain issues relating to: (i) the determination procedures of PRC resident enterprise status and (ii) tax registration and other related procedures for PRC resident enterprises. SAT Bulletin 45 also provides that if an offshore PRC resident enterprise presents a copy of the Chinese tax resident determination certificate issued by the competent tax authorities to a payer of PRC-sourced dividends, interest, royalties and other income, such payer shall not withhold income tax on these payments to the offshore PRC resident enterprise. We believe that we are not a PRC resident enterprise with reference to the criteria set forth in SAT Notice 82. However, if we were to be considered as a PRC resident enterprise, we would be subject to the enterprise income tax at the rate of 25% on our global income as well as PRC enterprise income tax reporting obligations. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC. In addition, the 2008 EIT Law and the Implementation Rules provide that a withholding tax of 10% (which may be reduced by the relevant tax treaties between the PRC and other jurisdictions) will generally be applicable to dividends payable to non-resident enterprises, and, unlike the prior tax law, does not specifically exempt corporations that pay dividends from withholding all or part of such income tax when they pay dividends to their non-resident investors. To the extent we are not considered as a PRC resident enterprise or dividends paid from our PRC operating subsidiary are not deemed as dividends among qualified PRC resident enterprises, the dividends our PRC subsidiary pays to us will be subject to this withholding tax. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may be subject to PRC income tax on

our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC. In addition, this withholding tax may also apply to dividends we pay to our non-PRC individual shareholders if we were to be considered as a PRC resident enterprise. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China Dividends payable by us to our non-PRC shareholders and ADS holders, and gains on the sales of our ordinary shares or ADSs, may be subject to withholding taxes under PRC tax laws, which may materially reduce the value of your investment.

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**Value-Added Tax and Business Tax.** We are subject to value-added tax, or VAT, at the rate of 17% on the sales of our products. Pursuant to a PRC tax policy intended to encourage the development of software and integrated circuit industries and a notice jointly issued by the PRC Ministry of Finance and the SAT in October 2011, each of N-S Digital TV and Super TV is entitled to a refund of VAT paid at a rate of 14% (i.e., the excess of the effective VAT rate over 3%) of the sale value of some of our software products. The amount of VAT refund included in our total revenues was US\$7.4 million, US\$6.6 million and US\$5.4 million in 2012, 2013 and 2014, respectively, accounting for 8.2%, 7.5% and 6.6%, respectively, of our total revenues in the corresponding periods. We include such refunds in the total revenues in our consolidated statements of comprehensive income included elsewhere in this annual report. The VAT refund benefits have been renewed for N-S Digital TV and Super TV from January 1, 2011.

On November 16, 2011, the Ministry of Finance and the SAT issued a pilot tax program under which business tax will be replaced with VAT for certain pilot industries, including, among others, transportation services, research and development and technical services, information technology services and cultural and creative services. The pilot VAT program initially applied only to the pilot industries in Shanghai and has been subsequently expanded to eight additional regions, including, among others, Beijing and Guangdong province. Since August 1, 2013, the pilot VAT program has been further expanded nationwide. N-S Digital TV, Super TV and each of Super TV's and N-S Digital TV's subsidiaries have been recognized as VAT taxpayers since September 1, 2012 or November 1, 2012, respectively. Prior to the implementation of such pilot VAT program, each of Super TV's subsidiaries, N-S Digital TV and N-S Digital TV's subsidiaries was subject to business tax at a rate of 5% on certain service-type revenues, including those from our head-end integration services, head-end system development services, licensing income and royalty income. Super TV was exempted from business tax at a rate of 5% on the revenues generated from the technical support, technical training and personnel services it then provided. From September 1, 2012 or November 1, 2012 onwards, as the case may be, each of Super TV's subsidiaries, N-S Digital TV and N-S Digital TV's subsidiaries are required to pay VAT at a rate of 6% for research and development services, technical services and other services deemed by the relevant PRC tax authorities to be within the pilot industries, and is no longer subject to business tax.

***Tax Arrangement between the PRC and Hong Kong***

The Hong Kong government and the PRC government entered into the *Arrangement for Avoidance of Double Taxation on Income and Prevention of Tax Evasion* on August 21, 2006, which took effect on January 1, 2007 and April 1, 2007 in the PRC and Hong Kong, respectively. This arrangement provides certain tax incentives to use a Hong Kong company as an intermediate holding company for holding investments in the PRC. The withholding tax rate applicable to dividends received by a Hong Kong resident enterprise from its investments in the PRC is 5% compared to the 10% withholding tax rate applicable to dividends received by a company incorporated in a jurisdiction where there is no similar tax treaty or arrangement with the PRC, provided, among that the Hong Kong resident enterprise owns at least 25% of the shareholding of the PRC company at all times within the 12-month period immediately preceding the distribution of dividends. In addition, a full tax exemption in the PRC is available on a capital gain derived by a Hong Kong resident enterprise from the disposal of its shares in a PRC company, provided that the Hong Kong resident enterprise owns less than 25% of the shareholding of the PRC company at all times within the 12-month period immediately preceding the distribution of dividends and the assets of the PRC company do not consist mainly of real property situated in the PRC.

The SAT issued SAT Notice 601 and SAT Announcement 30 on October 27, 2009 and June 29, 2012, respectively, both of which are applicable to the tax arrangements between the PRC and Hong Kong. Specifically, SAT Notice 601 provides that only the enterprises with active operations can be recognized as beneficial owners under relevant tax treaties which are entitled to enjoy the corresponding tax benefits. It further provides that those enterprises that are established solely for the purposes of benefiting from favorable tax treatment under the relevant tax treaties should not be recognized as beneficial owners and therefore cannot enjoy favorable tax treatment. Furthermore, SAT

Announcement 30 provides that a comprehensive analysis should be made when determining the beneficial owner status based on all the factors set out in SAT Notice 601. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC.

**Table of Contents****Recent Acquisitions**

See Item 4. Information on the Company A. History and Development of the Company Our Investments and Acquisitions.

**Results of Operations**

The following table sets forth our condensed consolidated statements of operations by amount and as a percentage of our net revenues for the periods indicated:

	For the years ended December 31,					
	2012		2013		2014	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
(In thousands of U.S. dollars, except percentages)						
<b>Revenues:</b>						
Products	US\$ 85,319	96.1%	US\$ 82,926	95.1%	US\$ 73,520	90.2%
Services	4,925	5.6	5,521	6.4	9,423	11.5
Total revenues	90,244	101.7	88,447	101.5	82,943	101.7
Business and related taxes	(1,501)	(1.7)	(1,283)	(1.5)	(1,410)	(1.7)
Net revenues	88,743	100.0	87,164	100.0	81,533	100.0
<b>Cost of revenues:<sup>(1)</sup></b>						
Products	16,880	19.0	17,009	19.5	13,845	17.0
Services	3,952	4.5	4,652	5.4	4,384	5.4
Total cost of revenues	20,832	23.5	21,661	24.9	18,229	22.4
Gross profit	67,911	76.5	65,503	75.1	63,304	77.6
<b>Operating expenses:</b>						
Research and development expenses <sup>(1)</sup>	17,402	19.6	19,251	22.1	17,276	21.2
Selling and marketing expenses <sup>(1)</sup>	13,606	15.3	14,957	17.1	13,877	17.0
General and administrative expenses <sup>(1)</sup>	9,444	10.7	9,959	11.4	10,935	13.4
Total operating expenses	40,452	45.6	44,167	50.6	42,088	51.6
Income from operations	27,459	30.9	21,336	24.5	21,216	26.0
<b>Non-operating income/(expenses)</b>						
Interest income	6,318	7.1	1,901	2.2	1,312	1.6
Interest expense	(739)	(0.8)				
Loss from forward contracts	(690)	(0.8)				
	(4,487)	(5.0)				

## Impairment loss on long-term investments

Other income	549	0.6	534	0.6	3,069	3.8
Income before income taxes	28,410	32.0	23,771	27.3	25,597	31.4
Income tax expense	22,232	25.0	727	0.9	6,373	7.8
Net income before income/(loss) from equity method investments	6,178	7.0	23,044	26.4	19,224	23.6
Loss from equity method investments, net of income taxes	(640)	(0.8)	(468)	(0.5)	(59)	(0.1)
Net income	5,538	6.2	22,576	25.9	19,165	23.5
Net loss attributable to noncontrolling interest	1,389	1.6	1,832	2.1	1,725	2.1
Net income attributable to holders of ordinary shares	US\$ 6,927	7.8%	US\$ 24,408	28.0%	US\$ 20,890	25.6%

(1) Share-based compensation charges incurred during the period related to:

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	For the years ended December 31,					
	2012		2013		2014	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
(In thousands of U.S. dollars, except percentages)						
Cost of revenues	US\$ 5	0.0%	US\$ 41	0.0%	US\$ 12	0.0%
Research and development expenses	552	0.6	380	0.4	98	0.1
Selling and marketing expenses	356	0.4	492	0.6	130	0.2
General and administrative expenses	US\$ 1,701	1.9%	US\$ 1,358	1.5%	US\$ 1,459	1.8%

**Comparison of Years Ended December 31, 2014 and December 31, 2013**

**Revenues.** The following table sets forth revenues by sources and the percentage of our total revenues for the periods indicated:

	For the years ended December 31,			
	2013		2014	
	Amount	% of Total Revenues	Amount	% of Total Revenues
(In thousands of U.S. dollars, except percentages)				
<b>Products</b>				
Smart cards	US\$ 78,256	88.5%	US\$ 67,108	80.9%
Other products	4,670	5.3	6,412	7.7
Subtotal	82,926	93.8	73,520	88.6
<b>Services</b>				
Head-end system integration	2,731	3.1	4,591	5.6
Head-end system development	1,103	1.2	1,566	1.9
Licensing income	1,098	1.2	2,516	3.0
Royalty income	512	0.6	585	0.7
Other services	77	0.1	165	0.2
Subtotal	5,521	6.2	9,423	11.4
<b>Total revenues</b>	<b>US\$ 88,447</b>	<b>100.0%</b>	<b>US\$ 82,943</b>	<b>100.0%</b>



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Our total revenues decreased by 6.2% from US\$88.4 million in 2013 to US\$82.9 million in 2014, reflecting a decrease in the revenue from the sale of our products, partially offset by an increase in the revenue from the sale of our services.

Revenues from the sales of our products decreased by 11.3% from US\$82.9 million in 2013 to US\$73.5 million in 2014, mainly due to a decline in revenues from sales of smart cards as a result of decreases in both sales volume and ASP in 2014 compared to 2013, which was partially offset by an increase in revenue from other products.

Revenues from the sales of our services increased by 70.7% from US\$5.5 million in 2013 to US\$9.4 million in 2014, primarily due to an increase in head-end system integration and licensing income.

**Net Revenues.** Our net revenues decreased by 6.5% from US\$87.2 million in 2013 to US\$81.5 million in 2014.

**Cost of Revenues.** The following table sets forth cost of revenues by sources of revenues by amount and as a percentage of net revenues for the periods indicated:

	Years ended December 31,			
	2013	% of Net Revenues	2014	% of Net Revenues
	Amount		Amount	
(In thousands of U.S. dollars, except percentages)				
Products	US\$ 17,009	19.5%	US\$ 13,845	17.0%
Services	4,652	5.4	4,384	5.4
<b>Total cost of revenues</b>	<b>US\$ 21,661</b>	<b>24.9%</b>	<b>US\$ 18,229</b>	<b>22.4%</b>

Cost of revenues decreased by 15.8% to US\$18.2 million in 2014 from US\$21.7 million in 2013, reflecting a decrease in cost of revenues relating to both our products and services. Cost of revenues relating to our products decreased by 18.6% to US\$13.8 million in 2014 from US\$17.0 million in 2013, reflecting higher inventory write-downs with respect to surface mounted chips and other products in 2013. Cost of revenues relating to our services decreased by 5.8% to US\$4.4 million in 2014 from US\$4.7 million in 2013, reflecting higher inventory write-downs with respect to video-on-demand in 2013.

**Gross Profit and Gross Margin.** Gross profit decreased by 3.4% from US\$65.5 million in 2013 to US\$63.3 million in 2014. Our gross margin increased from 75.1% in 2013 to 77.6% in 2014, primarily due to a decrease in cost of revenues, reflecting higher inventory write-downs with respect to surface mounted chips, video-on-demand and other products in 2013.

**Operating Expenses.** Our operating expenses decreased by 4.7% to US\$42.1 million in 2014 from US\$44.2 million in 2013. This decrease reflected decreases in research and development expenses and sales and marketing expenses, partially offset by an increase in general and administrative expenses. Operating expenses, as a percentage of net revenues, increased to 51.6% in 2014 from 50.6% in 2013.



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**Research and Development Expenses.** Our research and development expenses decreased by 10.3% to US\$17.3 million in 2014 from US\$19.3 million in 2013. This decrease was mainly due to a decrease in project development expenses, office rent expenses, and personnel related expenses resulting from lower research and development headcount, as well as a decrease in share-based compensation. Our research and development expenses, as a percentage of net revenues, decreased to 21.2% in 2014 from 22.1% in 2013.

**Selling and Marketing Expenses.** Our selling and marketing expenses decreased by 7.2% to US\$13.9 million in 2014 from US\$15.0 million in 2013. This decrease was primarily due to a decrease in share-based compensation and marketing expenditures. Our selling and marketing expenses, as a percentage of net revenues, decreased to 17.0% in 2014 from 17.1% in 2013.

**General and Administrative Expenses.** Our general and administrative expenses increased by 9.8% to US\$10.9 million in 2014 from US\$10.0 million in 2013, primarily due to an increase in consulting expenses.

**Income from Operations.** As a result of the foregoing, our income from operations decreased by 0.6% to US\$21.2 million in 2014 from US\$21.3 million in 2013.

**Non-Operating Income (Expenses).** We had non-operating income of US\$4.4 million in 2014 compared to US\$2.4 million in 2013. Our non-operating income in 2014 primarily consisted of interest income of US\$1.3 million and other income of US\$3.1 million. Our interest income decreased by 31.0% from US\$1.9 million in 2013 to US\$1.3 million in 2014, primarily due to a decrease in the average balance of our bank deposits. Our other income increased significantly from US\$0.5 million in 2013 to US\$3.1 million in 2014, primarily due to an increase in government subsidy income.

**Income Tax Expenses.** Our income tax expenses increased from US\$0.7 million in 2013 to US\$6.4 million in 2014. The increase in our income tax expenses was primarily due to the retroactive adjustment of income tax expenses in 2011 and 2012 from the income tax rate of 15% to 10% as a result of the completion of the renewal for the designation of key software enterprise for Super TV with respect to 2011 and 2012, which decreased the tax expenses significantly in 2013.

**Loss from Equity Method Investments, Net of Income Taxes.** Our loss from equity method investments decreased from US\$0.5 million in 2013 to US\$0.1 million in 2014. Our loss from equity method investments in 2014 was mainly attributable to the loss from our equity investment in Guangzhou Rujia and Qingda Yongxin.

**Net Loss Attributable to Noncontrolling Interest.** Net loss attributable to noncontrolling interest decreased from US\$1.8 million in 2013 to US\$1.7 million in 2014. Net loss attributable to noncontrolling interest represents the proportional share of net loss of our consolidated, but not wholly-owned, subsidiaries that are attributable to the other shareholders of such subsidiaries. The change was primarily due to the loss of our majority-owned subsidiaries, in particular, Joysee and Cyber Cloud.

**Net Income Attributable to Holders of Ordinary Shares.** As a result of the foregoing, net income attributable to holders of ordinary shares decreased by 14.4% from US\$24.4 million in 2013 to US\$20.9 million in 2014. Our basic and diluted earnings per ordinary share in 2014 were US\$0.35 and US\$0.34, respectively.

**Table of Contents****Comparison of Years Ended December 31, 2013 and December 31, 2012**

**Revenues.** The following table sets forth revenues by sources and the percentage of our total revenues for the periods indicated:

	For the years ended December 31,			
	2012	% of Total Revenues	2013	% of Total Revenues
	Amount		Amount	
(In thousands of U.S. dollars, except percentages)				
<b>Products</b>				
Smart cards	US\$ 75,185	83.3%	US\$ 78,256	88.5%
Other products	10,134	11.2	4,670	5.3
Subtotal	85,319	94.5	82,926	93.8
<b>Services</b>				
Head-end system integration	2,175	2.5	2,731	3.1
Head-end system development	987	1.1	1,103	1.2
Licensing income	1,246	1.4	1,098	1.2
Royalty income	382	0.4	512	0.6
Other services	135	0.1	77	0.1
Subtotal	4,925	5.5	5,521	6.2
<b>Total revenues</b>	<b>US\$ 90,244</b>	<b>100.0%</b>	<b>US\$ 88,447</b>	<b>100.0%</b>

Our total revenues decreased by 2.0% from US\$90.2 million in 2012 to US\$88.4 million in 2013, reflecting a decrease in the revenue from the sales of our products.

Revenues from the sales of our products decreased by 2.8% from US\$85.3 million in 2012 to US\$82.9 million in 2013, primarily due to a decrease in revenues from other products, such as surface mounted chips, which was partially offset by increases in revenues from smart card sales.

Revenues from the sales of our services increased by 12.1% from US\$4.9 million in 2012 to US\$5.5 million in 2013, primarily due to an increase in head-end system integration.

**Net Revenues.** Our net revenues decreased by 1.8% from US\$88.7 million in 2012 to US\$87.2 million in 2013.

**Cost of Revenues.** The following table sets forth cost of revenues by sources of revenues by amount and as a percentage of net revenues for the periods indicated:

	Years ended December 31,	
	2012	2013

	Amount	% of Net Revenues	Amount	% of Net Revenues
	(In thousands of U.S. dollars, except percentages)			
Products	US\$ 16,880	19.0%	US\$ 17,009	19.5%
Services	3,952	4.5	4,652	5.4
<b>Total cost of revenues</b>	<b>US\$ 20,832</b>	<b>23.5%</b>	<b>US\$ 21,661</b>	<b>24.9%</b>

Cost of revenues increased by 4.0% to US\$21.7 million in 2013 from US\$20.8 million in 2012, primarily reflecting an increase in costs of revenues relating to our services, and, to a lesser extent, an increase in costs relating to our products. Cost of revenues relating to our products increased by 0.8% to US\$17.0 million in 2013 from US\$16.9 million in 2012, principally due to an increase in inventory write-downs for surface mounted chips and other products. Cost of revenues relating to our services increased by 17.7% to US\$4.7 million in 2013 from US\$4.0 million in 2012, mainly due to an increase in inventory write-downs for video-on-demand services.

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**Gross Profit and Gross Margin.** Gross profit decreased by 3.5% from US\$67.9 million in 2012 to US\$65.5 million in 2013. Our gross margin decreased from 76.5% in 2012 to 75.1% in 2013, primarily due to an increase in cost of revenues, attributable to inventory write-downs with respect to surface mounted chips and video-on-demand.

**Operating Expenses.** Our operating expenses increased by 9.2% to US\$44.2 million in 2013 from US\$40.5 million in 2012. This increase reflected increases in research and development expenses, sales and marketing expenses, and general and administrative expenses. Operating expenses, as a percentage of net revenues, increased to 50.6% in 2013 from 45.6% in 2012.

**Research and Development Expenses.** Our research and development expenses increased by 10.6% to US\$19.3 million in 2013 from US\$17.4 million in 2012. This increase was mainly due to an increase in personnel related expenses, as well as increases in project development expenses. Our research and development expenses, as a percentage of net revenues, increased to 22.1% in 2013 from 19.6% in 2012.

**Selling and Marketing Expenses.** Our selling and marketing expenses increased by 9.9% to US\$15.0 million in 2013 from US\$13.6 million in 2012. This increase was primarily due to an increase in marketing expenditures. Our selling and marketing expenses, as a percentage of net revenues, increased to 17.1% in 2013 from 15.3% in 2012.

**General and Administrative Expenses.** Our general and administrative expenses increased by 5.5% to US\$10.0 million in 2013 from US\$9.4 million in 2012, primarily due to increases in allowance for doubtful accounts and personnel related expenses, which were partially offset by decreases in consulting expenses and share-based compensation expenses.

**Income from Operations.** As a result of the foregoing, our income from operations decreased by 22.3% from US\$27.5 million in 2012 to US\$21.3 million in 2013.

**Non-Operating Income (Expenses).** We had non-operating income of US\$2.4 million in 2013 compared to US\$1.0 million in 2012. Our non-operating income in 2013 primarily consisted of interest income of US\$1.9 million and other income of US\$0.5 million. Our interest income decreased by 69.9% from US\$6.3 million in 2012 to US\$1.9 million in 2013, primarily due to a decrease in the average balance of our bank deposits. In 2012, we fully accrued an impairment charge of US\$4.5 million related to our investment in 3DiJoy based on the fair value of 3DiJoy we estimated with the assistance of a third party valuation firm, as we had doubts regarding 3DiJoy's ability to operate as a going concern given that it had been experiencing financial difficulties and had failed to obtain new capital funding from its shareholders or otherwise. We entered into foreign currency forward contracts in April and May 2011, which met the definition of derivatives and were measured at fair value. The change in the forward rate for U.S. dollar against the Renminbi from the last date of each year to the expiration dates of the foreign currency forward contracts was recognized as gain or loss from foreign currency forward contracts. We also incurred interest expenses of US\$0.7 million in 2012, as we borrowed short-term loans in connection with the above-mentioned foreign currency forward contracts. We did not incur interest expenses in 2013.

**Income Tax Expenses.** Our income tax expenses decreased from US\$22.2 million in 2012 to US\$0.7 million in 2013. The decrease in our income tax expenses was primarily due to (i) the retroactive adjustment of income tax expense in 2011 and 2012 from the income tax rate of 15% to 10% as a result of the completion of the renewal for the designation of "key software enterprise" for Super TV with respect to 2011 and 2012 and (ii) the preferential tax rate of 10% enjoyed by Super TV in 2013 as a "key software enterprise".

**Loss from Equity Method Investments, Net of Income Taxes.** Our loss from equity method investments decreased from US\$0.6 million in 2012 to US\$0.5 million in 2013. Our loss from equity method investments in 2013 was

mainly attributable to the loss from our equity method investments in Xinghe Union and Shibo Movie.

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**Net Loss Attributable to Noncontrolling Interest.** Net loss attributable to noncontrolling interest increased from US\$1.4 million in 2012 to US\$1.8 million in 2013. Net loss attributable to noncontrolling interest represents the proportional share of net loss of our consolidated, but not wholly-owned, subsidiaries that are attributable to the other shareholders of such subsidiaries. The change was primarily due to the loss of our majority-owned subsidiaries, in particular, Joysee and Cyber Cloud.

**Net Income Attributable to Holders of Ordinary Shares.** As a result of the foregoing, net income attributable to holders of ordinary shares increased by 252.4% from US\$6.9 million in 2012 to US\$24.4 million in 2013. Our basic and diluted earnings per ordinary share in 2013 were US\$0.41 and US\$0.41, respectively.

## B. Liquidity and Capital Resources

### Liquidity

	<b>For the years ended December 31,</b>		
	<b>2012</b>	<b>2013</b>	<b>2014</b>
	<b>(In thousands)</b>		
Cash and cash equivalents	US\$ 130,697	US\$ 79,085	US\$ 62,042
Net cash provided by operating activities	20,897	24,504	12,210
Net cash provided by/(used in) investing activities	55,025	(870)	284
Net cash used in financing activities	US\$ (147,214)	US\$ (76,884)	US\$ (26,712)

**Operating Activities.** Net cash provided by operating activities was US\$12.2 million in 2014, which was primarily derived from our net income of US\$19.2 million, adjusted to reflect the adding back of US\$0.8 million increase in allowance for doubtful accounts, US\$1.3 million increase in provision for inventory, US\$0.9 million depreciation and amortization and US\$1.7 million share-based compensation charges. Cash provided by operating activities in 2014 was partially offset by a decrease in cash from working capital items of US\$11.7 million.

Net cash provided by operating activities was US\$24.5 million in 2013, which was primarily derived from our net income of US\$22.6 million, adjusted to reflect the adding back of US\$2.8 million increase in provision for inventory, US\$2.6 million increase in allowance for doubtful accounts, US\$2.3 million share-based compensation charges and US\$1.0 million depreciation and amortization. Cash provided by operating activities in 2013 was partially offset by a decrease in cash from working capital items of US\$7.2 million.

Net cash provided by operating activities was US\$20.9 million in 2012, which was primarily derived from our net income of US\$5.5 million, adjusted to reflect the adding back of US\$4.5 million in impairment loss on long-term investments, US\$2.6 million share-based compensation charges, US\$1.4 million increase in allowance for doubtful accounts, US\$1.2 million depreciation and amortization, and US\$4.9 million increase in cash from working capital items.

**Investing Activities.** Net cash provided by investing activities was US\$0.3 million in 2014, primarily consisting of US\$2.2 million cash in acquired entities as a result of our acquisition of Shibo Movie and Xinsi Yijia in 2014 and US\$0.8 million decrease in bank deposits pledged as security for accounts payable to suppliers, which was partially offset by US\$2.8 million purchase of property and equipment.



Net cash used in investing activities was US\$0.9 million in 2013, primarily consisting of US\$0.9 million increase in bank deposits pledged as security for accounts payable to suppliers and US\$0.3 million purchase of property and equipment, which was partially offset by US\$0.4 million proceeds from disposal of equity method investment.

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Net cash provided by investing activities was US\$55.0 million in 2012, primarily consisting of the release of US\$55.5 million bank deposits pledged as security for the short-term loans we borrowed in 2011 in connection with the foreign currency forward contracts, which was partially offset by an aggregate of US\$1.6 million in connection with our investments in Shibo Movie and Xinghe Union in 2012.

**Financing Activities.** Net cash used in financing activities was US\$26.7 million in 2014, primarily consisting of the US\$29.7 million special cash dividend paid to our shareholders, which was partially offset by an advance payment of US\$2.3 million received in relation to an investment in Cyber Cloud.

Net cash used in financing activities was US\$76.9 million in 2013, which primarily reflected a special cash dividend paid to our shareholders.

Net cash used in financing activities was US\$147.2 million in 2012, primarily reflecting a US\$92.1 million special cash dividend paid to our shareholders and the repayment of short-term loans in an aggregate principal amount of US\$55.2 million that we borrowed in 2011 in connection with the foreign currency forward contracts.

According to the amended *PRC Company Law*, which took effect on March 1, 2014, and its predecessor law, our subsidiaries and variable interest entities in the PRC are required to make appropriations to the statutory surplus reserve which are still required to be made at the rate of 10% of profits after tax as determined under PRC GAAP until the balance of such reserve fund reaches 50% of the entities' registered capital.

Our subsidiaries and our variable interest entities in the PRC may, upon a resolution passed by their respective shareholders, convert the statutory surplus reserve into capital. The statutory reserve represents appropriations of retained earnings determined according to PRC law and may not be distributed. There were no appropriations to reserves other than to those of our subsidiaries and our variable interest entity in the PRC during any of the periods presented. However, as a result of these laws, US\$17.9 million and US\$18.0 million of our retained earnings were not available for distribution as of December 31, 2013 and December 31, 2014, respectively.

As a holding company, our ability to pay dividends and other cash distributions to our shareholders depends in part upon dividends and other distributions paid to us by our PRC subsidiaries. As of December 31, 2014, the amount of cash held by our PRC subsidiaries was RMB356.7 million (or US\$57.5 million), and the amount of cash held by entities outside the PRC was US\$4.5 million. There is a risk that any existing or future restrictions under the applicable PRC laws, rules or regulations on currency exchange may limit our ability to utilize the cash held by entities inside the PRC. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China Restrictions on currency exchange may limit our ability to effectively utilize our revenues as well as the ability of our PRC subsidiaries to obtain debt or equity financing from financial institutions or investors outside the PRC, including us for more information.

## **Capital Expenditures**

In 2012, 2013 and 2014, our capital expenditures totaled US\$2.4 million, US\$0.3 million and US\$2.8 million, respectively. Our capital expenditures in 2014 were attributable to the purchase of computers and other electronic equipment.

We believe that our current levels of cash and cash equivalents, and cash flows from operations in the near future, will be sufficient to meet our anticipated capital expenditure and other cash needs for at least the next 12 months. However, we may need additional cash resources in the future if we experience changed business conditions or other developments. We also may need additional cash resources in the future if we find and wish to pursue opportunities

for investment, acquisition, strategic cooperation or other similar actions. If we ever determine that our cash requirements exceed our amounts of cash and cash equivalents on hand, we may seek to issue debt or equity securities or obtain a credit facility. Any issuance of equity securities could cause dilution for our shareholders. Any incurrence of indebtedness could increase our debt service obligations and cause us to be subject to restrictive operating and finance covenants. It is possible that, when we need additional cash resources, financing will be available to us only in amounts or on terms that would not be acceptable to us or financing will not be available at all.

**Table of Contents****C. Research and Development, Patents and Licenses, etc.**

See Item 4. Information on the Company B. Business Overview Research and Development for information relating to our research and development.

See Item 4. Information on the Company B. Business Overview Intellectual Property for information relating to our intellectual property.

**D. Trend Information**

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2012 to December 31, 2014 that are reasonably likely to have a material adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that would cause the disclosed financial information to be not necessarily indicative of future operating results or financial condition.

**E. Off-Balance Sheet Arrangements**

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholders' equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

**F. Tabular Disclosure of Contractual Obligations**

The following table sets forth our contractual obligations as of December 31, 2014:

	Contractual Obligations				Total
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	
	(In thousands)				
Operating lease obligations <sup>(1)</sup>	710	21	0	0	731
Purchase obligations	1,585	0	0	0	1,585
<b>Total</b>	<b>2,295</b>	<b>21</b>	<b>0</b>	<b>0</b>	<b>2,316</b>

(1) Operating leases generally relate to the lease of our office premises.

**Item 6. Directors, Senior Management and Employees****A. Directors and Senior Management**

Our board of directors consists of six directors, including four independent directors. The following table sets forth certain information concerning our directors and executive officers as of April 28, 2015.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Zengxiang LU	44	Chairman and Chief Executive Officer
Jianhua ZHU	45	Director
Jianyue PAN	47	Independent Director
Eric Zhe XU	40	Independent Director
Michael ELYAKIM	41	Independent Director
Songzuo XIANG	50	Independent Director
Qian YUE	42	Acting Chief Financial Officer
Jian HAN	41	Chief Technology Officer
Huiqing CHEN	42	Chief Administrative Officer

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*Zengxiang LU*, one of our founders, has been a board member since 2004 and chairman of our board of directors and chief executive officer since June 2014. He was chairman of our board of directors and our chief strategy officer from December 2006 until November 2008 and chief executive officer from 2004 until December 2006. Dr. Lu was the president of Guangdong R&D prior to April 2010 and was also a director from 2005 until 2007. Dr. Lu worked on the development of CA systems at Tsinghua Tongfang from 1999 to August 2001. He was deputy general manager of N-T Information Engineering from August 2001 until 2004, and has served on the board of N-T Information Engineering since 1998. Dr. Lu holds a bachelor's degree in automation and a doctorate degree in signal processing from Tsinghua University.

*Jianhua ZHU*, one of our founders, has been a board member since 2004. He was the chairman of our board of directors from 2004 to December 2006, and from November 2008 to June 2014, and chief executive officer of our company from December 2006 to June 2014. From 2001 until 2004, Mr. Zhu was general manager of N-T Information Engineering. From 1998 until 2001, he was deputy general manager of N-T Information Engineering. He has also been the supervisor of N-T Information Engineering since 2006. Mr. Zhu was the executive director of Guangdong R&D prior to April 2010. He worked at the China Technology Import and Export Corp. from 1994 until 1997. Mr. Zhu holds a bachelor's degree and a master's degree in precision instrumentation from Tsinghua University.

*Jianyue PAN* has been an independent director of our company since December 2010. Mr. Pan serves as the global vice president and Asia Pacific president of Synopsys, Inc, a worldwide leading company in electronic design automation software and IP for semiconductor design. Since 1995, Mr. Pan has held different positions at Synopsys, including China chief representative and director of China sales. Prior to Synopsys, Mr. Pan held sales and management roles in Mentor Graphics, a U.S.-based company. Prior to that, he held research and development roles in the Chinese Academy of Sciences. Prior to March 2011, Mr. Pan was an independent director of Beijing Lanxum Technology Co. Ltd., a Chinese A-share listed company. Mr. Pan holds a master's degree and a bachelor's degree in engineering from Tsinghua University in Beijing, and an Executive Master of Business Administration degree from China-Europe International Business School.

*Eric Zhe XU* has been an independent director of our company since December 2012. Mr. Xu is a Chartered Financial Analyst and currently serves as chairman of the board of directors of North Oakridge Capital Ltd. From December 2010 to February 2013, Mr. Xu served as managing director for the China Aerospace Industry Investment Fund. From October 2005 to October 2010, Mr. Xu served as a principal at SAIF Partners and, prior to that, as a consultant at Boston Consulting Group and an associate at A.T. Kearney Inc. Mr. Xu holds a Master of Business Administration degree from Harvard Business School and a bachelor's degree in economics from Peking University.

*Michael ELYAKIM* has been an independent director of our company since January 2014. Michael serves as the managing director for China investments at Aurec Capital Ltd., an Israel-based investment company, and is leading Aurec Capital's investments and operations in China. Since 2013, Michael has also served as a director of Shanghai Lezare International Trading, an organic cosmetic retail chain in China. Prior to joining Aurec Capital Ltd., Michael co-founded and was the managing partner of CIG, an Israel-based investment fund, and also acted as the mergers and acquisitions officer and director of the financial department for Scorpio BSG Ltd. Michael also held several senior positions in the investment banking sector in Israel and provided a variety of financial services. Michael holds a bachelor's degree in law and a bachelor's degree in economics from Tel-Aviv University and is a licensed Israeli lawyer.

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*Songzuo XIANG* has been an independent director of our company since September 2008. Dr. Xiang is the editor-in-chief of the Global Business & Finance magazine, a Chinese business publication sponsored by the Development Research Center of the State Council. He has also been appointed as the chief economist of the Agricultural Bank of China Limited since March 2012. Dr. Xiang is currently a director of AirMedia Group Inc., a company listed on the Nasdaq Global Market. Dr. Xiang was also a director of Hurray! Solutions Ltd. from 2000 to 2009 and its chief executive officer from March to October 2009, respectively. From 1995 to 1998, Dr. Xiang was deputy director of the Fund Planning Department at the Shenzhen branch office of the People's Bank of China. Dr. Xiang holds a master's degree in international affairs from Columbia University, a doctorate degree and a master's degree in economics from Renmin University of China and a bachelor's degree in mechanical engineering from Huazhong University of Science and Technology.

*Qian YUE* has served as our acting chief financial officer since January 2015, and vice president in charge of external cooperation and investments and overseas business development since 2008. She also oversees the business of Cyber Cloud, a subsidiary of our company. Prior to joining us, from 2006 to 2008, Ms. Yue held the role of vice president with responsibility for new energy and education investments at Wai Chun Investment Fund, a Hong Kong-based investment fund, where she was also executive director of the fund's Hong Kong-listed subsidiary. Prior to that, she held the role of vice president at Aerospace New World (China) Technology Co. Ltd and Beijing Asia Pacific East Communication Network Co. Ltd.

*Jian HAN* has served as chief technology officer of our company since June 2014, and previously, from the company's establishment to September 2012. Dr. Han is also the general manager of Cyber Cloud, a subsidiary of our company. From 2001 until joining our company, Dr. Han was chief technology officer at N-T Information Engineering. From 2000 to 2001, he was the digital broadcasting center project manager working on the development of CA systems at the Tsinghua Novel-Tongfang Research and Development Center. From 1999 to 2000, he was an associate researcher at the Microsoft China Research Institute. Dr. Han holds a Ph.D. in engineering and dual bachelor's degrees in automation and mechanical engineering from Tsinghua University.

*Huiqing CHEN* has served as the chief administrative officer of our company since our establishment in 2004, and is responsible for administrative affairs and human resources management. From 1998 until 2004, she was manager of the general manager's office at N-T Information Engineering. Ms. Chen holds a master's degree in biochemical engineering from Tsinghua University.

At our annual general meeting held on November 27, 2014, our shareholders approved the re-election of directors Jianhua Zhu and Zengxiang Lu as Class I directors, each to serve on the board of directors for a further three-year term. Andrew Yan resigned as a director, effective April 29, 2014.

There is no family relationship among any of our directors or executive officers. There is no shareholding qualification for directors.

## **B. Compensation of Directors and Senior Officers**

Our executive officers receive compensation in the form of salaries, annual bonuses and share options. Some of our current and former directors have received compensation in the form of share options. We do not provide any benefits to our non-executive directors upon retirement. In 2014, the aggregate cash compensation to our directors and executive officers was US\$1.0 million.

## **Share Options**

Our Amended and Restated China Digital TV Holding Co., Ltd. 2005 Stock Incentive Plan, or the 2005 Stock Incentive Plan, China Digital TV Holding Co., Ltd. 2008 Stock Incentive Plan, or the 2008 Stock Incentive Plan, China Digital TV Holding Co., Ltd. 2010 Stock Incentive Plan, or the 2010 Stock Incentive Plan, and China Digital TV Holding Co., Ltd. 2012 Stock Incentive Plan, or the 2012 Stock Incentive Plan, are intended to provide incentives to our directors, officers and employees as well as consultants and advisors of our company and its present or future parent company or subsidiaries, or related corporations.



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**Table of Contents*****The 2005 Stock Incentive Plan***

The 2005 Stock Incentive Plan was adopted by the board of directors of CDTV BVI on February 3, 2005 and the Amended and Restated 2005 Stock Incentive Plan was adopted by our board of directors and approved by our shareholders on September 13, 2007 to amend and restate the 2005 Stock Incentive Plan. In 2005, CDTV BVI was the ultimate holding company of our business. As a result of our restructuring in May 2007, CDTV BVI became our wholly-owned subsidiary and the options already granted under the 2005 Stock Incentive Plan were converted to options for the ordinary shares of our company. Pursuant to the 2005 Stock Incentive Plan, we may issue share options, stock appreciation rights, share bonuses, restricted shares, performance shares, share units, phantom shares, dividend equivalents or similar rights to purchase or acquire shares.

We reserved a total of 4,444,440 ordinary shares for issuance under the 2005 Stock Incentive Plan, subject to any adjustments as contemplated by the plan. We granted share options to purchase 3,067,498, 47,918, 543,674, 620,212 and 53,280 ordinary shares pursuant to the 2005 Stock Incentive Plan on February 3, 2005, April 13, 2006, September 22, 2006, December 5, 2006 and October 5, 2008, respectively. On November 19, 2010, the number of ordinary shares reserved for issuance under the 2005 Stock Incentive Plan was cancelled to the extent the corresponding options had not been awarded as of that date. Options to purchase 211 ordinary shares remained outstanding as of March 31, 2015 under the 2005 Stock Incentive Plan.

With respect to the share options that we granted on February 3, 2005, two vesting schedules apply. The first vesting schedule is as follows: 50% vest at the end of the six-month period after the award date, and the remaining 50% vest in 42 equal monthly installments, beginning from the end of the six-month period after the award date. The second vesting schedule is as follows: 25% vest on the first anniversary of the award date and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price for all share options granted on this date was US\$0.543 per share.

With respect to the share options that we granted on April 13, 2006, the vesting schedule is as follows: 50% vest at the end of the six-month period after the award date, and the remaining 50% vest in 42 equal monthly installments, beginning from the end of the six-month period after the award date. The original exercise price for all share options granted on this date was US\$0.543 per share.

With respect to the share options that we granted on September 22, 2006, the vesting schedule is as follows: 25% vest on the first anniversary of the award date and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price was US\$1.771 per share.

With respect to the share options that we granted on December 5, 2006, with the exception of share options that we granted to one of our executive officers, the vesting schedule is as follows: 25% vest on the first anniversary of the award date, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The executive officer's share options vest according to the following schedule: 25% of 320,000 options vest upon the closing of our initial public offering; 75% of 320,000 options vest in 36 substantially equal monthly installments, with the first installment vesting on the last day of the month following the month in which the executive officer took office; and 32,000 options vest upon the achievement of certain financial targets. In July 2010, these 32,000 shares were forfeited as the financial targets were not met. The original exercise price for all share options granted on this date was US\$4.172 per share.

With respect to the share options that we granted on October 5, 2008, the vesting schedule is as follows: 25% vest on the first anniversary of the award date and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price was US\$0.543 per share.

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### ***2008 Stock Incentive Plan***

The 2008 Stock Incentive Plan was adopted by our board of directors and approved by our shareholders on September 13, 2007. Pursuant to the 2008 Stock Incentive Plan, we may issue share options, share appreciation rights, share bonuses, restricted shares and restricted share units, performance shares, share units, phantom shares, dividend equivalents or similar rights to purchase or acquire shares.

We reserved a total of 1,200,000 ordinary shares for issuance under the 2008 Stock Incentive Plan, subject to any adjustments as contemplated by the plan. The plan also provides for an annual increase, beginning in 2009, in the number of ordinary shares that may be delivered pursuant to awards under the plan, totaling 2% of our issued and outstanding shares as of the first business day of the relevant calendar year. The maximum number of shares subject to awards that may be granted during any single calendar year is such number as equals 2% of our issued and outstanding shares as of the first business day of that calendar year. We granted share options to purchase 406,776, 357,548, 42,880 and 50,000 ordinary shares on October 5, 2008, June 2, 2009, February 10, 2010 and November 15, 2010, respectively. On November 19, 2010, the number of ordinary shares that had been reserved for issuance under the 2008 Stock Incentive Plan was cancelled to the extent the corresponding options had not been awarded as of that date. Options to purchase 538,653 ordinary shares remained outstanding as of March 31, 2015 under the 2008 Stock Incentive Plan.

With respect to the share options that we granted on October 5, 2008, the vesting schedule is as follows: 25% vest on the first anniversary of the award date, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price was US\$7.89 per share. On February 10, 2010, we accelerated the vesting schedule of a total of 29,480 share options to purchase 29,480 ordinary shares so that all these share options were vested on February 20, 2010.

With respect to the share options that we granted on June 2, 2009, the vesting schedule is as follows: 25% vest on the first anniversary of the award date, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price was US\$9.09 per share.

With respect to the share options that we granted on February 10, 2010, all these share options were vested on the grant date. The original exercise price was US\$0.543 per share.

With respect to the share options that we granted on November 15, 2010, the vesting of these options is conditional upon the fulfillment of certain performance targets by the optionee in the four years following the grant date. The original exercise price was US\$6.96 per share.

### ***2010 Stock Incentive Plan***

The 2010 Stock Incentive Plan was adopted by our board of directors on November 19, 2010. Pursuant to the 2010 Stock Incentive Plan, we may issue share options, share appreciation rights, share bonuses, restricted shares, performance shares, share units, phantom shares, dividend equivalents or similar rights to purchase or acquire shares.

We reserved a total of 3,600,000 ordinary shares for issuance under the 2010 Stock Incentive Plan, subject to adjustments as contemplated by the plan. We granted share options to purchase 1,000,000, 1,600,000, 700,000 and 300,000 ordinary shares on November 19, 2010, May 16, 2011, September 30, 2011 and November 19, 2011, respectively. Options to purchase 3,108,943 ordinary shares remained outstanding as of March 31, 2015 under the

2010 Stock Incentive Plan.

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With respect to the share options that we granted on November 19, 2010, the vesting schedule is as follows: 25% vest on the first anniversary of the award date, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on the last day of the month following the month in which the first anniversary of the award date occurs. The original exercise price was US\$6.90 per share.

With respect to the share options that we granted on May 16, 2011, two vesting schedules apply. The first vesting schedule is as follows: 25% vest on November 19, 2011, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on December 31, 2011 and then on the last day of the month following thereafter. The second vesting schedule is as follows: the vesting of the options is conditioned upon the fulfillment of certain performance targets by the optionees on April 1, 2012. The original exercise price was US\$4.90 per share.

With respect to the share options that we granted on September 30, 2011, the vesting schedule is as follows: 25% vest on November 19, 2011, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on December 31, 2011 and then on the last day of the month following thereafter. The original exercise price is US\$4.34 per share.

With respect to the share options that we granted on November 19, 2011, the vesting schedule is as follows: 25% vest on November 19, 2011, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on December 31, 2011 and then on the last day of the month following thereafter. The original exercise price is US\$4.34 per share.

### ***2012 Stock Incentive Plan***

The 2012 Stock Incentive Plan was adopted by our board of directors on May 1, 2012. Pursuant to the 2012 Stock Incentive Plan, we may issue share options, share appreciation rights, share bonuses, restricted shares, performance shares, share units, phantom shares, dividend equivalents or similar rights to purchase or acquire shares.

We reserved a total of 1,200,000 ordinary shares for issuance under the 2012 Stock Incentive Plan, subject to adjustments as contemplated by the plan. We granted share options to purchase 1,200,000 ordinary shares on January 8, 2013. Options to purchase 823,624 ordinary shares remained outstanding as of March 31, 2015 under the 2012 Stock Incentive Plan.

With respect to the share options that we granted on January 8, 2013, the vesting schedule is as follows: 25% vest on January 8, 2013, and the remaining 75% vest in 36 substantially equal monthly installments, beginning on February 28, 2013 and then on the last day of the month following thereafter. The original exercise price is US\$1.18 per share.

### ***The 2005, 2008, 2010 and 2012 Stock Incentive Plans***

Our board of directors administers the 2005 and 2008 Stock Incentive Plans and Jianhua Zhu administers the 2010 and 2012 Stock Incentive Plans. The administrator of each plan has wide discretion in determining who will receive awards, the type and timing of awards, the vesting schedule and other terms and conditions of the awards, including the exercise price of share option grants. Generally, if an outstanding share option grant made under the plans has not vested by the date of termination of the recipient's employment with us, no further installments of the recipient's grant will become exercisable following the date of termination of employment, and the recipient will have 30 days from such date to exercise any share options that had already vested but not yet been exercised. If any ordinary shares subject to a restricted share award remain subject to restrictions by the date of termination of employment, no additional ordinary shares will vest following the date of termination of employment.

The 2005 Stock Incentive Plan terminated on February 2, 2015. Our board of directors may amend or terminate the 2008, 2010 and 2012 Stock Incentive Plans at any time; provided, however, that our board of directors must seek the recipients' approval with respect to any amendment or termination that would adversely affect the rights of such recipients under any award already made. Without further action by our board of directors, the 2008, 2010 and 2012 Stock Incentive Plans will terminate on September 12, 2017, November 18, 2020 and April 30, 2022, respectively.

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In addition to the options granted pursuant to the 2005, 2008, 2010 and 2012 Stock Incentive Plans, on May 15, 2007, we granted options to purchase 40,000 ordinary shares to Louis T. Hsieh, who became an independent director of our company upon the completion of our initial public offering, at an exercise price of US\$4.172 per share. Mr. Hsieh retired from our board of directors in December 2009, following which 33,889 of his options were exercised with the remainder being forfeited.

On November 19, 2010, our board of directors approved an adjustment to the exercise price of all options granted prior to, but remained outstanding as of, December 23, 2010 under the 2005 Stock Incentive Plan, the 2008 Stock Incentive Plan and the 2010 Stock Incentive Plan, or the Adjusted Options. The per share exercise price of all Adjusted Options with a per share exercise price higher than US\$2.00 was reduced by US\$2.00 on December 23, 2010, and the per share exercise price of all Adjusted Options with a per share exercise price no more than US\$2.00 was reduced to US\$0.01. Our board of directors also resolved that if any future dividend is declared, the per share exercise price of all options granted prior to and outstanding as of the date of record of such dividend shall be reduced by an amount equal to the dividend payable on each ordinary share, provided that the per share exercise price after adjustment shall not be less than US\$0.01. Due to special cash dividends of US\$0.56, US\$2.30 and US\$0.50 per ordinary share declared in May 2011, November 2012 and April 2014, respectively, the per share exercise prices of all of the options granted prior to and remaining outstanding as of June 20, 2011, November 26, 2012 and April 14, 2014, each a record date, were reduced by US\$0.56, US\$2.30 and US\$0.50 pursuant to such resolution of our board of directors referenced above, respectively, provided that the per share exercise prices after adjustment shall not be less than US\$0.01.

The following table sets forth information on share options that have been granted and were outstanding as of March 31, 2015 pursuant to the 2005, 2008, 2010 and 2012 Stock Incentive Plans:

	Number of Ordinary Shares Underlying Outstanding Options	Exercise Price per Ordinary Share**	Date of Grant	Date of Expiration
<b>Directors and Executive Officers</b>				
Zengxiang LU	1,150,000	US\$ 1.54	May 16, 2011	May 15, 2021
		US\$ 0.68	January 8, 2013	January 7, 2023
Jianhua ZHU	1,150,000	US\$ 1.54	November 19, 2010	November 18, 2020
		US\$ 0.68	January 8, 2013	January 7, 2023
Huiqing CHEN		US\$ 2.53	October 5, 2008	October 4, 2018
	*	US\$ 3.73	June 2, 2009	June 1, 2019
		US\$ 1.54	September 30, 2011	September 29, 2021
		US\$ 0.68	January 8, 2013	January 7, 2023
Qian YUE		* US\$ 1.54	May 16, 2011	May 15, 2021
		US\$ 0.68	January 8, 2013	January 7, 2023
Jian HAN		* US\$ 2.53	October 5, 2008	October 4, 2018
		US\$ 3.73	June 2, 2009	June 1, 2019
		US\$ 1.54	November 19, 2011	November 18, 2021
<b>Other Grantees</b>				
Other grantees as a group (comprising 108 individuals)	1,788,442			

- \* The number of ordinary shares underlying the outstanding options held by each of the officers represents less than 1% of our ordinary shares.
- \*\* The exercise price per Ordinary Share has reflected the impact of the exercise price modifications in December 2010, June 2011, November 2012 and April 2014, respectively.



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### **C. Board Practices**

#### **General**

The functions and powers of our board of directors include, among others:

convening shareholders annual general meetings and reporting its work to shareholders at such meetings;

implementing shareholders resolutions;

determining our business plans and investment proposals;

declaring dividends and distributions;

exercising the borrowing powers of our company and mortgaging the property of our company;

approving the transfer of shares of our company, including the registering of such shares in our share register; and

exercising any other powers conferred by the shareholders meetings or under our Second Amended and Restated Memorandum and Articles of Association.

#### **Terms of Directors**

Our Second Amended and Restated Memorandum and Articles of Association provide for three classes of directors, each with three-year terms. The term of the Class I directors, who are Dr. Zengxiang Lu and Jianhua Zhu, will expire upon the annual general meeting of shareholders to be held in 2017; the term of the Class II director, who is Michael Elyakim, will expire upon the annual general meeting of shareholders to be held in 2015; and the term of the Class III directors, who are Jianyue Pan, Songzuo Xiang and Eric Zhe Xu, will expire upon the annual general meeting of shareholders to be held in 2016.

#### **Employment Agreements**

We have entered into service contracts with our directors. The service contracts do not provide any benefits to our directors upon termination of service.

We have entered into an employment agreement with each of our executive officers. Under these agreements, we may terminate an executive officer's employment for cause at any time, without notice or remuneration, for certain acts of the executive officer, including but not limited to material acts of fraud, material violations of our terms of employment, material dereliction of duty or engaging in graft to the material harm of the company. An executive officer may terminate employment if a government regulatory agency determines that working conditions are

extremely deficient and injurious to health, if the executive has been subject to violence, threats or illegal constraints upon his liberty, or if we have failed to pay compensation on time. We and each executive officer may also decide to terminate such executive officer's employment for other reasons or no reason after providing written notice at least 30 days in advance and after we have made arrangements for a successor. Our employment agreements do not provide any benefits to any of our executive officers upon termination.

Each executive officer who has executed an employment agreement with us has agreed to hold in confidence and not to use, both during and after such executive officer's term of employment, any of our confidential information, including but not limited to information relating to important company policies, technological secrets, commercial secrets, company processes and any intellectual property discovered, invented or created by such executive officer during his or her term of employment. In addition, each of our executive officers has agreed to give us full rights to any work-related patents, inventions or achievements.

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Each executive officer has also agreed that for one year after terminating employment with us, such executive officer will not, without our consent, accept employment by any of our competitors or engage in any activities that, directly or indirectly, compete with us. In addition, each executive officer has agreed that he or she will not, without our consent, induce any of our employees to terminate employment with us.

## **Board Committees**

To enhance our corporate governance, our board of directors has established two board committees: an audit committee and a corporate governance and nominations committee. The charters of each of our audit committee and corporate governance and nominations committee are publicly available on our website at <http://ir.chinadtv.cn>. In addition, Songzuo Xiang, one of our independent directors, assists the board in reviewing and approving our compensation structure, including all forms of compensation relating to our directors and executive officers, and administering our stock incentive plans.

### ***Audit Committee***

Our audit committee is responsible for, among other things:

recommending to our shareholders, if appropriate, the annual reappointment of our independent auditors and pre-approving all audit and non-audit services permitted to be performed by our independent auditors;

annually reviewing with our independent auditors any audit problems or difficulties and management's response;

reviewing and approving all proposed related-party transactions, as defined in Item 404 of Regulation S-K promulgated by the SEC;

discussing the annual audited financial statements with management and our independent auditors;

discussing with management and the independent auditors major issues regarding accounting principles and financial statement presentations;

reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of material control deficiencies;

discussing policies with respect to risk assessment and risk management;

timely reviewing reports from the independent auditors regarding all critical accounting policies and practices to be used by our company, all alternative treatments of financial information within U.S. GAAP that have been discussed with management and all other material written communications between the independent auditors and management;

establishing procedures for the receipt, retention and treatment of complaints received by us regarding accounting, internal accounting controls or auditing matters, and for the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters;

annually reviewing and reassessing the adequacy of our audit committee charter;

meeting separately and periodically with management and our internal and independent auditors; and

reporting regularly to our board of directors.

Our audit committee currently consists of Songzuo Xiang and Jianyue Pan, and has a formal written charter that sets forth its duties and powers. Our board has determined that each of Songzuo Xiang and Jianyue Pan qualifies as an independent director under the rules of the SEC and the NYSE. Our board also has determined that Songzuo Xiang qualifies as an audit committee financial expert within the meaning of the rules of the SEC. Our audit committee meets at least once each quarter.

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We currently only have two members on our audit committee and we no longer comply with Section 303A.07 of the NYSE Listed Company Manual, which, among other things, requires a listed company to have an audit committee that has a minimum of three members. As a foreign private issuer, we are permitted to follow home country practice in lieu of such requirements pursuant to Section 303A.00 of the NYSE Listed Company Manual. The corporate governance practice in our home country, the Cayman Islands, does not require companies to have a minimum number of members on the audit committee.

### ***Corporate Governance and Nominations Committee***

Our corporate governance and nominations committee consists of Songzuo Xiang and Jianyue Pan, and has a formal written charter that sets forth its duties and powers. Our corporate governance and nominations committee is responsible for identifying individuals qualified to become members of our board of directors and recommending them to our board of directors for nomination. Our corporate governance and nominations committee is also responsible for implementing our Code of Business Conduct and Ethics.

We currently do not have a compensation committee and we no longer comply with Section 303A.05 of the NYSE Listed Company Manual, which, among other things, requires a listed company to have a compensation committee composed entirely of independent directors. However, Songzuo Xiang, one of our independent directors, currently assists the board in reviewing and approving our compensation structure, including all forms of compensation relating to our directors and executive officers, and administering our stock incentive plans. As a foreign private issuer, we are permitted to follow home country practice in lieu of such requirements pursuant to Section 303A.00 of the NYSE Listed Company Manual. The corporate governance practice in our home country, the Cayman Islands, does not require companies to have a compensation committee.

### **Corporate Governance Guidelines**

Our board of directors has adopted a set of corporate governance guidelines. These guidelines reflect certain guiding principles with respect to the composition, selection and performance evaluation of our board of directors, the board committees, management succession and executive compensation. They are publicly available on our website at <http://ir.chinadtv.cn>.

### **D. Employees**

See Item 4. Information on the Company B. Business Overview Employees.

### **E. Share Ownership**

Under the Exchange Act Rule 13d-3, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or to direct the voting of such security, or investment power, which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be the beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed a beneficial owner of securities as to which such person has no economic interest.



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The following table sets forth certain information with respect to the directors, officers and each of the persons known to us who own beneficially 5% or more of our ordinary shares as of March 31, 2015 unless otherwise indicated. The number of ordinary shares outstanding in calculating the percentages for each listed person includes the ordinary shares underlying share options held by such person. The percentage of beneficial ownership of each listed person is based on 59,770,311 ordinary shares outstanding (excluding the 752,781 ordinary shares that were issued and held for the Company's account in preparation for exercise of share options by option holders under our employee stock incentive plans), as well as the ordinary shares underlying share options exercisable by such person within 60 days of March 31, 2015.

	Shares beneficially owned	
	Number	Percent
<b>Directors and Executive Officers</b>		
Zengxiang LU <sup>(1)</sup>	10,676,102	17.53%
Jianhua ZHU <sup>(2)</sup>	10,476,102	17.20%
Jianyue PAN	*	*
Eric Zhe XU		
Michael ELYAKIM	*	*
Songzuo XIANG		
Qian YUE <sup>(3)</sup>	**	**
Jian HAN <sup>(4)</sup>	**	**
Huiqing CHEN <sup>(5)</sup>	**	**
Directors and executive officers as a group <sup>(6)</sup>	22,340,501	36.72%
<b>Principal Shareholders</b>		
Glories Global <sup>(7)</sup>	4,300,000	7.19%
Parker International <sup>(8)</sup>	3,956,797	6.62%

\* Beneficially owns less than 1% of our ordinary shares.

\*\* Upon exercise of all share options exercisable within 60 days of March 31, 2015, would beneficially own less than 1% of our ordinary shares.

- (1) Represents: (i) the 9,273,393 ordinary shares and 200,000 ADSs held by Polar Light Group Limited, which is wholly owned by Dr. Zengxiang Lu; (ii) the 155,418 ordinary shares held by China Cast; and (iii) the 1,125,000 ordinary shares issuable upon exercise of options held by Dr. Lu that are exercisable within 60 days of March 31, 2015. Dr. Lu, together with Jianhua Zhu, exercises investment and voting powers over the shares held by China Cast. Dr. Lu owns 50% of the equity interest of China Cast and disclaims beneficial ownership of those shares held by China Cast except to the extent of his pecuniary interest therein.
- (2) Represents: (i) the 9,273,393 ordinary shares held by Smart Live Group Limited, which is wholly owned by Jianhua Zhu; (ii) the 155,418 ordinary shares held by China Cast Investment Holdings Limited, or China Cast; and (iii) the 1,125,000 ordinary shares issuable upon exercise of options held by Mr. Zhu that are exercisable within 60 days of March 31, 2015. Mr. Zhu, together with Dr. Zengxiang Lu, exercises investment and voting powers over the shares held by China Cast. Mr. Zhu owns 50% of the equity interest of China Cast and disclaims beneficial ownership of those shares held by China Cast except to the extent of his pecuniary interest therein.
- (3) Represents the sum of ADSs owned by Ms. Yue and ordinary shares issuable upon exercise of options held by Ms. Yue.

- (4) Represents the sum of ordinary shares owned by Mr. Han and ordinary shares issuable upon exercise of options held by Mr. Han.
- (5) Represents the sum of ordinary shares owned by Ms. Chen and ordinary shares issuable upon exercise of options held by Ms. Chen.
- (6) Represents 100% of the 155,418 ordinary shares held by China Cast (Dr. Zengxiang Lu and Jianhua Zhu jointly exercise investment and voting powers over the shares held by China Cast), ordinary shares and ADSs held by Dr. Lu (other than those ordinary shares held through China Cast), Mr. Zhu (other than those ordinary shares held through China Cast), Ms. Yue, Mr. Han, Ms. Chen, Mr. Pan and Mr. Elyakim and ordinary shares issuable upon exercise of options held by Dr. Lu, Mr. Zhu, Ms. Yue, Mr. Han and Ms. Chen.
- (7) Represents the sum of ADSs owned by Glories Global Limited, which is owned by Yan Juan Weng, a PRC citizen.
- (8) Represents the sum of ADSs owned by Parker International Limited, which is owned by Shmuel Meitar.



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**Item 7. Major Shareholders and Related Party Transactions**

**A. Major Shareholders**

Please refer to Item 6. Directors, Senior Management and Employees E. Share Ownership in this annual report.

None of our major shareholders has voting rights different from those of our other shareholders. To the best of our knowledge, we are not directly or indirectly controlled by another corporation, by any foreign government or by any other natural or legal person severally or jointly.

We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

For information regarding our shares held or beneficially owned by persons in the United States, see Item 9. The Offer and Listing A. Offering and Listing Details Market and Share Price Information in this annual report.

**B. Related Party Transactions**

**Super TV and N-S Digital TV Arrangements**

We operated our business in the PRC through N-S Digital TV, a PRC company that was previously owned by PRC citizens and became a wholly-owned subsidiary of our company in June 2014. We did not own any equity interest in N-S Digital TV before it became our subsidiary in June 2014. Through Super TV, our indirectly wholly-owned subsidiary in the PRC, we had entered into a series of contractual arrangements with N-S Digital TV and its shareholders, including contracts relating to transfer of assets, supply of smart cards and related software products, provision of equipment and technical support and related services, technology development and licenses, and certain shareholder rights and corporate governance matters. These contractual agreements were terminated with effect from June 20, 2014.

The following is a summary of the material provisions of certain of these agreements. For more complete information you should read these agreements in their entirety.

***Technical Support, Smart Cards and Software, Licenses and Equipment***

***Technical Support and Related Services Agreement, dated June 7, 2004 and amended on February 9, 2012, between N-S Digital TV and Super TV.*** Super TV exclusively provides N-S Digital TV and/or its customers with technical support, technical training, personnel services relating to N-S Digital TV's marketing activities and services relating to the maintenance and optimization for the products and software of N-S Digital TV's customers at N-S Digital TV's request. The fees for such technical support and services are determined at Super TV's discretion and payable within five days after the delivery of the support and services or at any other time agreed to by the parties. In 2014, N-S Digital TV did not make any payment to Super TV under this agreement. The term of this agreement is 15 years, which may not be terminated prior to its termination date without Super TV's written consent. The term of this agreement will be automatically renewed for an additional 15 years upon its termination date, unless written notice has been given by Super TV.

***Technology License Agreement, dated June 7, 2004 and amended on February 9, 2012, between N-S Digital TV and Super TV.*** N-S Digital TV granted Super TV, free of charge, an exclusive license to use certain software copyrights, patents, unpatentable technology and technical secrets relating to the digital television business that was transferred from N-T Information Engineering to N-S Digital TV. The term of the license is ten years. This agreement may not be terminated or amended without the written consent of Super TV prior to its termination date and will be automatically renewed for an additional ten years upon its termination date, unless written notice has been given by Super TV.

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***Technology Development Agreement, dated June 7, 2004 and amended on February 9, 2012, between N-S Digital TV and Super TV.*** N-S Digital TV engaged Super TV to develop all technology required by N-S Digital TV or its customers. The fees payable by N-S Digital TV to Super TV under the agreement will be calculated according to the following formula:

The price at which N-S Digital TV sells the technology products developed by Super TV multiplied by a set percentage multiplied by the quantity of the products sold.

The set percentage is determined by Super TV. In 2014, N-S Digital TV did not make any payment to Super TV under this agreement. The term of the agreement is ten years, which may not be terminated prior to its termination date without Super TV's written consent. The term of this agreement will be automatically renewed for an additional ten years upon its termination date, unless written notice has been given by Super TV.

***Products and Software Purchase Agreement, dated June 7, 2004 and amended on February 9, 2012, between N-S Digital TV and Super TV.*** N-S Digital TV agreed to exclusively purchase from Super TV all the smart cards and related software products required for its CA systems. The purchase price was RMB65 (US\$9.5) for each smart card (including related software), which is determined by Super TV and may be adjusted annually by Super TV based on fair market value. The term of the agreement is 15 years, which may not be terminated prior to its termination date without Super TV's written consent. The term of this agreement will be automatically renewed for another 15 years upon its termination date, unless written notice has been given by Super TV. N-S Digital TV subsequently obtained Super TV's consent to produce by itself or purchase from a third party smart cards beginning March 2006. The aggregate value of transactions between N-S Digital TV and Super TV under this agreement was RMB117.0 million (US\$19.0 million) in 2014.

***Framework Agreement for Purchase of Computer Chips, dated December 12, 2008, between N-S Digital TV and Super TV.*** Pursuant to this agreement, N-S Digital TV will purchase computer chips from Super TV, which, in turn, will source such computer chips from suppliers such as STM and Infineon. The term of this agreement is indefinite and is terminable by agreement between the parties. In 2014, N-S Digital TV did not make any payment to Super TV under this agreement.

***Framework Agreement for Sale of Software Products, dated July 14, 2009, between N-S Digital TV and Super TV.*** Super TV granted N-S Digital TV the exclusive right to sell its software products relating to advertisement editing and CA systems and other software products as agreed by the parties. The amount, price and related fees will be specified by each order provided by N-S Digital TV to Super TV. The agreement has a term of five years and is terminable by Super TV at any time. In 2011, Digital Rights Management, a content protection system for IPTV, was sold under the framework agreement. The aggregate value of transactions between N-S Digital TV and Super TV under this agreement was RMB0.8 million (US\$0.1 million) in 2014.

**Shareholder Rights and Corporate Governance**

***Equity Transfer Option Agreement***

An equity transfer option agreement was entered into among Super TV, N-T Information Engineering and Li Yang on June 7, 2004, as amended by a supplemental agreement, dated September 1, 2005, among Super TV,

N-T Information Engineering, Li Yang and N-S Digital TV, and further amended by a second supplemental agreement, dated August 18, 2007, among Super TV, N-T Information Engineering, Li Yang, N-S Digital TV and Wei Gao, a third supplemental agreement, dated June 20, 2008, among Super TV, N-S Digital TV, N-T Information Engineering, Wei Gao and Junming Wu, a fourth supplemental agreement, dated November 24, 2008, among Super TV, N-S Digital TV, N-T Information Engineering, Junming Wu, Lei Zhang and Shizhou Shen, a fifth supplemental agreement, dated July 11, 2011, among Super TV, N-S Digital TV, Junming Wu, Lei Zhang, Shizhou Shen, Wenjun Wang and Tianxing Wang, and a supplemental agreement, dated February 9, 2012, among Super TV, N-S Digital TV, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen, referred to collectively as the Equity Transfer Option Agreement. Pursuant to the Equity Transfer Option Agreement, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen, being all the shareholders of N-S Digital TV, jointly grant Super TV an exclusive and irrevocable option to purchase all of their equity interests in N-S Digital TV at any time that Super TV deems fit. Super TV may purchase such equity interests by itself or designate another party to purchase such equity interests. The total consideration for the granting of the option was RMB10 (US\$1.6). The exercise price of the option will be determined by Super TV or its designated third party at the time of the exercise, subject to the requirements of the PRC law or approval of relevant authorities with respect to the minimum purchase price and the basis for the determination of the purchase price. Following any exercise of the option, the parties will enter into a definitive equity interest transfer agreement within two days, or any period agreed to among the parties, after a written notice of exercise is delivered. The Equity Transfer Option Agreement does not have a specified term and will remain in effect unless terminated with the written consent of Super TV.

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Pursuant to the Equity Transfer Option Agreement, at all times before Super TV acquires 100% of the equity interests in N-S Digital TV, without Super TV's consent, N-S Digital TV may not (i) amend its organizational documents, increase or reduce its registered capital or otherwise change its capital structure; (ii) sell, transfer, pledge or otherwise dispose of any legal or beneficial interest in any of its assets, business or revenues, or allow the creation of any encumbrance thereon; (iii) engage in any activities that may negatively impact its operations or the value of its assets; or (iv) incur, assume or guarantee any debts except in the ordinary course of business, extend any loan or credit to any person, enter into any material contracts, or engage in any merger or combination with, acquisition of, or make investment in, any other person.

Under the Equity Transfer Option Agreement, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen undertake not to do any of the following without Super TV's consent, at all times before Super TV acquires 100% of the equity interests in N-S Digital TV: (i) transfer or pledge to any third party their equity interests in N-S Digital TV; (ii) cause N-S Digital TV to issue new shares or engage in any transactions that will result in changes to their existing shareholding structures or transfer to any third party N-S Digital TV's equity interests in their respective associated companies; (iii) receive any dividends, loan interest or other benefits from N-S Digital TV; or (iv) make any material adjustment or change to N-S Digital TV's business and operations.

***Business Operating Agreement***

A business operating agreement, dated September 1, 2005, was entered into among Super TV, N-T Information Engineering, Li Yang and N-S Digital TV, as amended by a supplemental agreement, dated August 18, 2007, among Super TV, N-S Information Engineering, Li Yang, N-S Digital TV and Wei Gao, and further amended by a second supplemental agreement, dated June 20, 2008, among Super TV, N-S Digital TV, N-T Information Engineering, Wei Gao and Junming Wu, a third supplemental agreement, dated November 24, 2008, among Super TV, N-S Digital TV, N-T Information Engineering, Junming Wu, Lei Zhang and Shizhou Shen, a fourth supplemental agreement, dated July 11, 2011, among Super TV, N-S Digital TV, Junming Wu, Lei Zhang, Shizhou Shen, Wenjun Wang and Tianxing Wang, and a supplemental agreement, dated February 9, 2012, among Super TV, N-S Digital TV, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen, referred to collectively as the Business Operating Agreement. Pursuant to the Business Operating Agreement, N-S Digital TV and its shareholders agreed to (i) accept the policies and guidelines furnished by Super TV from time to time with respect to the hiring and dismissal of employees, operational management and financial system of N-S Digital TV; (ii) appoint the candidates recommended by Super TV as directors of N-S Digital TV and appoint the senior management personnel of Super TV as the general manager, chief financial officer and other senior officers of N-S Digital TV based on Super TV's recommendations; (iii) replace or remove any director or senior management personnel of N-S Digital TV at Super TV's request; and (iv) seek a guarantee from Super TV first when any guarantee is required to secure performance by N-S Digital TV of any contract or working capital loans borrowed by N-S Digital TV and pledge its assets and receivables to Super TV as a counter-guarantee. To date, N-S Digital TV has not sought any such guarantee from Super TV. In addition, Super TV has agreed with N-S Digital TV to serve as a guarantor of N-S Digital TV with respect to contracts or transactions entered into between N-S Digital TV and third parties in respect of N-S Digital TV's business operations. However, N-S Digital TV has not asked Super TV to provide, and Super TV has not provided, any such guarantee in favor of a third party. The Business Operating Agreement has a term of ten years and may be renewed at the option of Super TV by giving written notice for a term to be determined by Super TV. Super TV may terminate this agreement at any time by giving 30 days' advance written notice to the other parties to this agreement.

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**Table of Contents*****Powers of Attorney***

Each of Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen executed an irrevocable power of attorney, dated January 16, 2012, to appoint Super TV or a third party designated by Super TV as an attorney-in-fact to exercise all his voting rights as a shareholder of N-S Digital TV. The term of the powers of attorney is ten years, subject to earlier termination in the event of the termination of the relevant share pledge agreement. The powers of attorney will be automatically renewed upon the extension of the term of the relevant share pledge agreement.

***Share Pledge Agreements***

N-T Information Engineering and Super TV entered into a share pledge agreement, dated September 1, 2005, pursuant to which N-T Information Engineering had pledged all of its equity interests in N-S Digital TV to Super TV to secure the payment obligations of N-S Digital TV under certain contractual arrangements between N-S Digital TV and Super TV. This agreement was terminated on November 24, 2008, following the transfer by N-T Information Engineering of all of its equity interests in N-S Digital TV to Lei Zhang and Shizhou Shen. On November 24, 2008, Mr. Zhang and Mr. Shen each entered into a share pledge agreement with Super TV, pursuant to which Mr. Zhang and Mr. Shen have pledged all of their respective equity interests in N-S Digital TV to Super TV to secure their respective payment obligations under their respective loan agreements with Super TV, each dated November 24, 2008.

Pursuant to the share pledge agreement, dated September 1, 2005, between Super TV and Li Yang, as amended by a supplemental agreement, dated August 18, 2007, between Super TV, Li Yang and Wei Gao, and further amended by a second supplemental agreement, dated June 20, 2008, among Super TV, Wei Gao and Junming Wu, Mr. Wu has pledged all of his equity interests in N-S Digital TV to Super TV to secure the payment obligations of N-S Digital TV under certain contractual arrangements between N-S Digital TV and Super TV. This agreement was terminated on July 11, 2011, following the transfer by Mr. Wu of all of his equity interests in N-S Digital TV to Tianxing Wang.

Each of Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen entered into a share pledge agreement with Super TV on July 11, 2011, which was superseded by another share pledge agreement with Super TV on January 16, 2012. Pursuant to the share pledge agreements, each of Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen pledged all his equity interests in N-S Digital TV to Super TV to secure his and N-S Digital TV's performance of their respective obligations under the VIE contractual arrangements between N-S Digital TV or its shareholders and Super TV. Under such share pledge agreements, each of Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen agreed not to transfer his equity interests in N-S Digital TV or create, or allow the creation of, any pledge on their respective equity interests in N-S Digital TV that may affect Super TV's interests without Super TV's consent. Pursuant to such agreements, Super TV is entitled to receive the dividends on the pledged equity interests during the term of the pledge. The duration of each of the share pledge agreements is equivalent to the maximum duration of the VIE contractual arrangements between N-S Digital TV and/or its shareholders and Super TV. The share pledge agreements may only be terminated: (i) by Super TV in writing; or (ii) upon the fulfillment of N-S Digital TV's and its shareholders' respective obligations under the VIE contractual arrangements between N-S Digital TV and/or its shareholders and Super TV, which is subject to Super TV's written confirmation. The share pledge agreements were registered with the Beijing Administration of Industry and Commerce on February 1, 2012.

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**Table of Contents*****Loan Agreements***

Pursuant to two loan agreements, each dated November 24, 2008, between Super TV and each of Lei Zhang and Shizhou Shen, respectively, as amended by a supplemental agreement to the loan agreements, dated January 16, 2012, among Super TV, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen, Super TV provided a loan in the principal amount of RMB6.2 million (US\$0.9 million) to each of Mr. Zhang and Mr. Shen. The term of each loan is ten years, which is automatically renewable for another ten years upon its termination date, unless a written notice has been provided by Super TV one month prior to such termination date. Mr. Zhang and Mr. Shen may not repay the loan prior to the termination date of the relevant loan agreement, unless so requested by Super TV, and may only repay the loan by (i) transferring all his equity interests in N-S Digital TV to Super TV or any third party designated by Super TV and (ii) paying Super TV with the entire proceeds obtained by himself from such transfer. The interest rate of each loan is nil. Super TV provided such loans to Mr. Zhang and Mr. Shen to fund their acquisitions of N-T Information Engineering's equity interests in N-S Digital TV.

Pursuant to three loan agreements, each dated July 11, 2011, between Super TV and each of Wenjun Wang, Tianxing Wang and Lei Zhang, respectively, as amended by a supplemental agreement to the loan agreements, dated January 16, 2012, among Super TV, Wenjun Wang, Tianxing Wang, Lei Zhang and Shizhou Shen, and as further amended by a second supplemental agreement, dated April 12, 2013, between Super TV and Tianxing Wang, Super TV provided a loan in the principal amount of RMB43.3 million (US\$6.7 million), RMB38.6 million (US\$6.0 million) and RMB35.1 million (US\$5.5 million) to each of Wenjun Wang, Tianxing Wang and Lei Zhang, respectively. The term of each loan is ten years, which is automatically renewable for another ten years upon its termination date, unless a written notice has been provided by Super TV one month prior to such termination date. Wenjun Wang, Tianxing Wang and Lei Zhang may not repay the loan prior to the termination date of the relevant loan agreement, unless so requested by Super TV, and may only repay the loan by (i) transferring all his equity interests in N-S Digital TV to Super TV or any third party designated by Super TV and (ii) paying Super TV with the entire proceeds obtained by himself from such transfer. The interest rate of each loan is nil. Super TV provided such loans to Wenjun Wang, Tianxing Wang and Lei Zhang in July 2011 to fund their additional contribution to N-S Digital TV's registered capital.

In June 2014, Super TV, N-S Digital TV and the nominee shareholders of N-S Digital TV, namely Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang, entered into a termination agreement that terminated the series of contractual agreements underlying the VIE structure between the nominee shareholders of N-S Digital TV and Super TV. Pursuant to the termination agreement, the termination is conditioned upon the nominee shareholders transferring 100% of their equity interest in N-S Digital TV to Super TV, with the consideration of such transfer equaling and offset by the amount of loans owed to Super TV by the nominee shareholders under the loan agreements entered into between each of the nominee shareholders and Super TV.

On the same date, Super TV and the nominee shareholders of N-S Digital TV, namely Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang, entered into a share transfer agreement, pursuant to which the nominee shareholders of N-S Digital TV transferred the 100% equity interest in N-S Digital TV to Super TV for a consideration of RMB150 million. Pursuant to the share transfer agreement, the nominee shareholders shall promptly de-register the share pledge agreements entered into between each of Tianxing Wang, Lei Zhang, Shizhou Shen and Wenjun Wang with Super TV, and facilitate the transfer of equity interest in N-S Digital TV. As a result, N-S Digital TV became a wholly-owned subsidiary of Super TV.

**Other Related Party Transactions*****Shareholders Agreement***

Pursuant to the First Amended and Restated Shareholders Agreement of China Digital TV Holding Co., Ltd., or the Shareholders Agreement, dated September 13, 2007, among N-T Information Engineering, N-S Digital TV, CDTV BVI, China Capital, China Cast, SAIF, Capital Funds and certain other shareholders, as amended by an agreement, dated June 14, 2011, among us, N-S Digital TV, China Cast, SAIF, Capital Funds and certain other shareholders, at any time beginning six months after the closing of our initial public offering, each of SAIF, Capital Funds and China Capital may, on three occasions only, require us to effect the registration on a form other than Form F-3 of all or part of the registrable securities then outstanding. In addition, any holder of registrable securities may require us to effect a registration statement on Form F-3 (or any successor form or any comparable form for a registration in a jurisdiction other than the United States) for a public offering of registrable securities so long as we are entitled to use Form F-3 (or a comparable form) for such offering. Demand for a registration on Form F-3 may be made on unlimited occasions, although we are not obligated to effect more than one such registration per shareholder in any six-month period.



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Registrable securities are ordinary shares not previously sold to the public and issued or issuable or sold to SAIF, Capital Funds and China Capital, including: (a) ordinary shares issuable upon conversion or exercise of either (i) any of the Series A preferred shares, or (ii) any options or warrants to purchase ordinary shares or the Series A preferred shares of our company; (b) ordinary shares held by Capital Funds and China Capital; (c) ordinary shares issued pursuant to share splits, share dividends, and similar distributions to SAIF, Capital Funds and China Capital; and (d) any other securities of our company granted with registration rights pursuant to the Shareholders Agreement.

Holders of registrable securities also have piggyback registration rights, which may require us to register all or any part of the registrable securities then held by such holders when we register any of our ordinary shares.

We are generally required to bear all of the registration expenses incurred in connection with three demand registrations on a form other than Form F-3 for each of SAIF, Capital Funds and China Capital, unlimited Form F-3 and piggyback registrations, except underwriting discounts and selling commissions, but including reasonable expenses of one counsel for the party exercising the registration right. The registration rights under the Shareholders Agreement shall terminate on June 14, 2015.

### ***Interest Payment Agreement***

Pursuant to an agreement, dated November 30, 2006, between Super TV and N-S Digital TV, N-S Digital TV agreed to pay interest at a rate equal to commercial banks lending rate for one-year loans on the payments payable by N-S Digital TV to Super TV for the purchases of products from Super TV. Interest payable will start to accrue from the first day of the month following the confirmation of the corresponding sales until the actual payment. No interest was accrued as of December 31, 2014 under this agreement.

### ***Share Transfer Agreements (Xinsi Yijia and Cyber Cloud)***

Pursuant to a series of share transfer agreements, dated April 30, 2014, among Super TV, CSM Holdings, Yuewu Yuntian, Holch Capital, Cyber Cloud and Xinsi Yijia, Cyber Cloud acquired the equity interest in Xinsi Yijia hold by Yuewu Yuntian, and in exchange, Yuewu Yuntian obtained certain equity interests in Cyber Cloud.

### ***Share Transfer Agreement (Shibo Movie)***

Pursuant to a share transfer agreement, dated June 18, 2014, between N-S Digital TV and N-S Information Technology, N-S Digital TV transferred its 100% equity interest in Shibo Movie to N-S Information Technology, for a consideration of RMB5.2 million (US\$0.8 million).

### ***Share Transfer Agreement (N-S Media Investment)***

Pursuant to a share transfer agreement, dated June 18, 2014, between N-S Digital TV and N-S Information Technology, N-S Digital TV transferred its 100% equity interest in N-S Media Investment to N-S Information Technology, for a consideration of RMB17.2 million (US\$2.8 million).

## **C. Interests of Experts and Counsel**

Not Applicable.

**Item 8. Financial Information**

**A. Consolidated Statements and Other Financial Information**

**Consolidated Statements**

See Item 18. Financial Statements.

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### **Legal Proceedings**

We are not currently a party to any material legal proceeding and, to our knowledge, there are no material legal proceedings threatened against us. From time to time, we may be subject to various claims and legal actions arising in the ordinary course of business.

### **Dividend Policy**

In December 2008, in the belief that a special dividend is an efficient use of our cash to maximize shareholder value, our board of directors determined to declare and pay a special cash dividend of US\$1.00 per ordinary share of the company. This special dividend in the amount of US\$57.3 million was fully paid by the end of February 2009.

In November 2010, our board of directors declared a special cash dividend of US\$2.00 per ordinary share to be paid in two installments of US\$1.00 each. The special cash dividend was fully paid on May 31, 2011.

In May 2011, our board of directors declared a special cash dividend of US\$0.56 per ordinary share. US\$32,937,000 was paid in 2012 and the remaining US\$79,000 was paid in 2013.

In November 2012, our board of directors declared a special cash dividend of US\$2.30 per ordinary share to be paid in two installments of US\$1.00 and US\$1.30, respectively. Cash dividend totaling US\$59,013,000 was paid in 2012, US\$76,863,000 was paid in 2013, and the remaining US\$57,000 was paid in 2014.

We declared a special cash dividend of US\$0.50 per ordinary share on April 2, 2014. The dividend was paid in May 2014.

Our board of directors has the discretion to determine the payment of any dividends. As a matter of company policy, our board of directors will consider declaring and paying dividends for a given period, subject to the board of directors determination that (i) we have sufficient profit attributable to shareholders for such period and (ii) our funding requirements can be fully satisfied if a proposed dividend is declared and paid. Our board of directors will review and decide whether to revise our dividend policy, from time to time, in light of our future operations and earnings, capital requirements and surplus, financial condition, contractual restrictions, general business conditions and other factors as the board of directors may deem relevant.

We may rely on our operating subsidiary, Super TV, for our cash needs, including the funds necessary to pay dividends to our shareholders. The payment of dividends by Super TV is subject to limitations. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China We may rely on dividends and other distributions on equity paid by our operating subsidiary to fund cash and financing requirements, and limitations on the ability of our operating subsidiary to pay dividends to us could materially restrict our ability to conduct our business.

Holders of ADSs will be entitled to receive dividends, subject to the terms of the deposit agreement, less the fees and expenses payable under the deposit agreement. Cash dividends will be paid by the depository to holders of ADSs in U.S. dollars. Other distributions, if any, will be paid by the depository to holders of our ADSs by any means it deems legal, fair and practical.

## **B. Significant Changes**

There have been no significant changes since December 31, 2014, the date of the annual financial statements in this annual report.

**Table of Contents****Item 9. The Offer and Listing****A. Offering and Listing Details  
Market and Share Price Information**

Our ADSs, each representing one ordinary share, have been listed on the NYSE since October 5, 2007. Our ADSs trade under the symbol STV. The NYSE is the principal trading market for our ADSs, which are not listed on any other exchanges in or outside of the United States.

The high and low closing prices of our ADSs on the NYSE since listing are as follows:

	Price per ADS (US\$)	
	High	Low
<b>Yearly:</b>		
2008	27.55	4.25
2009	11.31	5.83
2010	9.21	5.30
2011	7.42	3.17
2012	4.35	1.68
2013	2.27	1.36
2014	4.94	1.81
<b>Quarterly:</b>		
First Quarter, 2013	2.27	1.70
Second Quarter, 2013	1.84	1.45
Third Quarter, 2013	1.72	1.36
Fourth Quarter, 2013	2.14	1.58
First Quarter, 2014	3.69	1.81
Second Quarter, 2014	4.79	2.61
Third Quarter, 2014	4.94	3.24
Fourth Quarter, 2014	4.66	3.00
First Quarter, 2015	3.87	2.90
<b>Monthly:</b>		
October 2014	4.66	3.86
November 2014	3.97	3.50
December 2014	3.72	3.00
January 2015	3.15	2.90
February 2015	3.87	2.91
March 2015	3.75	3.41
April 2015 (through April 27)	4.34	3.74

As of March 31, 2015, a total of 39,277,950 ADSs were outstanding, excluding the 752,781 ADSs that were held for our account in preparation for exercise of share options by option holders under our employee stock incentive plans. As of March 31, 2015, 39,277,950 ordinary shares were registered in the name of Deutsche Bank Trust Company Americas, the depository under the deposit agreement, excluding 752,781 ordinary shares that were issued and held for our account in preparation for exercise of share options by option holders under our employee stock incentive plans.

**B. Plan of Distribution**

Not Applicable.

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**C. Markets**

Our ADSs, each representing one ordinary share, have been listed on the NYSE since October 5, 2007 under the symbol STV.

**D. Selling Shareholders**

Not Applicable.

**E. Dilution**

Not Applicable.

**F. Expenses of the Issue**

Not Applicable.

**Item 10. Additional Information**

**A. Share Capital**

Not Applicable.

**B. Memorandum and Articles of Association**

We incorporate by reference into this annual report the description of our Second Amended and Restated Memorandum and Articles of Association contained in our registration statement on Form F-1 (File No. 333-146072) filed with the SEC on September 14, 2007. Our shareholders adopted our Second Amended and Restated Memorandum and Articles of Association on September 13, 2007.

**C. Material Contracts**

Other than the contracts described elsewhere in this annual report, we and our operating companies have not entered into any material contracts that are not in the ordinary course of business within the two years preceding the date of this annual report.

**D. Exchange Controls**

The Cayman Islands currently have no exchange control restrictions. See also Item 4. Information on the Company B. Business Overview Regulation Foreign Currency Exchange and Item 4. Information on the Company B. Business Overview Regulation Regulation of Foreign Exchange in Certain Onshore and Offshore Transactions for information

on foreign currency exchange in the PRC.

**E. Taxation**

The following discussion of the material Cayman Islands and United States federal income tax consequences of an investment in the ADSs is based upon laws and relevant interpretations thereof in effect as of the date of this annual report, all of which are subject to change. This summary does not deal with all possible tax consequences relating to an investment in the ADSs, such as the tax consequences under state, local and other tax laws.



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### **Cayman Islands Taxation**

To the extent the following discussion relates to Cayman Islands law with respect to the income tax consequence of an investment in our ADSs, it represents the opinion of Conyers Dill & Pearman.

The Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciations and there is no taxation in the nature of inheritance tax or estate duty or withholding tax applicable to us or to any holder of ADSs or ordinary shares. There are no other taxes likely to be material to us levied by the Government of the Cayman Islands except for stamp duties which may be applicable on instruments executed in, or after execution brought within the jurisdiction of, the Cayman Islands. No stamp duty is payable in the Cayman Islands on transfers of shares of Cayman Islands companies except those which hold interests in land in the Cayman Islands. The Cayman Islands is a party to a double tax treaty entered into with the United Kingdom in 2010 but is otherwise not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

Pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, we have obtained an undertaking from the Governor-in-Cabinet:

that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciations shall apply to the Company or its operations; and

that the aforesaid tax or any tax in the nature of estate duty or inheritance tax shall not be payable on the shares, debentures or other obligations of the Company.

The undertaking for us is for a period of 20 years from May 1, 2007.

### **United States Federal Income Taxation**

This section describes the material United States federal income tax consequences of owning ADSs. It applies to you only if you are a U.S. holder, as defined below, and you hold your ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

a dealer in securities;

a trader in securities that elects to use a mark-to-market method of accounting for securities holdings;

a tax-exempt organization;

a life insurance company;

a person liable for alternative minimum tax;

a person that actually or constructively owns 10% or more of our voting stock;

a person that holds ADSs as part of a straddle or a hedging or conversion transaction;

a person that purchases or sells ADSs as part of a wash sale for tax purposes; or

a person whose functional currency is not the U.S. dollar.

**U.S. holders are urged to consult their tax advisors about the application of the United States federal tax rules to their particular circumstances as well as the state, local and foreign tax consequences to them of the purchase, ownership and disposition of our ADSs or ordinary shares.**

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed Treasury regulations, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the depositary and the assumption that each obligation in the Deposit Agreement and any related agreement will be performed in accordance with its terms.

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If a partnership holds the ADSs, the United States federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in a partnership holding the ADSs should consult its tax advisor with respect to the United States federal income tax treatment of an investment in the ADSs.

You are a U.S. holder if you are a beneficial owner of ADSs and you are:

a citizen or resident of the United States;

a corporation (or other entity taxable as a corporation for United States federal income tax purposes) organized under the laws of the United States, any State or the District of Columbia;

an estate whose income is subject to United States federal income tax regardless of its source; or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax. The tax treatment of holding shares is identical to that of holding ADSs.

## ***Taxation of Dividends***

Under the United States federal income tax laws, and subject to the PFIC rules discussed below, the gross amount of any dividend we pay out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a non-corporate U.S. holder, including an individual, dividends that constitute qualified dividend income will be taxable to you at the preferential rates applicable to long-term capital gains provided that you hold the ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends we pay with respect to the ADSs generally will be qualified dividend income provided that, in the year that you receive the dividend, the ADSs are readily tradable on an established securities market in the United States. The NYSE should qualify as an established securities market in the United States.

You must include any foreign tax withheld from the dividend payment in this gross amount even though you do not in fact receive it. The dividend is taxable to you when the depository receives the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the ADSs and thereafter as capital gain.

Subject to certain limitations, in the event that PRC tax is withheld and paid over to the PRC with regard to the dividend payments, the PRC tax will generally be creditable or deductible against your United States federal income tax liability. See Item 3. Key Information D. Risk Factors Risks Relating to the People's Republic of China Dividends payable by us to our non-PRC shareholders and ADS holders, and gains on the sales of our ordinary shares or ADSs,

may be subject to withholding taxes under PRC tax laws, which may materially reduce the value of your investment. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the preferential tax rates. To the extent a refund of the tax withheld is available under PRC law, the amount of tax withheld that is refundable will not be creditable against your United States federal income tax liability.

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Dividends will generally be income from sources outside the United States, and, depending on your circumstances, will be either passive or general category income for purposes of computing the foreign tax credit allowable to you.

### ***Taxation of Capital Gains***

Subject to the PFIC rules discussed below, if you sell or otherwise dispose of your ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your ADSs. Capital gain of a non-corporate U.S. holder, including an individual, is generally taxed at preferential rates where the holder has a holding period greater than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

### ***PFIC Rules***

Based on analyses of our income and the value of our assets, we believe we were not a PFIC for the taxable year ended December 31, 2014. However, we were a PFIC during the taxable years 2009 through 2013 for U.S. federal income tax purposes. This conclusion is a factual determination that is made annually and thus we may or may not be a PFIC for the taxable year ending December 31, 2015 or subsequent taxable years. To the extent that we hold a significant amount of cash or other passive assets in the future, it is more likely that we would be treated as a PFIC in future taxable years. You will generally be treated as holding stock of a PFIC in the first taxable year of your holding period in which we became a PFIC and subsequent taxable years even if we cease to satisfy the tests to be classified as a PFIC in subsequent taxable years, unless you make certain elections.

In general, we will be a PFIC with respect to you if for any taxable year in which you held our ADSs:

at least 75% of our gross income for the taxable year is passive income; or

at least 50% of the value, determined on the basis of a quarterly average, of our assets is attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, rents (other than certain rents and royalties derived in the active conduct of a trade or business), annuities and gains from assets that produce passive income. If a foreign corporation owns at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

Although we were not a PFIC for the taxable year ended December 31, 2014, because we were classified as a PFIC for prior years as described above, you will generally be subject to the special PFIC tax rules if you held our ADSs while we were treated as a PFIC or, if you make or have made a timely mark-to-market election, the mark-to-market rules as described below.

***Special PFIC Rules.*** If we are treated as a PFIC, and you are a U.S. holder that did not make a mark-to-market election, you will be subject to special rules with respect to:

any gain you realize on the sale or other disposition of your ADSs; and

any excess distribution that we make to you (generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the ADSs during the three preceding taxable years or, if shorter, your holding period for the ADSs).

Under these rules:

the gain or excess distribution will be allocated ratably over your holding period for the ADSs;

the amount allocated to the taxable year in which you realized the gain or excess distribution will be taxed as ordinary income;

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the amount allocated to each prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year; and

the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC.

Moreover, your ADSs will be treated as stock in a PFIC if we were a PFIC at any time during your holding period in your ADSs, even if we are not currently a PFIC. For purposes of this rule, if you make a mark-to-market election with respect to your ADSs, you will be treated as having a new holding period in your ADSs beginning on the first day of the first taxable year beginning after the last taxable year for which the mark-to-market election applies. In addition, notwithstanding any election you make with regard to the ADSs, dividends that you receive from us will not constitute qualified dividend income to you if we are a PFIC either in the taxable year of the distribution or the preceding taxable year. Dividends that you receive that do not constitute qualified dividend income are not eligible for taxation at the preferential rates applicable to qualified dividend income. Instead, you must include the gross amount of any such dividend paid by us out of our accumulated earnings and profits (as determined for United States federal income tax purposes) in your gross income, and it will be subject to tax at rates applicable to ordinary income.

If we are or were a PFIC for any taxable year during which you hold or held our ADSs, unless you make or have made a timely mark-to-market election (as described below), we will continue to be treated as a PFIC with respect to you for all subsequent years during which you hold the ADSs, unless we have ceased to be classified as a PFIC under the tests described above and you make a deemed sale election. If you make a deemed sale election, you will be deemed to have sold your ADSs at their fair market value on the last day of the last taxable year in which we qualified as a PFIC and any gain from such deemed sale would be subject to the excess distribution rules described above. After the deemed sale election, so long as we do not become a PFIC in a subsequent taxable year, your ADSs with respect to which a deemed sale election was made will not be treated as equity interests in a PFIC. However, as discussed above, we may be treated as a PFIC in future taxable years, in which case you would be subject to the excess distribution rules discussed above with respect to such future taxable years, unless a mark-to-market election, as discussed below, is made.

***Mark-to-Market Rules.*** If you own ADSs in a PFIC that are treated as marketable stock, you should generally be able to make a mark-to-market election. We believe that our ADSs are and will continue to be marketable stock as long as they continue to be traded on the NYSE, other than in *de minimis* quantities, on at least 15 days during each calendar quarter. If you make this election, you will not be subject to the PFIC rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your ADSs at the end of the taxable year over your adjusted basis in your ADSs. These amounts of ordinary income will not be eligible for the favorable tax rates applicable to qualified dividend income or long-term capital gains. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). Your basis in the ADSs will be adjusted to reflect any such income or loss amounts.

If you have made a timely mark-to-market election, you will not be required to include in income mark-to-market gain or loss for a year in which we are not treated as a PFIC. However, cessation of PFIC status does not terminate the mark-to-market election and such election will continue to apply in any future year in which we are again treated as a PFIC and you will be required to include mark-to-market gain or loss in income, as discussed above.





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