

NETWORK CN INC
Form 10-K
March 27, 2009

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

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

For the transition period from ____ to ____

Commission file number 000-30264

NETWORK CN INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

90-0370486
(I.R.S. Employer
Identification Number)

21/F., Chinachem Century Tower, 178 Gloucester Road, Wanchai, Hong Kong
(Address of principal executive offices)

(852) 2833-2186
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock, \$0.001 Par Value
(Title of Each Class)

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer <input type="radio"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="radio"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="radio"/>

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

As of June 30, 2008, the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, was approximately \$109 million.

As of March 25, 2009, 71,641,608 shares of the registrant's common stock, par value \$0.001 per share, were outstanding.

Documents Incorporated by Reference: None

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this annual report include “forward-looking statements” within the meaning of such term in Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements involve known and unknown risks, uncertainties and other factors which could cause actual financial or operating results, performances or achievements expressed or implied by such forward-looking statements not to occur or be realized. Forward-looking statements made in this Report generally are based on our best estimates of future results, performances or achievements, predicated upon current conditions and the most recent results of the companies involved and their respective industries. Forward-looking statements may be identified by the use of forward-looking terminology such as “may”, “will”, “could”, “should”, “project”, “expect”, “believe”, “estimate”, “anticipate”, “intend”, “contingent”, “opportunity” or similar terms, variations of those terms or the negative of those terms or other variations of those terms or comparable words or expressions. Potential risks and uncertainties include, among other things, such factors as:

- our potential inability to raise additional capital;
- changes in domestic and foreign laws, regulations and taxes;
- uncertainties related to China's legal system and economic, political and social events in China;
- Securities and Exchange Commission regulations which affect trading in the securities of “penny stocks;” and
- changes in economic conditions, including a general economic downturn or a downturn in the securities markets.

Additional disclosures regarding factors that could cause our results and performance to differ from results or performance anticipated by this annual report are discussed in Item 1A. “Risk Factors”. Readers are urged to carefully review and consider the various disclosures made by us in this annual report and our other filings with the Security and Exchange Commission (the “SEC”). These reports attempt to advise interested parties of the risks and factors that may affect our business, financial condition and results of operations and prospects. The forward-looking statements made in this annual report speak only as of the date hereof and we disclaim any obligation to provide updates, revisions or amendments to any forward-looking statements to reflect changes in our expectations or future events.

USE OF TERMS

Except as otherwise indicated by the context, references in this report to:

- “BVI” are references to the British Virgin Islands;
- “China” and “PRC” are to the People’s Republic of China;
- the “Company”, “NCN”, “we”, “us”, or “our”, are references to Network CN Inc., a Delaware corporation and its direct and indirect subsidiaries: NCN Group Limited, or NCN Group, a BVI limited company; NCN Huamin Management Consultancy (Beijing) Company Limited, or NCN Huamin, a PRC limited company; Cityhorizon Limited, or Cityhorizon Hong Kong, a Hong Kong limited company, and its wholly owned subsidiaries, Cityhorizon Limited, or Cityhorizon BVI, a BVI limited company; and Huizhong Lianhe Media Technology Co., Ltd., or Lianhe, a PRC limited company; and the Company’s variable interest entities: Shanghai Quo Advertising Company Limited, or Quo Advertising, a PRC limited company and its 51% owned subsidiary, Xuancai yi (Beijing) Advertising Company Limited, or Xuancai yi, a PRC limited company; and Beijing Huizhong Bona Media Advertising Co., Ltd., or Bona, a PRC limited company; and Huizhi Botong Media Advertising Beijing Co., Ltd., or Botong, a PRC limited company.

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- “NCN Landmark” are references to NCN Landmark International Hotel Group Limited, a British Virgin Islands limited company, and its wholly-owned subsidiary, Beijing NCN Landmark Hotel Management Limited, a PRC limited company;
- “NCN Management Services” are references to NCN Management Services Limited, a British Virgin Islands limited company;
- “RMB” are to the Renminbi, the legal currency of China;
- the “Securities Act” are to the Securities Act of 1933, as amended; and the “Exchange Act” are to the Securities Exchange Act of 1934, as amended;
- “Tianma”, are references to Guangdong Tianma International Travel Service Co., Ltd, a PRC limited company; and
- “U.S. dollar”, “\$” and “US\$” are to the legal currency of the United States.

PART I

ITEM 1. BUSINESS

Overview

Our mission is to become a nationwide leader in providing out-of-home advertising in China, primarily serving the needs of branded corporate customers. We seek to acquire rights to install and operate roadside advertising panels and mega-size advertising panels in the major cities in China. In most cases, we are responsible for installing advertising panels, although in some cases, advertising panels might have already been installed, and we will be responsible for operating and maintaining the panels. Once the advertising panels are put into operation, we sell advertising airtime to our customers directly. Since late 2006, we have been operating a growing advertising network of roadside LED digital video panels, mega-size LED digital video billboards and light boxes in major Chinese cities. LED (known as “Light Emitting Diode”) technology has evolved to become a new and popular form of advertising in China, capable of delivering crisp, super-bright images both indoors and outdoors.

Our total advertising revenues were \$4,622,270, \$1,442,552 and \$nil for the years ended December 31, 2008, 2007 and 2006 respectively. Our net loss was \$59,484,833, \$14,646,619, \$4,468,706 for the years ended December 31, 2008, 2007 and 2006 respectively. Results of operations during the year ended December 31, 2008 were negatively affected by a variety of factors including various administrative delays and restrictions of the Beijing Olympic Committee limiting advertisements during the Olympic period in Olympic-related panels to official Olympic sponsors only; non-Olympic sponsors with whom the Company had negotiated were forced to withdraw; and slowing demand due to the worldwide financial crisis and deteriorating economic conditions in China, leading many customers to cut their advertising budgets.

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Due to the unexpected unfavorable market conditions described above, our revenues and cash inflows were less than we expected. To address this issue, in the latter half of 2008, the Company has undergone drastic cost-cutting exercises including reduction of the Company's workforce, rentals, as well as selling and marketing expenses and other general and administrative expenses. The commercial viability of each of the Company's concession rights was re-assessed. Some commercially non-viable concession right contracts were terminated accordingly and management has successfully negotiated with certain authority parties of concession rights to reduce advertising operating right fees. We will continue to strictly control our operating costs in 2009. More resources will be allocated to those commercially viable projects and we will continue to explore prominent advertising-related projects.

History

We were incorporated under the laws of the State of Delaware on September 10, 1993 under the name EC Capital Limited. Our predecessor companies were involved in a variety of business and were operated by various management teams under different operating names. Between 2004 and 2006 we operated under the name Teda Travel Group Inc., which was primarily engaged in the provision of management services to hotels and resorts in China. On August 1, 2006, we changed our name to "Network CN Inc." in order to better reflect our new vision to build a nationwide information and entertainment network in China.

From early 2006 until 2008, we had two business divisions: our Media Business Division and a Non-Media Business Division. We initially focused on the Non-Media Business Division, which was mainly comprised of a travel network through which we provided agency tour services and hotel management services. In 2006, we acquired 55% of the equity interest in Tianma, a PRC company engaged in the provision of tour services to customers both inside and outside of the PRC. In 2006 and 2007, we earned substantially all of our revenues from these tour services. We also provided day-to-day management services to hotels and resorts in the PRC. During the latter half of 2006, we adjusted our primary focus away from the tourism and hotel management businesses to the building of a media network with the goal of becoming a nationwide leader in out-of-home, digital display advertising, roadside LED digital video panels and mega-size video billboards. In November 2006 we secured a media-related contract for installing and managing out-of-home LED advertising video panels. In 2007, we secured further rights to operate mega-size LED and roadside LED panels in prominent cities in the PRC through either entering business agreements with authorities parties or business combination, and began generating revenues from our Media Business.

Acquisition of Tianma

On June 16, 2006, to take advantage of China's booming travel market, we acquired, through NCN Management Services, 55% of the equity interests of Tianma, a travel agency headquartered in Guangdong Province in the PRC, for an aggregate purchase price of \$936,283, \$833,333 of which was in cash and \$102,950 of which was in 362,500 shares of our common stock. The results of operations of Tianma have been included in the Company's consolidated statement of operations since the completion of the acquisition on June 16, 2006.

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Tianma is an authorized inbound and outbound travel operator and provides travel agency services to customers for both inbound and outbound travel. It organizes independent inbound and outbound tour and travel packages for a variety of destinations within China and internationally. Tour packages may include air and land transportation, hotels, restaurants and tickets to tourist destinations and other excursions. Tianma books all elements of such packages with third-party service providers, such as airlines, car rental companies and hotels, or through other tour package providers and then resells such packages to its clients. As the Company does not foresee any major contribution from Tianma in the near future, the Company disposed of Tianma in September 2008. For details, please refer to the below Sub-section – Recent Development.

Acquisition of Quo Advertising

On January 31, 2007, we acquired 100% of the equity interests of Quo Advertising, an advertising agency headquartered in Shanghai, China, pursuant to a purchase and sale agreement and a trust agreement, dated January 24, 2007, between the Company and Lina Zhang and Qinxiu Zhang, PRC individuals. The Company acquired Quo Advertising for a purchase price of \$907,600, \$64,000 of which was in cash and the balance of which was in 300,000 shares of our common stock, valued at \$843,600. The results of operations of Quo Advertising have been included in the Company's consolidated statement of operations since the completion of the acquisition on January 31, 2007.

Quo Advertising was founded in 1996 in Shanghai, China and provided advertising design, production, public relations and event management services for domestic and international clients before our acquisition. The acquisition strengthens our media network in the PRC. Our media business was mainly run through Quo Advertising in 2007 and 2008.

Acquisition of Xuancai yi

Effective September 1, 2007, we acquired, through Quo Advertising, a 51% majority of the equity interests of Xuancai yi, an advertising agency located in Beijing, China, for a consideration of up to RMB 12,245,000 (approximately \$1,667,000) in cash, payable over time based on Xuancai yi's achievement of certain net profit targets. An initial payment of RMB2,500,000 (approximately \$330,000) was made in September 2007 and the balance of the payment was due as follows: (1) up to RMB 2,454,300 (approximately \$337,000) based on Xuancai yi's net profit for the four months ended December 31, 2007; (2) up to RMB 1,834,500 (approximately \$252,000) based on Xuancai yi's net profit for the first quarter of fiscal year 2008; (3) up to RMB 1,827,400 (approximately \$251,000) based on Xuancai yi's net profit for the second quarter of fiscal year 2008; (4) up to RMB1,819,100 (approximately \$250,000) based on Xuancai yi's net profit for the third quarter of fiscal year 2008; and (5) up to RMB1,809,700 (approximately \$248,000) based on Xuancai yi's net profit for the fourth quarter of fiscal year 2008. As Xuancai yi failed to achieve the net profit targets in each of the above periods, no further cash payment is expected to be made with respect to the above earn-out consideration. The results of operations of Xuancai yi have been included in the Company's consolidated statement of operations since the acquisition date on September 1, 2007.

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Xuancai yi was founded in 2007 and obtained the right to manage and operate a mega-size high resolution LED advertising billboard in a prominent location in China's capital city, Beijing. The billboard, covering more than 758 square meters, is located on the East Third Ring Road near the exit of the Airport Highway. As of December 31, 2008, a business agreement entered into between Xuancai yi and its media partner has expired and so Xuancai yi has maintained minimal operations.

Acquisition of Cityhorizon BVI

On January 1, 2008, we entered into a share purchase agreement with our wholly owned subsidiary Cityhorizon Hong Kong, to acquire 100% of the equity interest in Cityhorizon BVI and its wholly owned subsidiaries, Lianhe and Bona, from Cityhorizon BVI's sole shareholder, Liu Man Ling, for an aggregate purchase price of \$8,738,000, \$5,000,000 of which was in cash and the balance of which was in 1,500,000 shares of restricted common stock of par value of \$0.001 each, valued at \$3,738,000. The results of operations of Cityhorizon BVI, Lianhe and Bona have been included in the Company's consolidated statement of operations since the completion of the acquisition on January 1, 2008.

Cityhorizon BVI is an investment holding company and its subsidiaries Lianhe and Bona were both founded in 2006. Lianhe is principally engaged in the provision of technology and management consulting services and Bona is principally engaged in the provision of advertising services. The purpose of the acquisition was to further strengthen our Media Network in China. There has been no change in Lianhe's and Bona's businesses since the date of acquisition.

Consolidation of Variable Interest Entity - Botong

On January 1, 2008, the Company caused its subsidiary, Lianhe, to enter into a series of commercial agreements with Botong and its registered shareholders, pursuant to which Lianhe is obligated to provide exclusive technology and management consulting services to Botong in exchange for service fees amounting to substantially all of the net income of Botong. Each of the registered PRC shareholders of Botong also entered into equity pledge agreements and option agreements with Lianhe which cannot be amended or terminated except by written consent of all parties. Pursuant to these equity pledge agreements and option agreements, each shareholder pledged its equity interest in Botong for the performance of Botong's payment obligations under the exclusive technology and management consulting services agreements. In addition, the shareholders of Botong assigned to Lianhe all their voting rights as shareholders of Botong and Lianhe has the option to acquire the equity interests of Botong at a mutually agreed purchase price that will first be used to repay any loans payable to Lianhe or any affiliate of Lianhe by the registered Botong shareholders.

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In addition, as of January 1, 2008, Lianhe committed to extend loan totaling \$137,179 to the registered shareholders of Botong for the purpose of financing such shareholders' investment in Botong. Through the above contractual arrangements, Lianhe becomes the primary beneficiary of Botong which is a variable interest entity as defined under FIN 46 (Revised). The results of operations of Botong have been included in the Company's consolidated statement of operations since January 1, 2008.

Botong was founded in 2007 and obtained the right to manage and operate for a 6-year period, a mega-size high resolution LED advertising billboard located at Haoyou Emporium Wangujing in Beijing. There has been no change of its business since the date of acquisition.

Other Contractual Arrangements with the PRC Operating Companies

PRC regulations limit foreign ownership of companies that provide advertising services. Our advertising business was initially run through our trust arrangements with Quo Advertising which directly operated our advertising network projects.

In January 2008, after our acquisition of Cityhorizon BVI and its PRC subsidiaries Lianhe and Bona, we restructured our advertising business in order to strengthen our compliance with existing PRC regulation. Through Lianhe, we entered into an exclusive management consulting services agreement and an exclusive technology consulting services agreement with each of Quo Advertising and Bona. In addition, we entered into an equity pledge agreement and an option agreement with each of the registered PRC shareholders of Quo Advertising and Bona, pursuant to which these shareholders pledged 100% of their shares to Lianhe and granted Lianhe the option to acquire their shares at a mutually agreed purchase price which shall first be used to repay any loans payable to Lianhe or any affiliate of Lianhe by the registered PRC shareholders. These commercial arrangements enable us to exert effective control on these entities and their subsidiaries, and transfer their economic benefits to the Company for financial results consolidation pursuant to FIN 46(R).

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Corporate Structure

The following chart reflects our organization structure as of the date of this annual report:

Recent Developments

Disposal of Non-Media Business Division

In 2008, the Board of Directors of the Company resolved that it was in the best interests of the Company to focus on developing its media business and to explore ways of divesting its travel business. The Company entered into stock purchase agreements disclosed below, to dispose of its entire Non-Media Business Division.

On September 1, 2008, the Company completed the sale of all its interests in NCN Management Services to Zhanpeng Wang, or Wang, an individual for a consideration of HK\$1,350,000, or approximately \$173,000, in cash. Wang acquired NCN Management Services along with its subsidiaries, which include 100% interest in NCN Hotels Investment Limited, 100% interest in NCN Pacific Hotels Limited and a 55% interest (through trust) in Tianma. The Company reported a gain on the sale, net of income taxes and minority interests of \$61,570.

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On September 30, 2008, the Company completed the sale of its 99.9% interest in NCN Landmark to Ngar Yee Tsang, or Tsang, an individual, for a cash consideration of \$20,000. Tsang acquired NCN Landmark along with its subsidiary, 100% interest in Beijing NCN Landmark Hotel Management Limited, a PRC corporation. The Company reported a gain on the sale, net of income taxes and minority interests of \$4,515.

The Company treated the sales of NCN Management Services along with its subsidiaries and variable interest entity and NCN Landmark along with its subsidiary as a discontinuation of operations.

3% Convertible Promissory Notes and Warrants

On November 19, 2007, the Company and Quo Advertising, entered into a 3% note and warrant purchase agreement with affiliated investment funds of Och-Ziff Capital Management Group, or the Och-Ziff Investors, pursuant to which the we agreed to issue 3% Senior Secured Convertible Notes due June 30, 2011 in the aggregate principal amount of up to \$50,000,000 and warrants to acquire an aggregate amount of 34,285,715 shares of our common stock. The notes and warrants were issued in three tranches: (1) on November 19, 2007, notes in the aggregate principal amount of \$6,000,000, warrants exercisable for 2,400,000 shares at \$2.50 per share and warrants exercisable for 1,714,285 shares at \$3.50 per share were issued; (2) on November 28, 2007, notes in the aggregate principal amount of \$9,000,000, warrants exercisable for 3,600,000 shares at \$2.50 per share and warrants exercisable for 2,571,430 shares at \$3.50 per share were issued; and (3) on January 31, 2008, notes in the aggregate principal amount of \$35,000,000, warrants exercisable for 14,000,000 shares at \$2.50 per share and warrants exercisable for 10,000,000 shares at \$3.50 per share were issued. The notes bore interest at 3% per annum payable semi-annually in arrears and were convertible into shares of common stock at an initial conversion price of \$1.65 per share, subject to customary anti-dilution adjustments. In addition, the conversion price was subject to downward adjustment on an annual basis if we failed to meet certain annual earnings per share (“EPS”) targets described in the purchase agreement. The EPS targets for fiscal 2008, 2009 and 2010 are \$0.081, \$0.453, and \$0.699 respectively. The warrants were to expire on June 30, 2011 and granted the holders the right to acquire shares of common stock at \$2.50 and \$3.50 per share, subject to customary anti-dilution adjustments. The exercise price of the warrants was also subject to a downward adjustment whenever the conversion price of the notes was adjusted downward. In connection with our issuance of the 3% Senior Secured Convertible Notes, we also entered into a registration rights agreement with the Och-Ziff Investors, pursuant to which, as amended, we agreed to file at their request, a registration statement registering for resale any shares issued to the Och-Ziff Investors upon conversion of the notes or exercise of the warrants.

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On January 31, 2008, we issued \$35,000,000 in additional notes and amended and restated the terms of the \$15,000,000 in notes issued in the second tranche. Concurrent with the issuance of the third tranche, we loaned substantially all the proceeds from the notes to our BVI subsidiary, the NCN Group, which was evidenced by an intercompany note issued by NCN Group in favor of the Company, or the NCN Group Note. At the same time we also entered into a security agreement, pursuant to which we granted to the collateral agent for the benefit of the convertible note holders, a first-priority security interest in certain of our assets, including the NCN Group Note and 66% of the shares of the NCN Group. In addition, the NCN Group and certain of our indirect subsidiaries each granted us a security interest in certain of their assets to, among other things, secure the NCN Group Note and certain related obligations.

As of December 31, 2008, the Company failed to meet EPS target for fiscal 2008. The Och-Ziff Investors agreed the conversion price of the 3% Convertible Promissory Notes remained unchanged at \$1.65 and have not proposed any adjustment to the conversion price as of December 31, 2008. None of the conversion options and warrants associated with the above convertible promissory notes has been exercised.

Our Services

We install and operate roadside advertising panels in major cities throughout China. The following table summarizes by location the number of roadside advertising panels that the Company has the right to install and operate and the installation status:

Location	No. of Advertising Panels (1)	Panels Installed As of March 1, 2009 (3)	Panels Owned As of March 1, 2009	Expiration (2)
Changning District, Shanghai	120	41	41	2009
Qingdao	950	-	-	2024
Lujiazui Financial District, Shanghai	85	85	85	2009
Nanjing Road Pedestrian Street, Shanghai	52	52	52	2010
Wuhan	120	4	4	2015
Changsha	120	-	-	2010