ASIAINFO HOLDINGS INC
Form 10-Q
November 14, 2002

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002

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

FOR THE TRANSITION PERIOD FROM ---- TO ----

Commission File Number 001-15713

ASIAINFO HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	752506390
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4TH FLOOR, ZHONGDIAN INFORMATION TOWER
6 ZHONGGUANCUN SOUTH STREET, HAIDIAN DISTRICT
BEIJING 100086, CHINA
(Address of principal executive office, including zip code)

+8610 6250 1658
(Registrant's telephone number, including area code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [_]

The number of shares outstanding of the Registrant's common stock as of November 8, 2002 was 44,186,985

ASIAINFO HOLDINGS, INC.

FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2002

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In US Dollars thousands, except per share amounts)

	Thre S
	2001
Revenues:	

Network solutions	$ 86,
Software solutions	7,
Total revenues	94,
Cost of revenues:	
Network solutions	77,
Software solutions	
Total cost of revenues	78,
Gross profit	15,
Operating expenses:	
Sales and marketing (excluding stock-based compensation: 2001: $78; 2002: $31 and amortization of acquired intangible assets: 2001: nil; 2002: $238)	6,
General and administrative (excluding stock-based compensation: 2001: $104; 2002: $41 and amortization of acquired intangible assets: 2001: nil; 2002: $147)	3,
Research and development (excluding stock-based compensation: 2001: $34; 2002: $10 and amortization of acquired intangible assets: 2001: nil; 2002: $92)	1,
Amortization of deferred stock compensation	
Amortization of acquired intangible assets	
Total operating expenses	12,
Income from operations	3,
Other income (expense):	
Interest income	1,
Interest expense	(
Other (expenses) income, net	
Total other income (expense), net	1,
Income before income taxes, minority interests and equity in loss of affiliate	4,
Income tax expense	
Income before minority interests	3,
Minority interests in (income) loss of consolidated subsidiaries	(
Equity in loss of affiliate	(
Net income	$ 3,
Net income per share:	
Basic	$ 0
Diluted	$ 0
Shares used in computing per share amounts:	
Basic	41,757,
Diluted	45,159,

See notes to condensed consolidated financial statements.

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In US Dollars thousands, except per share amounts)

	N
	2001
Revenues:	
Network solutions	$ 130,00
Software solutions	21,35
Total revenues	151,36
Cost of revenues:	
Network solutions	108,62
Software solutions	2,56
Total cost of revenues	111,19
Gross profit	40,16
Operating expenses:	
Sales and marketing (excluding stock-based compensation: 2001: $305; 2002: $66 and amortization of acquired intangible assets: 2001: nil; 2002: $513)	17,76
General and administrative (excluding stock-based compensation: 2001: $488; 2002: $206 and amortization of acquired intangible assets: 2001: nil; 2002: $515)	10,69
Research and development (excluding stock-based compensation: 2001: $144; 2002: $60 and amortization of acquired intangible assets: 2001: nil; 2002: $244)	5,52
Amortization of deferred stock compensation	93
In-process research and development	
Amortization of acquired intangible assets	
Total operating expenses	34,92
Income from operations	5,24
Other income (expense):	
Interest income	6,22
Interest expense	(88
Other (expenses) income, net	(3
Total other income (expense), net	5,30
Income before income taxes, minority interests and equity in loss of affiliate	10,54
Income tax expense	2,26
Income before minority interests	8,28
Minority interests in (income) loss of consolidated subsidiaries	(23
Equity in loss of affiliate	(57

Net income	$ 7,47
Net income per share:	
Basic	$ 0.1
Diluted	$ 0.1
Shares used in computing per share amounts:	
Basic	41,343,38
Diluted	45,689,78

See notes to condensed consolidated financial statements.

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In US Dollars thousands, except per share amounts)

	December 31, 2001 (1)
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 110,635
Restricted cash	13,475
Short-term investments	27,184
Accounts receivable, trade (net of allowance for doubtful accounts of $1,094 and $1,961 at December 31, 2001 and September 30, 2002, respectively)	66,723
Inventories - hardware and parts	1,180
Other receivables	10,533
Deferred income taxes - current	1,689
Prepaid expenses and other current assets	1,417
Total current assets	232,836
Property and equipment - net	5,376
Goodwill	2,188
Other acquired intangibles - net	-
Investment in affiliate	5,272
Deferred income taxes	188
Total Assets	$ 245,860
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Short-term bank loans	$ 2,924
Accounts payable	23,789
Other payables	1,682
Deferred revenue	4,279

Accrued employee benefits	9,088
Accrued expenses	11,431
Income taxes payable	4,743
Other taxes payable	2,524
Total current liabilities	60,460
Deferred income taxes	-
Total Liabilities	60,460
Minority interest	610
Stockholders' Equity:	
Common stock, 100,000,000 shares authorized, $0.01 par value, shares issued and outstanding: 2001: 42,132,818; 2002: 44,152,307	421
Additional paid-in capital	178,649
Deferred stock compensation	(512)
Retained earnings	6,204
Accumulated other comprehensive income	28
Total stockholders' equity	184,790
Total Liabilities and Stockholders' Equity	$ 245,860

See notes to condensed consolidated financial statements.

(1) Derived from the audited balance sheet included in the annual report on Form 10-K of AsiaInfo Holdings, Inc., for the year ended December 31. 2001.

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ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In US Dollars thousands, except per share amounts)

	Nine Months September
	2001
	(unaudit
Cash flows from operating activities:	
Net income	$ 7,474
Adjustments to reconcile net income to net cash (used in) provided by operating activities:	
Depreciation	1,630
Amortization of goodwill	818
Amortization of other acquired intangible assets	-
In-process research and development	-
Amortization of deferred stock compensation	937
Deferred income taxes	(35)
Minority interest in income (loss) of consolidated subsidiaries	235
Equity in loss of an affiliate	576

Loss on disposal of property and equipment	159
Bad debt expense	643
Changes in operating assets and liabilities, net of effects of business acquired:	
Restricted cash	969
Accounts receivable	(26,005)
Inventories	7,626
Other receivables	(788)
Prepaid expenses and other current assets	(775)
Accounts payable	(12,201)
Other payables	(751)
Deferred revenue	(8,916)
Accrued employee benefits	(826)
Accrued expenses	4,276
Income taxes payable	1,717
Other taxes payable	(285)
Net cash (used in) provided by operating activities	(23,522)
Cash flows from investing activities:	
Decrease in short-term investments	87,990
Purchases of property and equipment	(1,278)
Proceeds from disposal of fixed assets	11
Increase in loan receivable	-
Investment in affiliate	(6,157)
Purchase of a subsidiary, net of cash acquired	-
Net cash provided by (used in) investing activities	80,566

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS--(CONTINUED)
(In US Dollars thousands, except per share amounts)

	Nine Months E September 3
	2001
	(unaudited
Cash flows from financing activities:	
Increase in short-term bank loans	$ 40,535
Repayment of short-term bank loans	(44,446)
Proceeds on exercise of stock options	2,621
Earning distribution of consolidated subsidiaries	-
Net cash used in financing activities	(1,290)
Net increase in cash and cash equivalents:	55,754
Cash and cash equivalents at beginning of period	48,834

Effect of exchange rate changes on cash and cash equivalents	10
Cash and cash equivalents at end of period	$ 104,598
Supplemental cash flow information:	
Cash paid during the period:	
Interest	$ 888
Income taxes	$ 580
Deferred stock compensation	$ 937

Non-cash investing activity:

In February 2002, the Company acquired 100% of the outstanding equity shares of Bonson for cash of $33,387, of which $624 represented acquisition costs, and the issuance of 1,031,686 shares of common stock with a fair market value at the time the acquisition was announced of approximately $18,003. Of the cash amount, $20,433 was paid on April 4, 2002. In connection with the acquisition, the Company acquired tangible assets with a fair value of $28,364 and assumed liabilities of $17,737.

See notes to condensed consolidated financial statements.

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three and Nine Months Ended September 30, 2001 and 2002
(In US dollars thousands, except per share amounts)

1. GENERAL AND BASIS OF PREPARATION

Interim Financial Information - The accompanying condensed consolidated financial statements of AsiaInfo Holdings, Inc. (the "Company"), and its wholly-owned subsidiaries as of September 30, 2002 and for the three- and nine-months ended September 30, 2001 and 2002 are unaudited. In the opinion of management, the condensed consolidated financial statements include all adjustments (consisting only of normal recurring accruals) that management considers necessary for a fair presentation of its financial position. Operating results and cash flows for interim periods are not necessarily indicative of results for the entire year.

This financial data should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001. This financial data should also be read in conjunction with the Company's critical accounting policies included in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

AsiaInfo Holdings, Inc. is incorporated in the State of Delaware, in the United States (the "US"). The Company principally operates through the following directly owned subsidiaries, or their respective subsidiaries: AsiaInfo Technologies (China), Inc. ("AsiaInfo Technologies") (100% owned), Guangdong Wangying Information Technology Co., Ltd. ("Wangying") (40% owned, but controlled by the Company), both incorporated in the People's Republic of China ("China" or the "PRC"), Marsec Holdings, Inc. ("Marsec") (79% owned), and Bonson Information Technology Holdings Limited, ("Bonson") (100% owned), both incorporated in the Cayman Islands.

On March 2, 2000, the Company completed an initial public offering of 5,750,000 shares of its common stock, raising net proceeds of $126,610. The Company's common stock is traded on The Nasdaq National Market in the United States.

The Company acts as a holding company and, through certain subsidiaries, sources network-related equipment in the United States for sale to customers in the PRC.

AsiaInfo Technologies was established as a wholly foreign owned enterprise with an initial operating term of 15 years commencing May 2, 1995 (date of establishment). Its principal activities are conducted in the PRC and comprise the provision of telecommunications-related information technology professional services and software products. In November 2001, the Company merged its wholly owned subsidiary, Zhejiang AsiaInfo Telecommunication Technology Co., Ltd. ("AI Zhejiang"), into AsiaInfo Technologies. AI Zhejiang's activities were performed in the PRC and comprised the development and sale of communication hardware and software as well as providing related technology services. AI Zhejiang was acquired in April 1999, and its results of operations are included in the Company's financial statements from the date of acquisition.

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

On December 31, 2001, AsiaInfo Technologies formed a wholly owned subsidiary, AsiaInfo Technologies (Chengdu), Inc., with an initial operating term of 15 years to provide hardware procurement support for network solution projects.

Wangying was established on September 6, 2000 with an initial operating term of 4 years for a particular customer project in the PRC. As of September 30, 2002, Wangying is being liquidated.

Marsec, through its wholly owned subsidiary, provides internet security consulting and services in the PRC. In September 2001, the Company exercised warrants to purchase 200,000 additional voting preferred shares of Marsec at $3.50 a share, increasing its investment in Marsec from 75% to 79%.

On April 27, 2001, the Company invested $6,157 to acquire a 14.25% interest (in the form of voting preferred shares) in Intrinsic Technology (Holdings), Ltd. ("Intrinsic"), a Cayman Islands company engaged in wireless infrastructure solutions development through two wholly-owned subsidiaries in the PRC.

In 2000, the Company dissolved its subsidiary AsiaInfo-CTC Network Systems Inc.

In February 2002, the Company acquired 100% of the outstanding equity shares of Bonson, a leading developer of wireless telecommunications software and solutions, operating through its subsidiary Guangzhou Bonson Technology Limited, based in Guangzhou, China, for $32,763 in cash and the issuance of 1,031,686 shares of the Company's common stock. (See Note 10).

The consolidated financial statements of the Company include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated. Investments in 50% or less owned affiliates over which the Company exercises significant influence, but not control, are accounted for using the equity method.

Revenue from network solutions contracts, which includes the procurement of hardware on behalf of customers, systems design, planning, consulting and system integration is recognized based on the percentage of completion method. Labor costs and direct project expenses are used to determine the stage of completion except for revenues associated with the procurement of hardware. Such hardware-related revenues are recognized upon delivery. Estimates of hardware warranty costs are included in determining project costs.

Software solutions revenues represent license fees and related services that allow customers to use the Company's software products in perpetuity up to a maximum number of users. Contract revenue from software license fees and software implementation services represent customer orders requiring significant production, modifications, or customization of the software. Contract revenue for software is recognized in conjunction with the revenues of the related solutions project over the installation and customization period based on the percentage of completion of the project as measured by labor costs and direct project expenses. The Company may also sell packaged software occasionally, and license fees from such software sales are recognized as revenue upon the

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

occurrence of the following events: an agreement is close to being entered into, the fee is determined, collection of the fee is reasonably assured, and the delivery to or acceptance by the customer of the software product has occurred. Costs related to insignificant obligations for a period up to one year, which include telephone support, are accrued at the time the revenue is recorded. Software revenues include the benefit of the rebate of value added taxes on sales of software received from the tax authorities as part of the PRC government's policy of encouragement of software development in the PRC. The rebate was approximately $759 and $550 for the three months ended September 30, 2001 and 2002, respectively, and $2,454 and $1,813 for the nine months ended September 30, 2001 and 2002, respectively.

Revisions in estimated contract profits are made in the period in which the circumstances requiring the revision become known. Provisions, if any, are made currently for anticipated losses on uncompleted contracts. Revenue in excess of billings is recorded as unbilled receivables and included in trade accounts receivable, and amounted to $45,910 at December 31, 2001 and $36,354 at September 30, 2002. Billings in excess of revenues recognized are recorded as deferred income. Billings are rendered based on agreed milestones included in the contracts with customers. At December 31, 2001 and September 30, 2002, the balance of trade accounts receivable of $20,813 and $26,279, respectively, represented amounts billed but not yet collected. All billed and unbilled amounts are expected to be collected within 1 year. The Company revisits its estimate on collectibility on a periodic basis. As a result, bad debt expenses were $162 and $568 for the three months ended September 30, 2001 and 2002, respectively. Bad debt expenses were $643 and $553 for the nine months ended September 30, 2001 and 2002, respectively.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at December 31, 2001 and September 30, 2002 and the reported amounts of revenues and expenses during the three and nine months ended September 30, 2001 and 2002. Actual results could differ from those estimates.

The financial records of the Company's PRC subsidiaries are maintained in Renminbi ("RMB"), their functional currency and the currency of the PRC. Their balance sheets are translated into United States dollars based on the rates of exchange ruling at the balance sheet date. Their statements of operations are translated using a weighted average rate for the period. Translation adjustments are reflected as cumulative translation adjustments in the statement of stockholders' equity.

The Renminbi is not fully convertible into United States dollars or other foreign currencies. The rate of exchange quoted by the People's Bank of China on September 30, 2002 was US$1.00=RMB8.2771. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate or at any other rate.

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. Effective January 1, 2002, the Company discontinued amortization of its existing goodwill, which arose from the acquisition of AI Zhejiang and the Company's investment in Intrinsic, and was being amortized over 5 years.

In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles such as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairment of certain intangible assets, including goodwill. The effects of adopting the non-amortization provisions of SFAS No. 142, assuming these provisions were adopted as of January 1, 2001, are summarized at Note 4. SFAS No. 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company has completed the transitional goodwill impairment test and concluded that no impairment of recorded goodwill was necessary as of January 1, 2002.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for the recognition of obligations associated with the retirement of tangible long-lived assets. SFAS No. 143 is effective for financial statements issued for years beginning after June 15, 2002. Management does not believe that the adoption of SFAS No. 143 will have a significant impact on its financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144

(In US dollars thousands, except per share amounts)

addresses the financial accounting and reporting requirements for the impairment or disposal of long-lived assets and discontinued operations. SFAS No. 144 applies to all recorded long-lived assets that are held for use or that will be disposed of, but excludes goodwill and other intangible assets that are not amortized. SFAS No. 144 was adopted by the Company on January 1, 2002. Adoption of SFAS No. 144 did not have a significant effect on the Company's financial position or results of operations.

In July 2002, the Financials Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 replaces the previous accounting guidance provided by the Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002 and the Company does not anticipate that the statement will have a material impact on the Company's financial statements or results of operations.

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, demand deposits and highly liquid investments, which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased.

3. SHORT-TERM INVESTMENTS

Short-term investments are classified as available for sale and consist principally of certificates of deposit issued by major financial institutions, and have maturities of between 6 and 12 months. As there are no significant market price movements for such investments, they are held at cost and accrued interest. There were no realized or unrealized gains or losses as of September 30, 2002.

4. GOODWILL - ADOPTION OF STATEMENT 142

The following table summarizes the effect of adopting the non-amortization provisions of SFAS No. 142, assuming these provisions were adopted as of January 1, 2001.

	Three Months Ended September 3	
	2001	2002

Reported net income	$3,519	$468
Add back: Goodwill amortization	290	-
Adjusted net income	$3,809	$468
Basic earnings per share:		
Reported net income	$ 0.08	$0.01
Goodwill amortization	0.01	-
Adjusted net income	$ 0.09	$0.01
Diluted earnings per share:		
Reported net income	$ 0.08	$0.01
Goodwill amortization	$ 0.01	-
Adjusted net income	$ 0.09	$0.01

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three and Nine Months Ended September 30, 2001 and 2002
(In US dollars thousands, except per share amounts)

4. GOODWILL - ADOPTION OF STATEMENT 142 - CONTINUED

	Nine Months Ended S	
	2001	
Reported net income	$7,474	
Add back: Goodwill amortization	818	
Adjusted net income	$8,292	
Basic earnings per share:		
Reported net income	$ 0.18	
Goodwill amortization	0.02	
Adjusted net income	$ 0.20	
Diluted earnings per share:		
Reported net income	$ 0.16	
Goodwill amortization	0.02	
Adjusted net income	$ 0.18	

(In US dollars thousands, except per share amounts)

5. COMPREHENSIVE INCOME

The components of comprehensive income for the periods presented are as follows:

	Three Months Ended Se
	2001
Net income	$3,519
Change in cumulative translation adjustment	2
Comprehensive income	$3,521

	Nine Months Ended Se
	2001
Net income	$7,474
Change in cumulative translation adjustment	10
Comprehensive income	$7,484

6. SHORT-TERM BANK LOANS

As of September 30, 2002, the Company had total short-term credit facilities for working capital purposes totaling $23,000 ($3,000 expiring in October 2002 and $20,000 expiring in October 2003). The facilities were secured by bank deposits of $10,900 as of December 31, 2001 and $10,000 as of September 30, 2002. At September 30, 2002, unused short-term credit facilities were $21,701 and used facilities totaled $1,299. The used facilities are pledged for issuing letters of credit to hardware suppliers and customers. In addition, as of September 30, 2002, the Company had short-term borrowings of $72 in RMB, the currency of the PRC, secured by Bonson's assets.

6. SHORT-TERM BANK LOANS - CONTINUED

The RMB loan bears interest at a rate of 4.8% per annum and are repayable upon demand by the lending bank. Additional bank deposits of $4,458 were used for issuing standby letters of credit and guarantees as of September 30, 2002. Bank deposits pledged as security for these credit facilities totaled $13,475 and $14,458 as of December 31, 2001 and September 30, 2002, respectively, and are presented as restricted cash in the condensed consolidated balance sheets.

7. INCOME TAXES

(In US dollars thousands, except per share amounts)

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

A reconciliation between the provision for income taxes computed by applying the US federal tax rate to income before income taxes, minority interest and equity in loss of affiliate and the actual provision for income taxes is as follows:

	Three Months Ended September 30,	
	2001	2002
US federal rate	35%	3
Difference between statutory rate and foreign effective tax rate	(21)	(2
Expenses not deductible for tax purpose -- deferred stock compensation expense	6	
Other	-	(
	20%	1

	Nine Months Ended September 30,	
	2001	2002
US federal rate	35%	3
Difference between statutory rate and foreign effective tax rate	(20)	(2
Expenses not deductible for tax purpose -- deferred stock compensation expense	6	
Other	-	(
	21%	1

Change in valuation allowance represented a reduction of valuation allowance of approximately $180 that was recorded to reduce the deferred tax assets arising from the tax loss carry forward which was approved by the PRC taxing authority during the second quarter of 2002.

8. CAPITAL STOCK

Option activity in the Company's stock option plans is summarized as follows:

	Number of shares	Outstanding options weighted average exercise price per share
Outstanding, January 1, 2002:	8,309,168	$ 9.40
Granted	24,600	14.56
Cancelled	(255,740)	11.58
Exercised	(172,563)	4.26
Outstanding, March 31, 2002	7,905,465	$ 9.46
Granted	51,000	11.89
Cancelled	(230,790)	14.21
Exercised	(666,340)	2.56
Outstanding, June 30, 2002	7,059,335	$ 9.97
Granted	3,171,317	4.03
Cancelled	(164,690)	12.56
Exercised	(148,900)	1.25
Outstanding, September 30, 2002	9,917,062	$ 8.16

The exercise price of all options granted during the three months and the nine months ended September 30, 2002 was equal to the fair market value of the Company's common stock on the dates of grant.

9. NET INCOME PER SHARE

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

	Three Months End September 30,	
	2001	2
Net income (numerator):		
Net income used in computing basic and diluted net income per share	$ 3,519	$
Shares (denominator):		
Weighted average Common Stock Outstanding	41,757,250	44
Shares used in computing basic net income per share	41,757,250	44
Dilutive effect of stock options outstanding using the treasury stock method	3,402,006	
Shares used in computing net income per share	45,159,256	44
Net income per share:		
Basic	$ 0.08	$
Diluted	$ 0.08	$

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three and Nine Months Ended September 30, 2001 and 2002
(In US dollars thousands, except per share amounts)

9. NET INCOME PER SHARE - CONTINUED

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2002
Net income (numerator):		
Net income used in computing basic and diluted net income per share	$ 7,474	$ 5,50
Shares (denominator):		
Weighted average Common Stock Outstanding	41,343,389	43,387,64
Shares used in computing basic net income per share	41,343,389	43,387,64
Dilutive effect of stock options outstanding using the treasury stock method	4,346,396	2,377,69
Shares used in computing net income per share	45,689,785	45,765,34
Net income per share:		
Basic	$ 0.18	$ 0.1
Diluted	$ 0.16	$ 0.1

As of September 30, 2001 and 2002, the Company had 2,434,520 and 8,100,297 options outstanding, respectively, which could have potentially diluted earnings per share ("EPS") in the future, but which were excluded in the computation of diluted EPS in these periods, as their exercise prices were above the average market values in such periods.

10. ACQUISITION

On February 6, 2002, the Company completed the acquisition of Bonson. The acquisition was accounted for as a purchase in accordance with SFAS No. 141, "Business Combinations." Under the terms of the share purchase agreement, the Company acquired all outstanding capital stock of Bonson for $32,763 in cash and 1,031,686 shares of the Company's common stock. The total purchase price as of February 6, 2002 had been allocated to the assets acquired and liabilities assumed based on their respective fair values as follows, (in thousands):

Total purchase price:	
Cash consideration	$32,763
Common stock	18,003
Acquisition expenses	624
	$51,390

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ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three and Nine Months Ended September 30, 2001 and 2002
(In US dollars thousands, except per share amounts)

10. ACQUISITION - CONTINUED

Purchase Price Allocation:

Fair market value of net tangible assets acquired at February 6, 2002	$10,627	
Intangible assets acquired:		Economic Life
Core technology	1,280	3.5 years
Trade name	700	Indefinite
Contract backlog	2,700	2 years
Favorable lease	400	2.1 years
License	700	Indefinite
In-process technology	350	
Goodwill	35,067	Indefinite
Deferred tax liabilities	(434)	
	$51,390	

The Company recorded a one-time charge of $350 in the first quarter of 2002 for purchased in-process technology related to a development project that had not reached technological feasibility, had no alternative future use, and for which successful development was uncertain. The conclusion that the in-process development effort, or any material sub-component, had no alternative future use was reached in consultation with the Company's and Bonson's management.

The following selected unaudited pro forma combined results of operations for the three months and nine months ended September 30, 2001 and 2002 of the Company and Bonson have been prepared assuming that the acquisitions occurred at the beginning of the periods presented. The following pro forma financial information is not necessarily indicative of the results that would have occurred had the acquisition been completed at the beginning of the periods indicated nor is it indicative of future operating results:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2002	2001	2002
Total revenue	$ 98,615	$ 32,571	$ 168,939	$ 98,198
Net income	3,766	468	7,549	5,184
Net income per share				
- Basic	$ 0.09	$ 0.01	$ 0.18	$ 0.12
- Diluted	$ 0.08	$ 0.01	$ 0.16	$ 0.11
Shares used in calculation of net income per share				
- Basic	42,788,936	44,081,170	42,375,075	43,669,661
- Diluted	46,190,942	44,835,907	46,721,471	46,047,359

The pro forma results of operations give effect to certain adjustments, including amortization of purchased intangibles with definite lives, associated with the acquisition. The charge for purchased in-process research and development of $350 has been excluded from the pro forma results, as it is a material non-recurring charge.

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
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(In US dollars thousands, except per share amounts)

11. SEGMENT INFORMATION

Information on the Company's operating segments is as follows:

	Three Months Ended September 3 (unaudited)			
	2001/1/	2002		
		Strategic Business Units and P		
		Communications Solutions	Operation Support System Solutions	N S So (
Revenues net of hardware cost:				
Network solutions net of hardware cost	$12,437	$ 4,299	$ 1,007	$
Software	7,708	1,651	7,422	
Consolidated revenues net of hardware cost	20,145	5,950	8,429	
Consolidated cost of sales net of hardware cost	4,605	2,076	3,896	
Consolidated gross profit	$15,540	$ 3,874	$ 4,533	$
Gross profit:				
Network solutions	$ 8,674	$ 2,581	$ 804	$
Software	6,866	1,293	3,729	
Consolidated gross profit	$15,540	$ 3,874	$ 4,533	$
Depreciation and amortization:				
Network solutions	$ 506	$ 225	$ 53	$
Software	313	87	389	
	$ 819	$ 312	$ 442	$

Amortization of deferred stock compensation:

Network solutions	$ 106	$ 29	$ 5	$
Software	110	11	37	
	$ 216	$ 40	$ 42	$
Amortization of acquired intangible assets:				
Network solutions	$ -	$ -	$ 57	$
Software	-	-	420	
	$ -	$ -	$ 477	$
Income from operations:				
Network solutions	$ 2,446	$ (98)	$ 278	$
Software	1,061	264	(153)	
Consolidated income from operations	$ 3,507	$ 166	$ 125	$

ASIAINFO HOLDINGS, INC.
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11. SEGMENT INFORMATION - CONTINUED

	Nine Months Ended September 3 (unaudited)			
	2001/1/	2002		
		Strategic Business Units and P		
		Communications Solutions	Operation Support System Solutions	N S So (
Revenues net of hardware cost:				
Network solutions net of hardware cost	$30,021	$ 20,145	$ 5,354	
Software	21,357	3,676	20,985	
Consolidated revenues net of hardware cost	51,378	23,821	26,339	
Consolidated cost of sales net of hardware cost	11,210	9,161	8,727	
Consolidated gross profit	$40,168	$ 14,660	$ 17,612	
Gross profit:				
Network solutions	$21,376	$ 12,377	$ 4,240	
Software	18,792	2,283	13,372	

Consolidated gross profit	$40,168	$ 14,660	$ 17,612
Depreciation and amortization:			
Network solutions	$ 1,431	$ 858	$ 228
Software	1,017	156	893
	$ 2,448	$ 1,014	$ 1,121
Amortization of deferred stock compensation:			
Network solutions	$ 464	$ 151	$ 31
Software	473	28	122
	$ 937	$ 179	$ 153
Amortization of acquired intangible assets:			
Network solutions	$ -	$ -	$ 259
Software	-	-	1,013
	$ -	$ -	$ 1,272
Income from operations:			
Network solutions	$ 4,196	$ 2,029	$ 1,265
Software	1,048	394	1,714
Consolidated income from operations	$ 5,244	$ 2,423	$ 2,979

/1/ No strategic business unit and product offering information available for 2001.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three and Nine Months Ended September 30, 2001 and 2002
(In US dollars thousands, except per share amounts)

12. COMMITMENTS AND CONTINGENCIES

On December 4, 2001, a securities class action suit was filed in the United States against the Company, certain of the Company's directors and the co-lead underwriters involved in the Company's Initial Public Offering (the "IPO") on behalf of all persons and entities who purchased, converted, exchanged or otherwise acquired the common stock of the Company between March 2, 2000 and December 6, 2000, inclusive. The complaint alleges that the Company and certain of its officers and directors at the time of the IPO violated the federal securities laws by issuing and selling the Company's common stock pursuant to the IPO without disclosing to investors that several of the underwriters of the IPO had solicited and received excessive and undisclosed commissions from certain investors. The plaintiffs seek class action certification and claim for an unspecified amount of damages. While the outcome of this litigation is uncertain, management believes that the Company has meritorious defenses to the suit and intends to vigorously defend the action. In addition, management believes that the co-lead underwriters may have an obligation to indemnify the Company for the legal fees and other costs of defending this suit and that the

Company's directors' and officers' liability insurance policies may also cover the defense and exposure or settlement of the suit. On October 9, 2002, the United States District Court for the Southern District of New York dismissed without prejudice all claims against the individual defendants in the litigation (Louis Lau, Chairman of the Board, James Ding, President and Chief Executive Officer and Ying Han, Chief Financial Officer). The dismissals were based on stipulations signed by those defendants and the plaintiffs' representatives. The case remains pending against the Company.

13. RELATED PARTY TRANSACTION

On May 16, 2002, China Merchants Bank, Beijing Branch ("Merchants Bank") entered into an agreement to provide a revolving credit facility to China Netcom Corporation Ltd. ("China Netcom") of up to approximately $9,061 in connection with China Netcom's past and future purchases of telecommunications network infrastructure software and solutions from AsiaInfo Technologies. China Netcom may draw on the facility to fund amounts that will become payable to AsiaInfo Technologies under bankers' acceptances. AsiaInfo Technologies has guaranteed China Netcom's obligations to Merchants Bank under the facility. The facility will expire on May 16, 2003. Edward Tian, a director and major shareholder of the Company, is the Chief Executive Officer of China Netcom, as well as a Vice President of China Netcom's parent company, China Netcom Communication Group Corporation.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information, the statements contained in this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 (the "Reform Act") contains certain safe harbors regarding forward-looking statements. Certain of the forward-looking statements include management's expectations, intentions and beliefs with respect to our growth, our operating results, the nature of the industry in which we are engaged, our business strategies and plans for future operations, our needs for capital expenditures, capital resources and liquidity; and similar expressions concerning matters that are not historical facts. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. These cautionary statements are being made pursuant to the provisions of the Reform Act with the intention of obtaining the benefits of the safe harbor provisions of the Reform Act. Among the factors that could cause actual results to differ materially are the factors discussed below under the heading "Factors Affecting our Operating Results and our Common Stock."

OVERVIEW

We are a leading provider of telecommunications software solutions in China. Our software products and network services enable our customers to build, maintain, operate, manage and continuously improve their Internet and telecommunications infrastructure.

We commenced our operations in Texas in 1993 and moved our operations from Texas to China in 1995. We began generating significant network solutions revenues in 1996 and significant software solutions revenues in 1998. We conduct the bulk of our business through our wholly-owned operating subsidiaries, AsiaInfo Technologies (China) Inc., or AsiaInfo Technologies, and Guangzhou Bonson Technology Limited, or Guangzhou Bonson, which are both Chinese companies.

We believe that there are opportunities for us to expand into new business areas and to grow our business both organically and through acquisitions. On February 6, 2002, we completed our acquisition of Bonson Information Technology Holdings Limited, or Bonson, a leading provider of operation support system solutions to wireless telecommunications carriers in China through its operating subsidiary, Guangzhou Bonson. The consideration paid to the former shareholders of Bonson consisted of $32.76 million in cash and 1,031,686 shares of our common stock which were valued at approximately $18 million at the time the acquisition was announced. The cash we paid in connection with the acquisition was paid out of our existing cash reserves. Bonson's operating results have been consolidated with our operating results from February 6, 2002. In view of the Bonson acquisition and potential future acquisitions we may engage in, our historical operating results may not be an adequate basis on which to evaluate our prospects.

We had invested a total of $2.7 million in our majority-owned network security business, Marsec System Inc., or Marsec, which focuses on high-end security

services for our customers. Marsec's operating results are consolidated with our operating results, with a provision for minority interest.

On April 27, 2001, we invested approximately $6.2 million to acquire a 14.25% equity interest in Intrinsic Technology (Holdings), Ltd., or Intrinsic, a company organized in the Cayman Islands and engaged in wireless Internet application and development through its two wholly-owned subsidiaries in China. We account for our interest in Intrinsic using the equity method.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to revenues and cost of revenues under customer contracts, warranty obligations, bad debts, income taxes, investment in affiliate, goodwill and other intangible assets, and litigation. We base our estimates and judgments on historical experience and on various other factors that we believe are reasonable. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

REVENUES AND COST OF REVENUES. We derive a significant portion of our revenue from fixed-price contracts using the percentage of completion method, which relies on estimates of total expected contract revenue and costs. We follow this method since reasonably dependable estimates of the revenue and costs applicable to various stages of a contract can be made. Recognized revenues and profit are subject to revisions as the contract progresses to completion. Accordingly, changes in our estimates would impact our future operating results.

WARRANTY OBLIGATIONS. We record our estimate of warranty costs at the time of final project acceptance, when all hardware pass-through revenue has been recognized. Revisions for estimated warranties may be required in the period in which actual warranties are known, thereby impacting our future operating results.

BAD DEBTS. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to change, changes to these allowances may be required, which would impact our future operating results.

INCOME TAXES. We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. In the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of their recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination is made.

INVESTMENT IN AFFILIATE. We account for our 14.25% interest in Intrinsic using the equity method. Intrinsic has incurred operating losses since our investment in April 2001. Sustained operating losses of this affiliate or other adverse events could result in our inability to recover the carrying value of the investment, which may require us to record an impairment charge in the future. Through September 30, 2002, we have not recorded an impairment charge for this investment. In accordance with applicable accounting principles, we will conduct an asset impairment test in the fourth quarter of 2002 in connection with our private equity investments. This will include our 14% interest in Intrinsic which is recorded on our balance sheet as an "investment in affiliate" of $4.9 million as of the end of the third quarter. We will report our findings at the fourth quarter earnings announcement.

GOODWILL AND OTHER INTANGIBLE ASSETS. We make assumptions regarding estimated future cash flows and other factors to determine the fair value of goodwill and other intangible assets. If these estimates or their related assumptions change in the future, we may be required to record an impairment charge if the estimated fair value of goodwill and other intangible assets is less than its recorded amount. As required under Statement of Financial Accounting Standards No. 142, we have completed a transitional goodwill impairment test and have concluded that no impairment of recorded goodwill was necessary as of January 1, 2002.

LITIGATION. We record contingent liabilities relating to litigation or other loss contingencies when we believe that the likelihood of loss is probable and the amount of the loss can reasonably be estimated. Changes in judgments of outcome and estimated losses are recorded, as necessary, in the period such changes are determined or become known. Any changes in estimates would impact our future operating results. Significant contingent liabilities, which we believe are at least possible, are disclosed in the notes to our consolidated financial statements.

REVENUES

Currently, our operations are organized into two strategic business units: communications solutions and operation support system solutions. Communications solutions and operation support system solutions comprise two of our core solutions offerings. We also offer our customers service application solutions (through our communications solutions business unit) and network security solutions (through our majority-owned subsidiary, Marsec). In deciding how to allocate our company's resources and assess performance, we frequently evaluate the separate operating results of our two strategic business units and Marsec. However, we also rely extensively in this process on our evaluation of the two primary types of revenue derived from our business: network solutions revenue and software solutions revenue (each described in greater detail below). Although both of our strategic business units generate network solutions revenue and software solutions revenue, the communications solutions business unit generates a majority of our total network solutions revenues, while the operation support system solutions business unit generates a majority of our total software solutions revenue. The following table illustrates our revenue breakdown both in terms of our strategic business units (communications solutions, operation support system solutions and network security solutions), and in terms of our two principal types of revenue (network solutions and software solutions):

	THREE MONTHS ENDED SEPTEMBER 30, 2002			
	STRATEGIC BUSINESS UNITS AND PRODUCT OFFERINGS			
BUSINESS LINE	Communications Solutions	Operation Support System Solutions	Network Security Solutions (Marsec)	Total
Network solutions net of hardware costs	$4,299,234	$1,006,812	$308,050	$ 5,614
Software solutions	1,650,662	7,422,659	-	9,073
Total revenues net of hardware costs	$5,949,896	$8,429,471	$308,050	$14,687

Although we account for our network solutions revenues on a gross basis, inclusive of hardware acquisition costs that are passed through to our customers, we manage our business internally based on revenues net of hardware costs, which is consistent with our strategy of providing our customers with high value IT professional services while gradually outsourcing lower-end services such as hardware acquisition and installation. This strategy may result in lower growth rates for total revenues as against prior periods, but will not adversely impact revenues net of hardware costs. The following table shows our revenue breakdown on this basis:

	NINE MONTHS ENDED SEPTEMBER 30,	YEAR END DECEMBER

	2002	2001	2001	2000	1999
Network solutions net of hardware costs	52%	58%	61%	61%	74
Software solutions	48%	42%	39%	39%	26
Total revenues net of hardware costs	100%	100%	100%	100%	100

As demonstrated by the foregoing table, software solutions revenue has accounted for an increasing portion of our total revenue net of hardware costs over the past several years, increasing from 7% in 1997 to 39% in 2001 and 48% for the first three quarters of 2002. We anticipate that software solutions revenue will account for approximately 40% to 42% of our total net revenues for 2002.

REVENUE BACKLOG. Most of our revenues are derived from customers' orders under separate binding contracts for hardware, network services, and software products and services. These contracts constitute our backlog at any given time. Revenues for hardware, network solutions and software solutions are recognized during the course of the relevant project, as described in more detail below. At September 30, 2002, our revenue backlog net of hardware

costs was $41.3 million, a 12% decrease compared to backlog one year ago. The decrease in total net revenue backlog was primarily due to the prolonged delays in the restructuring of certain state-controlled telecommunications companies in China, including China Telecommunications Corporation, or China Telecom, causing the carriers to delay their orders longer than previously expected. Software solutions backlog was $19.0 million, or 46% of net revenue backlog, a 13% increase over the period a year ago. Orders under contracts generated by Bonson accounted for 23% of the total backlog net of hardware costs and 34% of software solutions backlog. The software services component of net revenue backlog increased by 61% year-over-year while the hardware margin (derived from our hardware sales to customers as part of our services) component decreased 37% over the same period. We believe that these changes illustrate our successful transition from a pure systems integration company to a provider of total software solutions to China's telecommunications service providers.

NETWORK SOLUTIONS REVENUE. Network solutions revenue consists of hardware sales for equipment procured by us on behalf of our customers from hardware vendors, as well as services for planning, design, systems integration and training. We procure for and sell hardware to our customers as part of our total solutions strategy. We minimize our exposure to hardware risks by sourcing equipment from hardware vendors against letters of credit from our customers. We believe that as the telecommunications-related market in China develops our customers will increasingly purchase hardware directly from hardware vendors and hire us for our professional services.

We generally charge a fixed price for network solutions projects and recognize revenue based on the percentage of completion of the project. We use labor costs and direct project expenses to determine the stage of completion, except for revenue associated with the procurement of hardware on behalf of the customer. We recognize such hardware-related revenues upon delivery. Since a large part of the cost of a network solutions project often relates to hardware, the timing of hardware delivery can cause our quarterly gross revenue to fluctuate significantly. However, these fluctuations do not significantly affect our gross profit because hardware-related revenues generally approximate the costs of the hardware.

Network solutions projects generally have a life of nine to twelve months, during which there are three key milestones. The first milestone occurs when the hardware is delivered, which is usually between three and four months after signing the contract. The second milestone in a network solutions project is at primary acceptance, which usually occurs around three to four months after hardware delivery. At primary acceptance, all services and products are delivered. The third milestone is final acceptance, which occurs when the customer agrees that we have satisfactorily completed all of our work on the project.

SOFTWARE SOLUTIONS REVENUE. Software solutions revenues include two types of revenues: software license revenue and software services revenue. Software license revenue consists of fees received from customers for licenses to use our software products in perpetuity, typically up to a specified maximum number of users. In most cases, our customers must purchase additional user licenses from us when the number of users exceeds the specified maximum. Our software license revenue also includes the benefit of value added tax rebates on software license sales, which are part of the Chinese government's policy of encouraging China's software industry. Software services revenue consists of revenue from software installation, customization, training and other services. To date, substantially all of our revenue from both software

licenses and software services has been derived from customer orders for projects requiring some modifications or customization of our software. We recognize substantially all software revenue over the installation and customization periods, based on the percentage of completion of the related project as measured by labor costs and direct project expenses.

UNBILLED REVENUE. The foregoing network solutions and software solutions revenue recognition policies result in our recognizing certain revenues even though we are not due to receive the corresponding cash payment under the relevant contract. In the case of hardware sales, the customer typically holds back around 10 to 20% of the hardware contract payments at the time of delivery until final project acceptance. Although we record all hardware revenue at the time of delivery, the 10 to 20% held back by the customer is recorded as unbilled receivables and does not become billable until final project acceptance.

In the case of services, most of the revenue becomes billable at the time of primary acceptance, but the customer typically holds back around 10 to 20% of the services and software contract payments until final acceptance. Unpaid amounts for services, as well as for hardware, become payable at the time of final project acceptance. When we recognize revenue for which payments are not yet due, we book unbilled accounts receivable until the corresponding amounts become billable.

COST OF REVENUES

NETWORK SOLUTIONS COSTS. Network solutions costs consist primarily of third party hardware costs, compensation and travel expenses for the professionals involved in designing and implementing projects, and hardware warranty costs. We recognize hardware costs in full upon delivery of the hardware to our customers. In order to minimize our working capital requirements, we generally obtain from our hardware vendors payment terms that are timed to permit us to receive payment from our customers for the hardware before our payments to hardware vendors are due. However, in large projects we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements. We accrue hardware warranty costs when hardware revenue is fully recognized upon final acceptance. We obtain manufacturers' warranties for hardware we sell, which cover a portion of the warranties that we give to our customers. We currently accrue 0.5% of hardware sales to cover potential warranty expenses. This estimate of warranty cost is based on our current experience with contracts for which the warranty period has expired.

SOFTWARE SOLUTIONS COSTS. Software solutions costs consist primarily of three components:

- packaging and written manual expenses for our proprietary software products;
- compensation and travel expenses for the professionals involved in modifying, customizing or installing our software products and in providing consultation, training and support services; and
- software license fees paid to third-party software providers for the right to sublicense their products to our customers as part of our solutions offerings.

The costs associated with creating and enhancing our proprietary software are classified as research and development expenses as incurred.

OPERATING EXPENSES

Operating expenses are comprised of sales and marketing expenses, research and development expenses, general and administrative expenses, and amortization expenses for intangible assets and deferred stock compensation.

Operating expenses consist primarily of compensation expenses. Recently, in an effort to scale our business to accommodate lower market demand, we have reduced these costs through a 10% headcount reduction and a 10% salary cut for employees at the manager level and above.

Research and development expenses relate almost entirely to the development of new software and the enhancement and upgrading of existing software. We expense these costs as they are incurred.

We provide most of our officers, employees and directors, with stock options. In the past, we granted a number of options with exercise prices below the fair market value of the related shares at the time of grant, resulting in our incurring deferred compensation expenses. Most of the options granted with exercise prices below fair market value on the date of grant were issued prior to 1997. We do not, however, intend to issue options below fair market value in the future. Therefore, our deferred compensation expenses have been significantly higher historically than we expect them to be in future years. The difference between the exercise price and the fair market value of the related shares is amortized over the vesting period of the options and reflected on our income statement as amortization of deferred stock compensation. For further information, please see note 15 to our consolidated financial statements for the year ended December 31, 2001, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission on March 22, 2002.

We make bad debt provisions for accounts receivable balances based on management's assessment of their recoverability. In any event, we make bad debt provisions for all accounts receivable balances that are aged over one year. We include those bad debt provisions in general and administrative expenses.

TAXES

Except for certain of our hardware procurement and resale transactions, we conduct substantially all of our business through our Chinese operating subsidiaries. Our Chinese subsidiaries are generally subject to a 30% state corporate income tax and a 3% local income tax. AsiaInfo Technologies, our principal operating subsidiary, is classified as a "foreign invested enterprise" and as a "high technology" company for purposes of Chinese tax law and, as such, is entitled to preferential tax treatment in China. AsiaInfo Technologies operated free of Chinese state corporate income tax for three years, beginning with its first year of operation, and was entitled to a 50% tax reduction for the subsequent three years. The tax holiday for AsiaInfo Technologies expired on December 31, 1997 and the 50% tax reduction expired on December 31, 2000. However, AsiaInfo Technologies received a continuation of its preferential tax treatment from the local tax authorities in China for an additional three years, expiring at the end of 2003, which reduces our effective income tax rate to not less than 10%. In 2002, we anticipate that the effective corporate income tax rate applicable to AsiaInfo Technologies will be 10%.

AsiaInfo Technologies (Chengdu), Inc., or AsiaInfo Chengdu, our subsidiary which sources hardware in China for our customers, is classified as a "foreign invested enterprise" in China. AsiaInfo Chengdu operates free of Chinese state and local corporate income tax for two years beginning from its first year of operation, and is entitled to a 50% tax reduction for the subsequent three years. As such, the tax holiday for AsiaInfo Chengdu will expire on December 31, 2003 and the 50% tax reduction will expire on December 31, 2006.

Guangzhou Bonson is classified as a "foreign invested enterprise" and as a "high technology" company for purposes of Chinese tax laws. Guangzhou Bonson operated free of Chinese state and local corporate income tax for two years, beginning with its first year of operation, and is entitled to a 50% tax reduction for the subsequent three years. The tax holiday for Guangzhou Bonson expired on December 31, 2001 and the 50% tax reduction will expire on December 31, 2004. In 2002, the current corporate income tax rate for Guangzhou Bonson is 7.5%.

Sales of hardware procured in China are primarily made through AsiaInfo Chengdu and are subject to a 17% value added tax. Most of our sales of hardware procured outside China are made through our Hong Kong subsidiary, AsiaInfo H.K. Limited, or AsiaInfo H.K., and thus are not subject to the value added tax. We effectively pass value-added taxes on hardware sales through to our customers and do not include them in revenues reported in our financial statements. Sales of software in China are subject to a 17% value added tax. However, for companies that develop their own proprietary software, a value added tax refund is available. If the net amount of the value added tax payable exceeds 3% of software sales, the excess portion of the value added tax is refundable immediately. This policy is effective until 2010. Changes in Chinese tax laws may adversely affect our future operations.

We are also subject to U.S. income taxes on revenues generated in the U.S., including revenues from our limited hardware procurement activities through our U.S. parent company and interest income earned in the U.S.

FOREIGN EXCHANGE

A majority of our revenues and expenses relating to hardware sales are denominated in U.S. dollars, and substantially all of our revenues and expenses relating to the service component of our network solutions business and software business are denominated in Renminbi. Although, in general, our exposure to foreign exchange risks should be limited, the value of our shares will be affected by the foreign exchange rate between U.S. dollars and Renminbi because the value of our business is effectively denominated in Renminbi, while our shares are traded in U.S. dollars. Furthermore, a decline in the value of Renminbi could reduce the U.S. dollar equivalent of the value of the earnings from, and our investment in, our subsidiaries in China.

CONSOLIDATED RESULTS OF OPERATIONS

REVENUES. Gross revenues were $32.6 million and $97.7 million, respectively, in the three- and nine-month periods ended September 30, 2002, representing decreases of 65% and 35%, respectively, against the comparable periods in 2001. These decreases are primarily attributable to a shift in our customer's focus from increasing network capacity to increasing network productivity through the provision of more advanced applications.

Revenues net of hardware costs were $14.7 million and $51.4 million, respectively, in the three- and nine-month periods ended September 30, 2002, representing a decrease of 27% compared to the three-month period ended

September 30, 2001 and remaining relatively unchanged as compared to the nine-month period ended September 30, 2001. Total software revenues were $9.1 million and $24.7 million, respectively, in the three- and nine-month periods ended September 30, 2002, representing increases of 18% and 15%, respectively, over the comparable periods in 2001. Bonson contributed 34% to this quarter's total revenue net of hardware costs and 40% of software solutions revenue. As compared to the preceding quarter, software solutions revenues were up 3% and total net revenues were down approximately 25%. The year-over-year and sequential decrease in total net revenues was primarily attributable to the prolonged telecommunications industry restructuring in China. We expect further delays in order decisions from our major customers, affecting both our network solutions revenues and our software solutions revenues. We expect our net revenue to be approximately $12 million to $13 million for the fourth quarter of 2002 and in the range of $63.4 million to $64.4 million for the full year 2002, in line with our earnings guidance of July 23, 2002.

COST OF REVENUES. Our cost of revenues decreased 69% to $24.1 million and 42% to $64.8 million, respectively, in the three- and nine-month periods ended September 30, 2002, as compared to the same periods in 2001. These decreases in costs of revenues are attributable to lower hardware pass through costs in the third quarter of 2002 as compared to the third quarter of 2001 when we made a major hardware delivery in connection with a backbone project for China Unicom.

GROSS PROFIT. Gross profit was $8.5 million and $32.8 million, respectively, in the three- and nine-month periods ended September 30, 2002, representing decreases of 45% and 18%, respectively, against the comparable periods in 2001. Gross profit as a percentage of gross revenues, or gross margin, increased to 26% and 34%, respectively, in the three- and nine-month periods ended September 30, 2002, as compared to 17% and 27%, respectively, in the comparable periods of 2001. These increases in gross margin are primarily attributable to the smaller amount of low margin hardware pass through revenue recognized in the relevant periods of 2002. Gross profit as a percentage of net revenues decreased to 58% and 64%, respectively, in the three- and nine-month periods ended September 30, 2002, as compared to 77% and 78%, respectively, in the comparable periods of 2001.

OPERATING EXPENSES. Total operating expenses decreased 30% and 20%, respectively, to $8.5 million and $27.9 million, respectively, in the three- and nine-month periods ended September 30, 2002, from $12.0 million and $34.9 million, respectively, in the comparable periods in 2001. These decreases resulted from cost cutting measures implemented during the third quarter, including a 10% headcount decrease and a 10% salary cut for employees at the manager level and above. We expect to continue to maintain tight cost controls in the coming quarters.

Sales and marketing expenses decreased 51% and 36%, respectively, to $3.1 million and $11.5 million, respectively, in the three- and nine-month periods ended September 30, 2002 against the comparable periods in 2001. This decrease was attributable to reductions in staff, reduced efforts in international and channel sales, and tighter control of our marketing expenses.

General and administrative expenses decreased 23% and 28%, respectively, to $2.7 million and $7.7 million, respectively, in the three- and nine-month periods ended September 30, 2002, against the comparable periods in 2001. We plan to continue to reduce general and administrative expenses as part of our

cost cutting efforts.

Research and development expenses increased 8% and 21%, respectively, to $2.1 million and $6.7 million, respectively, in the three- and nine-month periods ended September 30, 2002, against the comparable periods in 2001, due to our increased focus on developing new products and solutions for China's telecom carriers, such as advanced operation support systems solutions.

We recognized a charge of $0.48 million for amortization of intangible assets in the third quarter of 2002 related to our acquisition of Bonson. As a result of that acquisition, we will amortize a total of $4.4 million in intangible assets over a period of two to three and a half years, $1.7 million of which will be amortized in 2002.

INCOME FROM OPERATIONS. Our operating income for the quarter decreased 99% to $43,000 and 5% to $5.0 million, respectively, in the three- and nine-month periods ended September 30, 2002, against the comparable periods in 2001. As compared to the preceding quarter, operating income decreased 99%. This decrease in profitability was attributable to our decrease in revenue and the partially fixed nature of our cost structure. The Bonson acquisition contributed 54% of our operating profit for the quarter. We expect operating profit for the year 2002 to be in the range of $4 million to $6 million.

OTHER INCOME (EXPENSE). Other income (expenses), consisting primarily of net interest income and expense, decreased from income (expense) of approximately $1.4 million and $5.3 million, respectively, in the three- and nine-month periods ended September 30, 2001 to income of $0.53 million and $1.7 million, respectively, in the three- and nine-month periods ended September 30, 2002, primarily due to a decrease in interest rates and our having less cash invested in interest bearing investments.

EQUITY IN LOSS OF AFFILIATE. In the three- and nine-month periods ended September 30, 2002, equity in loss of affiliate of approximately $0.1 million and $0.38 million, respectively, represented our proportionate share of the loss incurred by Intrinsic. In accordance with applicable accounting standards, we will conduct an asset impairment test of this investment in the fourth quarter.

NET INCOME. We recorded net income of $0.47 million, or $0.01 basic earnings per share, for the quarter ended September 30, 2002 and net income of $5.5 million, or $0.13 basic earnings per share, for the nine-month period ended September 30, 2002. This represents decreases of 87% as compared to the quarter ended September 30, 2001, 26% as compared to the nine-month period ended September 30, 2001 and 87% as compared to the second quarter of 2002. Bonson contributed 10% of total net income this quarter. We expect net income to be between $0 and $0.5 million, or equal $0.0 to $0.01 per basic share, for the fourth quarter of 2002 and approximately $5.5 million to $6 million, or $0.12 to $0.13 per basic share, for the year 2002.] This is in line with our earnings guidance of July 23, 2002.

LIQUIDITY AND CAPITAL RESOURCES

Our capital requirements are primarily working capital requirements related to hardware sales and costs associated with the expansion of our business, such as research and development and sales and marketing expenses. We recognize hardware costs in full upon delivery of the hardware to our customers. In order to minimize our working capital requirements, we generally obtain from our hardware vendors payment terms that are timed to permit us to receive

payment from our customers for the hardware before our payments to hardware vendors are due. However, we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements. See "Factors Affecting our Operating Results and our Common Stock - Our working capital requirements may increase significantly." We have historically financed our working capital and other financing requirements through careful management of our billing cycle, private placements of equity securities, our initial public offering in March of 2000 and, to a limited extent, bank loans.

Our accounts receivable balance at September 30, 2002 was $62.6 million, consisting of $26.3 million in billed receivables and $36.3 million in unbilled receivables. Our billed receivables are based on revenue we have booked and billed. Our unbilled receivables are based on revenue we have booked through the percentage completion method, but for which we have not yet billed the customer. For example, we recognize revenues for hardware pass-through at the time the hardware is accepted by the customer, based on the cost of the underlying hardware. However, our contracts with our customers will often allow the customers to withhold 10-20% of the total contract payments until final project acceptance, which on average is eight to nine months after hardware delivery. As a result, revenues from hardware pass-through generally represent a significant portion of our unbilled receivables and can cause the aging of these receivables to be relatively long.

At the end of the third quarter of 2002, our days sales outstanding were 173 days, as compared to 205 days as of the end of the second quarter. Our billed receivables were 73 days sales outstanding and our unbilled receivables were 100 days sales outstanding. The improvement in our days sales outstanding as compared to the end of the second quarter is primarily attributable to improved collection efforts and the increasing contribution of software solutions revenue to total net revenue.

As of September 30, 2002, we had total short-term credit facilities totaling $23 million, expiring in October, 2002 and October, 2003, for working capital purposes, of which unused short-term credit facilities were $21.7 million and $1.3 million had been used to issue letters of credit. In addition to the short-term credit facilities, we had short-term borrowings in Renminbi of $0.072 million as of September 30, 2002 for Bonson's working capital purposes, secured by Bonson's assets. The Renminbi loan bears interest at a rate of 4.8% per annum and is repayable upon demand by the lending bank. Bank deposits pledged as security for these credit facilities and bank loans, issuing letters of credit, and short-term credit facilities totaled $14.5 million as of September 30, 2002, and are presented as restricted cash in our consolidated balance sheets.

We ended the quarter with a cash position of $136.7 million, of which $4.0 million was in short term investments, $14.4 million was in restricted cash and $118.3 million of which was in cash and cash equivalents. The $14.4 million in restricted cash consists of $10 million used to secure our $20 million credit facility, $4.0 million pledged as security for issuing a standby letter of credit and $0.4 million held by Bonson and pledged as security for a bank guarantee. Our short-term investments feature fixed income, liquidity and low risk. The cash equivalents include investments in cash management accounts to enhance our interest income. We had net cash inflow of $7.6 million for the third quarter, primarily attributable to our improved collection efforts.

We anticipate that the net proceeds of our initial public offering in March 2000, together with available funds and cash flows generated from operations, will be sufficient to meet our anticipated needs for working capital, capital expenditures and business expansion through 2003. We may need to raise additional funds in the future, however, in order to fund acquisitions, develop new or enhanced services or products, respond to competitive pressures to compete successfully fhe section right of the 85.000% marker on the horizontal axis) would result

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The cash settlement amounts shown above are entirely hypothetical; they are based on market prices for the underlier stocks that may not be achieved on the determination date and on assumptions that may prove to be erroneous. The actual market value of your notes on the stated maturity date or at any other time, including any time you may wish to sell your notes, may bear little relation to the hypothetical cash settlement amounts shown above, and these amounts should not be viewed as an indication of the financial return on an investment in the offered notes. The hypothetical cash settlement amounts on notes held to the stated maturity date in the examples above assume you purchased your notes at their face amount and have not been adjusted to reflect the actual issue price you pay for your notes. The return on your investment (whether positive or negative) in your notes will be affected by the amount you pay for your notes. If you purchase your notes for a price other than the face amount, the return on your investment will differ from, and may be significantly lower than, the hypothetical returns suggested by the above examples. Please read Additional Risk Factors Specific to the Underlier-Linked Digital Notes The Market Value of Your Notes May Be Influenced by Many Unpredictable Factors in the accompanying Product Supplement No. 7.

Payments on the notes are economically equivalent to the amounts that would be paid on a combination of other instruments. For example, payments on the notes are economically equivalent to a combination of an interest-bearing bond bought by the holder and one or more options entered into between the holder and us (with one or more implicit option premiums paid over time). The discussion in this paragraph does not modify or affect the terms of the notes or the U.S. federal income tax treatment of the notes, as described elsewhere in this Pricing Supplement.

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We cannot predict the actual final underlier level or what the market value of your notes will be on any particular trading day, nor can we predict the relationship between the underlier level and the market value of your notes at any time prior to the stated maturity date. The actual amount that you will receive, if any, at maturity and the rate of return on the offered notes will depend on the actual initial underlier level, the cap level, the threshold settlement amount and the maximum settlement amount, which we will set on the trade date, and the actual final underlier level determined by the calculation agent as described above. Moreover, the assumptions on which the hypothetical returns are based may turn out to be inaccurate. Consequently, the amount of cash to be paid in respect of your notes, if any, on the stated maturity date may be very different from the information reflected in the table and chart above.

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ADDITIONAL RISK FACTORS SPECIFIC TO YOUR NOTES

An investment in your notes is subject to the risks described below, as well as the risks and considerations described under Risk Factors in the accompanying Prospectus, under Risk Factors in the accompanying Prospectus Supplement, under Additional Risk Factors Specific to the Notes in the accompanying General Terms Supplement, and under Additional Risk Factors Specific to the Underlier-Linked Digital Notes in the accompanying Product Supplement No. 7. You should carefully review these risks and considerations as well as the terms of the notes described herein and in the accompanying Prospectus, the accompanying Prospectus Supplement, the accompanying General Terms Supplement and the accompanying Product Supplement No. 7. Your notes are a riskier investment than ordinary debt securities. Also, your notes are not equivalent to investing directly in the underlier stocks, i.e., the stocks comprising the underlier to which your notes are linked. You should carefully consider whether the offered notes are suited to your particular circumstances.

The Notes Are Subject to the Credit Risk of the Bank

Although the return on the notes will be based on the performance of the underlier, the payment of any amount due on the notes is subject to the credit risk of the Bank, as issuer of the notes. The notes are our unsecured obligations. As further described in the accompanying Prospectus and Prospectus Supplement, the notes will rank on par with all of the other unsecured and unsubordinated debt obligations of the Bank, except such obligations as may be preferred by operation of law. Investors are dependent on our ability to pay all amounts due on the notes, and therefore investors are subject to our credit risk and to changes in the market s view of our creditworthiness. See Description of Senior Debt Securities Ranking on page 2 of the accompanying Prospectus.

The Amount Payable on Your Notes Is Not Linked to the Level of the Underlier at Any Time Other than the Determination Date

The final underlier level will be based on the closing level of the underlier on the determination date (subject to adjustment as described elsewhere in this Pricing Supplement). Therefore, if the closing level of the underlier dropped precipitously on the determination date, the cash settlement amount for your notes may be significantly less than it would have been had the cash settlement amount been linked to the closing level of the underlier prior to such drop in the level of the underlier. Although the actual level of the underlier on the stated maturity date or at other times during the life of your notes may be higher than the final underlier level, you will not benefit from the closing level of the underlier at any time other than on the determination date.

You May Lose Your Entire Investment in the Notes

You may lose your entire investment in the notes. The cash payment on your notes, if any, on the stated maturity date will be based on the performance of the S&P 500® Index as measured from the initial underlier level set on the trade date (which could be higher or lower than the actual closing level of the underlier on that date) to the closing level on the determination date. If the final underlier level is *less than* the threshold level, you will lose, for each $1,000 of the face amount of your notes, an amount equal to the *product* of (i) the buffer rate *times* (ii) the *sum* of the underlier return *plus* the threshold amount *times* (iii) $1,000. Thus, you may lose your entire investment in the notes, which would include any premium to face amount you paid when you purchased the notes.

Also, the market price of your notes prior to the stated maturity date may be significantly lower than the purchase price you pay for your notes. Consequently, if you sell your notes before the stated maturity date, you may receive significantly less than the amount of your investment in the notes.

Your Notes Do Not Bear Interest

You will not receive any interest payments on your notes. As a result, even if the cash settlement amount payable for your notes on the stated maturity date exceeds the face amount of your notes, the overall return you earn on your notes may be less than you would have earned by investing in a non-index-linked debt security of comparable maturity that bears interest at a prevailing market rate.

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The Potential for the Value of Your Notes to Increase Will Be Limited by the Maximum Settlement Amount

Your ability to participate in any change in the value of the underlier over the life of your notes will be limited because of the maximum settlement amount (which is equal to the threshold settlement amount). The maximum settlement amount will limit the cash settlement amount you may receive for each of your notes at maturity, no matter how much the level of the underlier may rise beyond the initial underlier level over the life of your notes. Accordingly, the amount payable for each of your notes may be significantly less than it would have been had you invested directly in the underlier.

The Notes Will Not Be Listed on Any Securities Exchange and We Do Not Expect A Trading Market For the Notes to Develop

The notes will not be listed or displayed on any securities exchange or any automated quotation system. Although CIBCWM and/or its affiliates may purchase the notes from holders, they are not obligated to do so and are not required to make a market for the notes. There can be no assurance that a secondary market will develop for the notes. Because we do not expect that any market makers will participate in a secondary market for the notes, the price at which you may be able to sell your notes is likely to depend on the price, if any, at which CIBCWM and/or its affiliates are willing to buy your notes.

If a secondary market does exist, it may be limited. Accordingly, there may be a limited number of buyers if you decide to sell your notes prior to the stated maturity date. This may affect the price you receive upon such sale. Consequently, you should be willing to hold the notes to the stated maturity date.

The Historical Performance of the Underlier Should Not Be Taken as an Indication of Its Future Performance

The final level of the underlier will determine the amount to be paid on the notes at maturity. The historical performance of the underlier does not necessarily give an indication of its future performance. As a result, it is impossible to predict whether the level of the underlier will rise or fall during the term of the notes. The level of the underlier will be influenced by complex and interrelated political, economic, financial and other factors.

You Have No Shareholder Rights or Rights to Receive Any Underlier Stock

Investing in the notes will not make you a holder of any of the underlier stocks. Neither you nor any other holder or owner of the notes will have any rights with respect to the underlier stocks, including any voting rights, any right to receive dividends or other distributions, any rights to make a claim against the underlier stocks or any other rights of a holder of the underlier stocks. Your notes will be paid in cash and you will have no right to receive delivery of any underlier stocks.

We May Sell an Additional Aggregate Face Amount of the Notes at a Different Issue Price

At our sole option, we may decide to sell an additional aggregate face amount of the notes subsequent to the date of this Pricing Supplement. The issue price of the notes in the subsequent sale may differ substantially (higher or lower) from the original issue price you paid as provided on the cover of this Pricing Supplement.

If You Purchase Your Notes at a Premium to Face Amount, the Return on Your Investment Will Be Lower Than the Return on Notes Purchased at Face Amount and the Impact of Certain Key Terms of the Notes Will Be Negatively Affected

The cash settlement amount will not be adjusted based on the issue price you pay for the notes. If you purchase notes at a price that differs from the face amount of the notes, then the return on your investment in such notes held to the stated maturity date will differ from, and may be substantially less than, the return on notes purchased at face amount. If you purchase your notes at a premium to face amount and hold them to the stated maturity date, the return on your investment in the notes will be lower than it would have been had you purchased the notes at face amount or a discount to face amount. In addition, the impact of the threshold level, the threshold settlement amount and the maximum settlement amount on the return on your investment will depend upon the price you pay for your notes relative to face amount. For example, if you

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purchase your notes at a premium to face amount, the threshold settlement amount and maximum settlement amount will permit a lower positive return on your investment in the notes than would have been the case for notes purchased at face amount or a discount to face amount. Similarly, if the final underlier level is less than the threshold level, you will incur a greater percentage decrease in your investment in the notes than would have been the case for notes purchased at face amount or a discount to face amount.

There are Potential Conflicts of Interest Between You and the Calculation Agent

The calculation agent will, among other things, determine the cash settlement amount payable at maturity of the notes. We will serve as the calculation agent. We may appoint a different calculation agent without your consent and without notifying you. The calculation agent will exercise its judgment when performing its functions. For example, the calculation agent may have to determine whether a market disruption event affecting the underlier has occurred. This determination may, in turn, depend on the calculation agent s judgment as to whether the event has materially interfered with our ability or the ability of one of our affiliates or a similarly situated party to unwind our hedge positions. Since this determination by the calculation agent will affect the payment at maturity on the notes, the calculation agent may have a conflict of interest if it needs to make a determination of this kind. See General Terms of the Underlier-Linked Digital Notes Role of Calculation Agent in the accompanying Product Supplement No. 7.

The Inclusion of Dealer Spread and Projected Profit from Hedging in the Original Issue Price Is Likely to Adversely Affect Secondary Market Prices

Assuming no change in market conditions or any other relevant factors, the price, if any, at which CIBCWM or any other party is willing to purchase the notes at any time in secondary market transactions will likely be significantly lower than the original issue price, since secondary market prices are likely to exclude underwriting commissions paid with respect to the notes and the cost of hedging our obligations under the notes that are included in the original issue price. The cost of hedging includes the projected profit that we, our affiliates or any third-party who may conduct hedging activities related to the notes, including any dealer in the notes, may realize in consideration for assuming the risks inherent in managing the hedging transactions. These secondary market prices are also likely to be reduced by the costs of unwinding the related hedging transactions. In addition, any secondary market prices may differ from values determined by pricing models used by CIBCWM as a result of dealer discounts, mark-ups or other transaction costs. Furthermore, if the dealer from which you purchase notes is to conduct trading and hedging activities for us in connection with the notes, that dealer may profit in connection with such trading and hedging activities and such profit, if any, will be in addition to the compensation that the dealer receives for the sale of the notes to you. You should be aware that the potential to earn a profit in connection with hedging activities may create a further incentive for the dealer to sell the notes to you, in addition to the compensation they would receive for the sale of the notes.

The Bank s Estimated Value of the Notes Will Be Lower than the Original Issue Price (Price to Public) of the Notes

The Bank s estimated value is only an estimate using several factors. The original issue price of the notes will exceed the Bank s estimated value because costs associated with selling and structuring the notes, as well as hedging the notes, are included in the original issue price of the notes. See The Bank s Estimated Value of the Notes in this Pricing Supplement.

The Bank s Estimated Value Does Not Represent Future Values of the Notes and May Differ from Others Estimates

The Bank s estimated value of the notes is determined by reference to the Bank s internal pricing models when the terms of the notes are set. This estimated value is based on market conditions and other relevant factors existing at that time and the Bank s assumptions about market parameters, which can include volatility, dividend rates, interest rates and other factors. Different pricing models and assumptions could provide valuations for the notes that are greater than or less than the Bank s estimated value. In addition, market conditions and other relevant factors in the future may change, and any assumptions may prove to be

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incorrect. On future dates, the value of the notes could change significantly based on, among other things, changes in market conditions, our creditworthiness, interest rate movements and other relevant factors, which may impact the price, if any, at which CIBCWM or any other person would be willing to buy notes from you in secondary market transactions. See The Bank s Estimated Value of the Notes in this Pricing Supplement.

The Bank s Estimated Value Is Not Determined by Reference to Credit Spreads for Our Conventional Fixed-Rate Debt

The internal funding rate used in the determination of the Bank s estimated value generally represents a discount from the credit spreads for our conventional fixed-rate debt. If the Bank were to use the interest rate implied by our conventional fixed-rate credit spreads, we would expect the economic terms of the notes to be more favorable to you. Consequently, our use of an internal funding rate would have an adverse effect on the terms of the notes and any secondary market prices of the notes. See The Bank s Estimated Value of the Notes in this Pricing Supplement.

We Cannot Control Actions By Any of the Unaffiliated Companies Whose Securities are Included in the Underlier

Actions by any company whose securities are included in the underlier may have an adverse effect on the price of its security, the final underlier level and the value of the notes. These companies will not be involved in the offering of the notes and will have no obligations with respect to the notes, including any obligation to take our or your interests into consideration for any reason. These companies will not receive any of the proceeds of the offering of the notes and will not be responsible for, and will not have participated in, the determination of the timing of, prices for, or quantities of, the notes to be issued. These companies will not be involved with the administration, marketing or trading of the notes and will have no obligations with respect to the cash settlement amount to be paid to you at maturity.

We and Our Respective Affiliates Have No Affiliation with the Underlier Sponsor and Have Not Independently Verified Its Public Disclosure of Information

We and our respective affiliates are not affiliated in any way with the underlier sponsor and have no ability to control or predict its actions, including any errors in or discontinuation of disclosure regarding the methods or policies relating to the calculation of the underlier. We have derived the information about the underlier sponsor and the underlier contained herein from publicly available information, without independent verification. You, as an investor in the notes, should make your own investigation into the underlier and the underlier sponsor. The underlier sponsor is not involved in the offering of the notes made hereby in any way and has no obligation to consider your interest as an owner of notes in taking any actions that might affect the value of the notes.

The U.S. Federal Tax Consequences of An Investment in the Notes Are Unclear

There is no direct legal authority regarding the proper U.S. federal tax treatment of the notes, and we do not plan to request a ruling from the U.S. Internal Revenue Service (the IRS). Consequently, significant aspects of the tax treatment of the notes are uncertain, and the IRS or a court might not agree with the treatment of the notes as prepaid cash-settled derivative contracts. If the IRS were successful in asserting an alternative treatment of the notes, the tax consequences of the ownership and disposition of the notes might be materially and adversely affected. The U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. See Supplemental Discussion of U.S. Federal Income Tax Consequences in the accompanying Product Supplement No. 7. Any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, including the character and timing of income or loss and the degree, if any, to which income realized by non-U.S. persons should be subject to withholding tax, possibly with retroactive effect. Both U.S. and non-U.S. persons considering an investment in the notes should review carefully the section of the accompanying Product Supplement No. 7 entitled Supplemental Discussion of U.S. Federal Income Tax Consequences and consult their tax advisers regarding the U.S. federal tax consequences of an investment

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in the notes (including possible alternative treatments and the issues presented by the notice), as well as tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

There Can Be No Assurance that the Canadian Federal Income Tax Consequences of an Investment in the Notes Will Not Change in the Future

There can be no assurance that Canadian federal income tax laws, the judicial interpretation thereof, or the administrative policies and assessing practices of the Canada Revenue Agency will not be changed in a manner that adversely affects investors. For a discussion of the Canadian federal income tax consequences of investing in the notes, please read the section of this Pricing Supplement entitled Certain Canadian Federal Income Tax Considerations as well as the section entitled Material Income Tax Consequences Canadian Taxation in the accompanying Prospectus. You should consult your tax advisor with respect to your own particular situation.

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THE UNDERLIER

The S&P 500® Index (the underlier) includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The underlier is calculated, maintained and published by S&P Dow Jones Indices LLC (S&P).

As of July 31, 2017, companies with multiple share class lines are no longer eligible for inclusion in the underlier. Constituents of the underlier prior to July 31, 2017 with multiple share class lines will be grandfathered in and continue to be included in the underlier. If a constituent company of the underlier reorganizes into a multiple share class line structure, that company will remain in the underlier at the discretion of the S&P Index Committee in order to minimize turnover. Also as of July 31, 2017, the criteria employed by S&P for purposes of making additions to the underlier were changed as follows:

- with respect to the U.S. company criterion, (i) the IEX was added as an eligible exchange for the primary listing of the relevant company s common stock and (ii) the former corporate governance structure consistent with U.S. practice requirement was removed; and

- with respect to constituents of the S&P MidCap 400® Index and the S&P SmallCap 600® Index that are being considered for addition to the underlier, the financial viability, public float and/or liquidity eligibility criteria no longer need to be met if the S&P Index Committee decides that such an addition will enhance the representativeness of the underlier as a market benchmark.

As of December 29, 2017, the 500 companies included in the underlier were divided into eleven Global Industry Classification Sectors. The Global Industry Classification Sectors include (with the approximate percentage currently included in such sectors indicated in parentheses): Consumer Discretionary (12.2%), Consumer Staples (8.2%), Energy (6.1%), Financials (14.8%), Health Care (13.8%), Industrials (10.3%), Information Technology (23.8%), Materials (3.0%), Real Estate (2.9%), Telecommunication Services (2.1%) and Utilities (2.9%). Sector designations are determined by the underlier sponsor using criteria it has selected or developed. Index sponsors may use very different standards for determining sector designations. In addition, many companies operate in a number of sectors, but are listed in only one sector and the basis on which that sector is selected may also differ. As a result, sector comparisons between indices with different index sponsors may reflect differences in methodology as well as actual differences in the sector composition of the indices. S&P and MSCI, Inc. have announced that the Global Industry Classification Sector structure is expected to be updated after the close of business on September 28, 2018. Among other things, the update is expected to broaden the current Telecommunications Services sector and rename it the Communication Services sector. The renamed sector is expected to include the existing telecommunication companies, as well as companies selected from the Consumer Discretionary sector currently classified under the Media industry group and the Internet & Direct Marketing Retail sub-industry, along with select companies currently classified in the Information Technology sector. Further, companies that operate online marketplaces for consumer products and services are expected to be included under the Internet & Direct Marketing sub-industry of the Consumer Discretionary sector, regardless of whether they hold inventory.

The above information supplements the description of the underlier found in the accompanying General Terms Supplement. This information was derived from information prepared by the underlier sponsor, however, the percentages we have listed above are approximate and may not match the information available on the underlier sponsor s website due to subsequent corporation actions or other activity relating to a particular stock. For more details about the underlier, the underlier sponsor and license agreement between the underlier sponsor and the Issuer, see The Underliers S&P 500® Index in the accompanying General Terms Supplement.

License Agreement

We and S&P have entered into a non-transferable, non-exclusive license agreement providing for the sublicense to us, in exchange for a fee, of the right to use the S&P 500® Index in connection with the issuance of the notes.

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The S&P 500® Index is a product of S&P Dow Jones Indices LLC (SPDJI), and has been licensed for use by CIBC. Standard & Poor s®, S&P® and S&P 500® are registered trademarks of Standard & Poor s Financial Services LLC; Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC (Dow Jones); and these trademarks have been licensed for use by SPDJI and sublicensed for certain purposes by CIBC. The notes are not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, Standard & Poor s Financial Services LLC, or their respective affiliates, and none of such parties make any representation regarding the advisability of investing in the notes nor do they have any liability for any errors, omissions, or interruptions of the S&P 500® Index.

Historical Closing Levels of the Underlier

The closing level of the underlier has fluctuated in the past and may, in the future, experience significant fluctuations. Any historical upward or downward trend in the closing level of the underlier during the period shown below is not an indication that the underlier is more or less likely to increase or decrease at any time during the life of your notes.

You should not take the historical levels of the underlier as an indication of the future performance of the underlier. We cannot give you any assurance that the future performance of the underlier or the underlier stocks will result in your receiving an amount greater than the outstanding face amount of your notes on the stated maturity date.

Neither we nor any of our affiliates make any representation to you as to the performance of the underlier. Before investing in the offered notes, you should consult publicly available information to determine the levels of the underlier between the date of this Pricing Supplement and the date of your purchase of the offered notes. The actual performance of the underlier over the life of the offered notes, as well as the cash settlement amount, may bear little relation to the historical closing levels shown below.

The graph below shows the daily historical closing levels of the underlier from January 5, 2008 through January 5, 2018. We obtained the closing levels in the graph below from Bloomberg Financial Services, without independent verification.

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THE BANK S ESTIMATED VALUE OF THE NOTES

The Bank s estimated value of the notes set forth on the cover of this Pricing Supplement is equal to the sum of the values of the following hypothetical components: (1) a fixed-income debt component with the same maturity as the notes, valued using our internal funding rate for structured debt described below, and (2) the derivative or derivatives underlying the economic terms of the notes. The Bank s estimated value does not represent a minimum price at which CIBCWM or any other person would be willing to buy your notes in any secondary market (if any exists) at any time. The internal funding rate used in the determination of the Bank s estimated value generally represents a discount from the credit spreads for our conventional fixed-rate debt. The discount is based on, among other things, our view of the funding value of the notes as well as the higher issuance, operational and ongoing liability management costs of the notes in comparison to those costs for our conventional fixed-rate debt. For additional information, see Additional Risk Factors Specific to Your Notes The Bank s Estimated Value Is Not Determined by Reference to Credit Spreads for Our Conventional Fixed-Rate Debt in this Pricing Supplement. The value of the derivative or derivatives underlying the economic terms of the notes is derived from the Bank s or a third party hedge provider s internal pricing models. These models are dependent on inputs such as the traded market prices of comparable derivative instruments and on various other inputs, some of which are market-observable, and which can include volatility, dividend rates, interest rates and other factors, as well as assumptions about future market events and/or environments. Accordingly, the Bank s estimated value of the notes is determined when the terms of the notes are set based on market conditions and other relevant factors and assumptions existing at that time. See Additional Risk Factors Specific to Your Notes The Bank s Estimated Value Does Not Represent Future Values of the Notes and May Differ from Others Estimates in this Pricing Supplement.

The Bank s estimated value of the notes will be lower than the original issue price of the notes because costs associated with selling, structuring and hedging the notes are included in the original issue price of the notes. These costs include the selling commissions paid to the Bank and other affiliated or unaffiliated dealers, the projected profits that our hedge counterparties, which may include our affiliates, expect to realize for assuming risks inherent in hedging our obligations under the notes and the estimated cost of hedging our obligations under the notes. Because hedging our obligations entails risk and may be influenced by market forces beyond our control, this hedging may result in a profit that is more or less than expected, or it may result in a loss. We or one or more of our affiliates will retain any profits realized in hedging our obligations under the notes. See Additional Risk Factors Specific to Your Notes The Bank s Estimated Value of the Notes Will Be Lower Than the Original Issue Price (Price to Public) of the Notes in this Pricing Supplement.

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SUPPLEMENTAL PLAN OF DISTRIBUTION (CONFLICTS OF INTEREST)

Pursuant to the terms of a distribution agreement, the Bank expects to agree to sell to CIBCWM, and CIBCWM expects to agree to purchase from the Bank, the aggregate face amount of the offered notes specified on the front cover of this Pricing Supplement. CIBCWM proposes initially to offer the notes to the public at the price to public set forth on the cover page of this Pricing Supplement, and to certain unaffiliated securities dealers at such price.

The Bank owns, directly or indirectly, all of the outstanding equity securities of CIBCWM. In accordance with FINRA Rule 5121, CIBCWM may not make sales in this offering to any of its discretionary accounts without the prior written approval of the customer.

We expect to deliver the notes against payment therefor in New York, New York on , 2018, which is expected to be the fifth scheduled business day following the date of this Pricing Supplement and of the pricing of the notes. Under Rule 15c6-1 of the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade notes on any date prior to two business days before delivery will be required, by virtue of the fact that the notes are expected to settle in five business days (T + 5), to specify alternative settlement arrangements to prevent a failed settlement.

The Bank may use this Pricing Supplement in the initial sale of the notes. In addition, CIBCWM or another of the Bank s affiliates may use this Pricing Supplement in market-making transactions in any notes after their initial sale. Unless CIBCWM or we inform you otherwise in the confirmation of sale, this Pricing Supplement is being used by CIBCWM in a market-making transaction.

While CIBCWM may make markets in the notes, it is under no obligation to do so and may discontinue any market-making activities at any time without notice. The price that it makes available from time to time after the issue date at which it would be willing to repurchase the notes will generally reflect its estimate of their value. That estimated value will be based upon a variety of factors, including then prevailing market conditions, our creditworthiness and transaction costs. However, for a period of approximately three months after the trade date, the price at which CIBCWM may repurchase the notes is expected to be higher than their estimated value at that time. This is because, at the beginning of this period, that price will not include certain costs that were included in the original issue price, particularly our hedging costs and profits. As the period continues, these costs are expected to be gradually included in the price that CIBCWM would be willing to pay, and the difference between that price and CIBCWM s estimate of the value of the notes will decrease over time until the end of this period. After this period, if CIBCWM continues to make a market in the notes, the prices that it would pay for them are expected to reflect its estimated value, as well as customary bid-ask spreads for similar trades. In addition, the value of the notes shown on your account statement may not be identical to the price at which CIBCWM would be willing to purchase the notes at that time, and could be lower than CIBCWM s price. See the section titled Supplemental Plan of Distribution Conflicts of Interest in the accompanying Prospectus Supplement.

The price at which you purchase the notes includes costs that the Bank or its affiliates expect to incur and profits that the Bank or its affiliates expect to realize in connection with hedging activities related to the notes, as set forth above. These costs and profits will likely reduce the secondary market price, if any secondary market develops, for the notes.

Any notes which are the subject of the offering contemplated by this Pricing Supplement, the accompanying Product Supplement No. 7, accompanying General Terms Supplement No. 1, accompanying Prospectus Supplement and accompanying Prospectus may not be offered, sold or otherwise made available to any retail investor in the European Economic Area. Consequently no key information document required by Regulation (EU) No 1286/2014 (the PRIIPs Regulation) for offering or selling the notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPS Regulation. For the purposes of this provision:

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(a) the expression retail investor means a person who is one (or more) of the following:

(i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, MiFID II); or

(ii) a customer within the meaning of Directive 2002/92/EC, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or

(iii) not a qualified investor as defined in Directive 2003/71/EC; and

(b) the expression an offer includes the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe for the notes.

Notes which have a maturity of less than one year may not be offered or sold other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the notes would otherwise constitute a contravention of Section 19 of the Financial Services and Markets Act 2000 (the FSMA) by the Bank.

Any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) in connection with the issue or sale of the notes may only be communicated or caused to be communicated in circumstances in which Section 21(1) of the FSMA does not apply to the Bank.

All applicable provisions of the FSMA must be complied with in respect to anything done by any person in relation to the notes in, from or otherwise involving the United Kingdom.

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CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a brief summary of the material U.S. federal income tax considerations relating to an investment in the notes. The following summary is not complete and is both qualified and supplemented by the discussion entitled Supplemental Discussion of U.S. Federal Income Tax Consequences in the accompanying Product Supplement No. 7, which you should carefully review prior to investing in the notes.

The U.S. federal income tax considerations of your investment in the notes are uncertain. No statutory, judicial or administrative authority directly discusses how the notes should be treated for U.S. federal income tax purposes. In the opinion of our tax counsel, Mayer Brown LLP, it would generally be reasonable to treat the notes as prepaid cash-settled derivative contracts. Pursuant to the terms of the notes, you agree to treat the notes in this manner for all U.S. federal income tax purposes. If this treatment is respected, you should generally recognize capital gain or loss upon the sale, exchange or payment upon maturity in an amount equal to the difference between the amount you receive in such transaction and the amount that you paid for your notes. Such gain or loss should generally be treated as long-term capital gain or loss if you have held your notes for more than one year.

The expected characterization of the notes is not binding on the IRS or the courts. It is possible that the IRS would seek to characterize the notes in a manner that results in tax consequences to you that are different from those described above or in the accompanying Product Supplement No. 7. Such alternate treatments could include a requirement that a holder accrue ordinary income over the life of the notes or treat all gain or loss at maturity as ordinary gain or loss. For a more detailed discussion of certain alternative characterizations with respect to the notes and certain other considerations with respect to an investment in the notes, you should consider the discussion set forth in Supplemental Discussion of U.S. Federal Income Tax Consequences of Product Supplement No. 7. We are not responsible for any adverse consequences that you may experience as a result of any alternative characterization of the notes for U.S. federal income tax or other tax purposes.

U.S. tax rules treat certain financial products issued to non-U.S. holders in 2017 or thereafter as giving rise to withholdable dividend equivalent payments when the financial product provides a payment or credit in respect of dividend payments on certain U.S. underliers. These rules do not apply if the financial product references a qualified index and does not contain short positions on more than 5 percent of the components within the index. Additionally, Treasury Regulations exclude financial products issued prior to 2019 that are not delta-one with respect to underlying securities that could pay withholdable dividend equivalent payments. In the opinion of Mayer Brown LLP, these rules should not apply to the notes.

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CERTAIN CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

In the opinion of Blake, Cassels & Graydon LLP, our Canadian tax counsel, the following summary describes the principal Canadian federal income tax considerations under the *Income Tax Act* (Canada) (the Canadian Tax Act) generally applicable at the date hereof to a purchaser who acquires beneficial ownership of a note pursuant to this Pricing Supplement and who for the purposes of the Canadian Tax Act and the regulations thereto and at all relevant times: (a) is neither resident nor deemed to be resident in Canada; (b) deals at arm s length with CIBC and any transferee resident (or deemed to be resident) in Canada to whom the purchaser disposes of the note; (c) does not use or hold and is not deemed to use or hold the note in, or in the course of, carrying on a business in Canada; (d) is entitled to receive all payments (including any interest and principal) made on the note, and (e) is not a, and deals at arm s length with any, specified shareholder of CIBC for purposes of the thin capitalization rules in the Canadian Tax Act (a Non-Resident Holder). A specified shareholder for these purposes generally includes a person who (either alone or together with persons with whom that person is not dealing at arm s length for the purposes of the Canadian Tax Act) owns or has the right to acquire or control or is otherwise deemed to own 25% or more of CIBC s shares determined on a votes or fair market value basis. Special rules which apply to non-resident insurers carrying on business in Canada and elsewhere are not discussed in this summary.

This summary is supplemental to and should be read together with the description of material Canadian federal income tax considerations relevant to a Non-Resident Holder owning notes under Material Income Tax Consequences Canadian Taxation in the accompanying Prospectus and a Non-Resident Holder should carefully read that description as well.

This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular Non-Resident Holder. Non-Resident Holders are advised to consult with their own tax advisors with respect to their particular circumstances.

Based on Canadian tax counsel s understanding of the Canada Revenue Agency s administrative policies and having regard to the terms of the notes, interest payable on the notes should not be considered to be participating debt interest as defined in the Canadian Tax Act and accordingly, a Non-Resident Holder should not be subject to Canadian non-resident withholding tax in respect of amounts paid or credited or deemed to have been paid or credited by CIBC on a note as, on account of or in lieu of payment of, or in satisfaction of, interest.

Non-Resident Holders should consult their own tax advisors regarding the consequences to them of a disposition of the notes to a person with whom they are not dealing at arm s length for purposes of the Canadian Tax Act.

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We have not authorized anyone to provide any information or to make any representations other than those contained or incorporated by reference in this Pricing Supplement, the accompanying Product Supplement No. 7, the accompanying General Terms Supplement, the accompanying Prospectus Supplement or the accompanying Prospectus. We take no responsibility for, and can provide no assurance as to the reliability of, any other information that others may give you. This Pricing Supplement, the accompanying Product Supplement No. 7, the accompanying General Terms Supplement, the accompanying Prospectus Supplement and the accompanying Prospectus is an offer to sell only the notes offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this Pricing Supplement, the accompanying Product Supplement No. 7, the accompanying General Terms Supplement, the accompanying Prospectus Supplement and the accompanying Prospectus is current only as of the respective dates of such documents.

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