

ASIAINFO-LINKAGE, INC  
Form 10-Q  
August 08, 2011  
Table of Contents

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

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from            to

Commission File Number 001-15713

**ASIAINFO-LINKAGE, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

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

**6 ZHONGGUANCUN SOUTH STREET, HAIDIAN DISTRICT**

**BEIJING 100086, CHINA**

(Address of principal executive offices, including zip code)

**+8610 8216 6688**

(Registrant's telephone number, including area code)

N/A

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

The number of shares of the registrant's common stock outstanding as of August 2, 2011 was 71,932,394.

**Table of Contents**

ASIAINFO-LINKAGE, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2011

TABLE OF CONTENTS

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	<b>1</b>
<b>Item 1. <u>Financial Statements (unaudited)</u></b>	<b>1</b>
a) <u>Condensed Consolidated Statements of Operations for the three months and six months ended June 30, 2011 and 2010</u>	1
b) <u>Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010</u>	2
c) <u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010</u>	3
d) <u>Condensed Consolidated Statements of Equity and Comprehensive Income for the three months and six months ended June 30, 2010</u>	4
e) <u>Condensed Consolidated Statements of Equity and Comprehensive Income for the three months and six months ended June 30, 2011</u>	5
f) <u>Notes to Condensed Consolidated Financial Statements</u>	6
<b>Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>21</b>
<b>Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>31</b>
<b>Item 4. <u>Controls and Procedures</u></b>	<b>31</b>
<b><u>PART II. OTHER INFORMATION</u></b>	<b>32</b>
<b>Item 1. <u>Legal Proceedings</u></b>	<b>32</b>
<b>Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b>33</b>
<b>Item 6. <u>Exhibits</u></b>	<b>33</b>
<b><u>SIGNATURE</u></b>	<b>34</b>
<b><u>EXHIBIT INDEX</u></b>	<b>35</b>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
<b>Revenues:</b>				
Software products and solutions	\$ 102,849	\$ 51,773	\$ 204,233	\$ 105,528
Service	7,140	6,288	14,017	10,122
Third-party hardware	6,197	1,237	12,417	2,891
<b>Total revenues</b>	<b>116,186</b>	<b>59,298</b>	<b>230,667</b>	<b>118,541</b>
<b>Cost of revenues:</b>				
Software products and solutions	57,228	21,015	109,797	40,660
Service	3,986	2,668	7,743	4,579
Third-party hardware	5,887	1,175	11,796	2,746
<b>Total cost of revenues</b>	<b>67,101</b>	<b>24,858</b>	<b>129,336</b>	<b>47,985</b>
<b>Gross profit</b>	<b>49,085</b>	<b>34,440</b>	<b>101,331</b>	<b>70,556</b>
<b>Operating (income) expenses:</b>				
Sales and marketing	19,201	7,300	38,456	14,914
General and administrative	5,626	4,458	13,640	13,105
Research and development	11,855	8,384	21,824	15,972
Government subsidy	(2,125)	0	(2,125)	0
<b>Total operating expenses</b>	<b>34,557</b>	<b>20,142</b>	<b>71,795</b>	<b>43,991</b>
<b>Income from operations</b>	<b>14,528</b>	<b>14,298</b>	<b>29,536</b>	<b>26,565</b>
<b>Other income, net</b>				
Interest income	1,195	741	2,613	1,402
Dividend income	176	250	180	254
Gain from sales of short-term investments	0	472	199	472
Other expenses, net	(160)	(50)	(275)	(50)
<b>Total other income, net</b>	<b>1,211</b>	<b>1,413</b>	<b>2,717</b>	<b>2,078</b>
<b>Income before income tax (benefit) expense and discontinued operations</b>	<b>15,739</b>	<b>15,711</b>	<b>32,253</b>	<b>28,643</b>
<b>Income tax (benefit) expense</b>	<b>(16,512)</b>	<b>2,429</b>	<b>(17,507)</b>	<b>4,484</b>
<b>Income from continuing operations</b>	<b>32,251</b>	<b>13,282</b>	<b>49,760</b>	<b>24,159</b>
<b>Discontinued operations:</b>				
Gain (loss) from operations of discontinued operations	0	242	0	(979)

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Income tax (expense) benefit for discontinued operations	0	(53)	0	213
<b>Gain (loss) from discontinued operations, net of taxes</b>	<b>0</b>	<b>189</b>	<b>0</b>	<b>(766)</b>
Net income	32,251	13,471	49,760	23,393
<b>Less: Net loss attributable to noncontrolling interest</b>	<b>(698)</b>	<b>(435)</b>	<b>(1,029)</b>	<b>(858)</b>
Net income attributable to AsiaInfo-Linkage, Inc.	\$ 32,949	\$ 13,906	\$ 50,789	\$ 24,251
<b>Earnings per share:</b>				
Net income from continuing operations attributable to AsiaInfo-Linkage, Inc. common stockholders:				
Basic	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.53
Diluted	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.52
Net income from discontinued operations attributable to AsiaInfo-Linkage, Inc. common stockholders:				
Basic	\$ 0	\$ 0	\$ 0	\$ (0.02)
Diluted	\$ 0	\$ 0	\$ 0	\$ (0.02)
Net income attributable to AsiaInfo-Linkage, Inc. common stockholders:				
Basic	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.51
Diluted	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.50
<b>Weighted average shares used in computation:</b>				
Basic	73,318,324	47,328,078	74,150,914	47,277,978
Diluted	73,961,561	48,325,405	74,766,963	48,264,122

See accompanying notes to condensed consolidated financial statements.

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

	June 30, 2011	December 31, 2010
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 188,141	\$ 237,844
Restricted cash	16,141	13,943
Short-term investments held-to-maturity securities	0	10,570
Short-term investments available-for-sale securities	32,794	31,682
Accounts receivable (net of allowances of \$3,862 and \$2,514 as of June 30, 2011 and December 31, 2010, respectively)	298,146	258,338
Inventories, net	6,368	9,902
Other receivables	5,639	5,934
Deferred income tax assets current	11,577	13,781
Prepaid expenses and other current assets	10,781	4,774
<b>Total current assets</b>	<b>569,587</b>	<b>586,768</b>
Long-term investments	5,646	5,646
Property and equipment, net	6,605	5,961
Other acquired intangible assets, net	183,845	209,626
Deferred income tax assets non-current	2,069	2,066
Goodwill	433,315	433,139
Prepayment for land use right	13,104	10,000
<b>Total assets</b>	<b>\$ 1,214,171</b>	<b>\$ 1,253,206</b>
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 105,370	\$ 89,867
Accrued expenses	27,411	25,391
Deferred revenue	20,686	27,963
Accrued employee benefits	53,665	72,309
Other payables	6,475	6,608
Income taxes payable	10,270	18,457
Other taxes payable	9,949	11,678
Deferred income tax liabilities current	3,711	3,657
<b>Total current liabilities</b>	<b>237,537</b>	<b>255,930</b>
Unrecognized tax benefits	3,154	4,870
Deferred income tax liabilities non-current	31,232	51,836
Other long-term liabilities	274	274
<b>Total liabilities</b>	<b>272,197</b>	<b>312,910</b>
Redeemable noncontrolling interest	1,323	1,918
Equity:		
AsiaInfo-Linkage, Inc. stockholders equity		

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Common stock (100,000,000 shares authorized; \$0.01 par value; 78,092,281 shares and 77,933,404 shares issued as of June 30, 2011 and December 31, 2010, respectively; 71,925,781 shares and 74,933,404 shares outstanding as of June 30, 2011 and December 31, 2010, respectively)	781	779
Additional paid-in capital	844,856	840,328
Treasury stock, at cost (6,166,500 shares and 3,000,000 shares as of June 30, 2011 and December 31, 2010, respectively)	(87,746)	(27,749)
Retained earnings	122,865	72,076
Statutory reserve	21,640	21,640
Accumulated other comprehensive income	38,179	30,794
Total AsiaInfo-Linkage, Inc. stockholders' equity	940,575	937,868
Noncontrolling interest	76	510
Total equity	940,651	938,378
Total liabilities, redeemable noncontrolling interest and equity	\$ 1,214,171	\$ 1,253,206

See accompanying notes to condensed consolidated financial statements.

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

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 49,760	\$ 23,393
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>		
Depreciation and amortization of property and equipment	1,378	839
Share-based compensation expenses	3,791	3,906
Amortization of other acquired intangible assets	25,793	871
Gain on disposal of property and equipment	(170)	(6)
Gain from sales of available-for-sale securities	(199)	(472)
Provision for bad debt	1,438	2,175
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	(41,246)	7,585
Inventories	3,534	1,039
Other receivables	305	(373)
Deferred income taxes	(18,237)	0
Prepaid expenses and other current assets	(216)	(1,520)
Prepayment for land use right	(2,870)	(434)
Accounts payable	15,495	(24,791)
Accrued expenses	2,019	3,032
Deferred revenue	(7,277)	(14,490)
Accrued employee benefits	(18,644)	(10,006)
Other payables	(371)	32
Other taxes payable	(7,519)	(2,377)
Income taxes payable	(9,904)	(50)
Net cash used in operating activities	(3,140)	(11,647)
<b>Cash flows from investing activities:</b>		
Increase in restricted cash	(2,198)	(384)
Purchases of available-for-sale securities	(2,715)	(2,919)
Purchases of held-to-maturity securities	(9,886)	(14,654)
Proceeds from sale of available-for-sale securities	1,721	1,937
Proceeds from maturity of held to maturity securities	20,686	13,726
Purchases of property and equipment	(1,683)	(635)
Proceeds from disposal of property and equipment	76	6
Purchase of businesses, net of cash acquired	0	(4,334)
Net cash provided by (used in) investing activities	6,001	(7,257)
<b>Cash flows from financing activities:</b>		
Proceeds from exercise of stock options	738	3,634
Repurchase of common stock	(59,997)	0
Net cash (used in) provided by financing activities	(59,259)	3,634
Effect of exchange rate changes on cash and cash equivalents	6,695	757



Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Net decrease in cash and cash equivalents	(49,703)	(14,513)
Cash and cash equivalents at beginning of period	237,844	238,553
Cash and cash equivalents at end of period	\$ 188,141	\$ 224,040

See accompanying notes to condensed consolidated financial statements.

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

(In thousands, except share amounts)

	Common Stock		AsiaInfo-Linkage, Inc. Stockholders			Accumulated Other Comprehensive Income	Noncontrolling Interest	Total Equity	Comprehensive Income	
	Outstanding Shares	Amount	Additional Paid-in Capital	Treasury (Accumulated) Stock	Retained earnings (Accumulated Deficit)					Statutory Reserve
<b>Balance at January 1, 2010</b>	47,115,821	\$ 501	\$ 244,838	\$ (27,749)	\$ 15,199	\$ 22,306	\$ 20,212	\$ 1,362	\$ 276,669	
Net income (loss)	0	0	0	0	10,345	0	0	(423)	9,922	9,922
Net loss attributable to redeemable noncontrolling interest	0	0	0	0	0	0	0	93	93	0
Other comprehensive income:										
Foreign currency translation adjustments	0	0	0	0	0	0	51	0	51	51
Net unrealized gain on available-for-sale investments, net of tax effects of \$ (194)	0	0	0	0	0	0	607	0	607	607
<b>Comprehensive income</b>										<b>\$ 10,580</b>
Stock option exercises	183,479	2	3,518	0	0	0	0	0	3,520	
Restricted stock units vesting	17,622	0	0	0	0	0	0	0	0	
Share-based compensation (restricted stock units)	0	0	201	0	0	0	0	0	201	
Share-based compensation (performance-based restricted stock units)	0	0	1,770	0	0	0	0	0	1,770	
<b>Balance at March 31, 2010</b>	47,316,922	\$ 503	\$ 250,327	\$ (27,749)	\$ 25,544	\$ 22,306	\$ 20,870	\$ 1,032	\$ 292,833	
Net income (loss)	0	0	0	0	13,906	0	0	(435)	13,471	13,471
Net loss attributable to redeemable noncontrolling interest	0	0	0	0	0	0	0	203	203	0
Other comprehensive income:										
Foreign currency translation adjustments	0	0	0	0	0	0	1,073	0	1,073	1,073
Transfer to statements of operations of realized gain on available-for-sale investments, net of tax effects of \$35	0	0	0	0	0	0	(437)	0	(437)	(437)
Net unrealized loss on available-for-sale investments, net of tax effects of \$47	0	0	0	0	0	0	(322)	0	(322)	(322)
<b>Comprehensive income</b>										<b>\$ 13,785</b>
Stock option exercises	15,721	0	115	0	0	0	0	0	115	
Restricted stock units vesting	2,800	0	0	0	0	0	0	0	0	
Share-based compensation (restricted stock units)	0	0	242	0	0	0	0	0	242	
Share-based compensation (performance-based restricted stock units)	0	0	1,693	0	0	0	0	0	1,693	
<b>Balance at June 30, 2010</b>	47,335,443	\$ 503	\$ 252,377	\$ (27,749)	\$ 39,450	\$ 22,306	\$ 21,184	\$ 800	\$ 308,871	

Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

See accompanying notes to condensed consolidated financial statements.

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

(In thousands, except share amounts)

	Common Stock		AsiaInfo-Linkage, Inc. Stockholders				Accumulated		Noncontrolling Interest	Total Equity	Comprehensive Income
	Outstanding Shares	Amount	Additional Paid-in Capital	Treasury Stock	Retained earnings (Accumulated Deficit)	Statutory Reserve	Comprehensive Income	Other			
<b>Balance at January 1, 2011</b>	74,933,404	\$ 779	\$ 840,328	\$ (27,749)	\$ 72,076	\$ 21,640	\$ 30,794	\$ 510	\$ 938,378		
Net income (loss)	0	0	0	0	17,840	0	0	(331)	17,509	\$ 17,509	
Net loss attributable to redeemable noncontrolling interest	0	0	0	0	0	0	0	197	197	0	
Other comprehensive income:											
Foreign currency translation adjustments	0	0	0	0	0	0	3,361	0	3,361	3,361	
Transfer to statements of operations of realized gain on available-for-sale investments, net of tax effects of \$30	0	0	0	0	0	0	(169)	0	(169)	(169)	
Net unrealized loss on available-for-sale investments, net of tax effects of \$4	0	0	0	0	0	0	(115)	0	(115)	(115)	
Comprehensive income										\$ 20,586	
Stock option exercises	114,874	1	698	0	0	0	0	0	699		
Restricted stock units vesting	35,090	1	(1)	0	0	0	0	0	0		
Share-based compensation (restricted stock units)	0	0	294	0	0	0	0	0	294		
Share-based compensation (performance-based restricted stock units)	0	0	1,603	0	0	0	0	0	1,603		
Repurchase of common stock	(248,900)	0	0	(4,956)	0	0	0	0	(4,956)		
<b>Balance at March 31, 2011</b>	74,834,468	\$ 781	\$ 842,922	\$ (32,705)	\$ 89,916	\$ 21,640	\$ 33,871	\$ 376	\$ 956,801		
Net income (loss)	0	0	0	0	32,949	0	0	(698)	32,251	32,251	
Net loss attributable to redeemable noncontrolling interest	0	0	0	0	0	0	0	398	398	0	
Other comprehensive income:											
Foreign currency translation adjustments	0	0	0	0	0	0	4,590	0	4,590	4,590	
Net unrealized loss on available-for-sale investments, net of tax effects of \$77	0	0	0	0	0	0	(282)	0	(282)	(282)	
Comprehensive income										\$ 36,559	
Stock option exercises	6,413	0	40	0	0	0	0	0	40		
Restricted stock units vesting	2,500	0	0	0	0	0	0	0	0		
Share-based compensation (restricted stock units)	0	0	325	0	0	0	0	0	325		
Share-based compensation (performance-based restricted stock units)	0	0	1,569	0	0	0	0	0	1,569		

Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Repurchase of common stock	(2,917,600)	0	0	(55,041)	0	0	0	0	(55,041)
<b>Balance at June 30, 2011</b>	71,925,781	\$ 781	\$ 844,856	\$ (87,746)	\$ 122,865	\$ 21,640	\$ 38,179	\$ 76	\$ 940,651

See accompanying notes to condensed consolidated financial statements.

**Table of Contents**

**ASIAINFO-LINKAGE, INC.**

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

(In thousands, except share and per share amounts)

**1. BASIS OF PREPARATION**

On July 1, 2010, AsiaInfo Holdings, Inc. ( AsiaInfo ) completed its combination with IT software and solutions provider Linkage Technologies International Holdings Limited ( Linkage ) through the acquisition of 100% of the outstanding share capital of its wholly-owned subsidiary, Linkage Technologies Investment Limited ( Linkage Technologies ) and was renamed AsiaInfo-Linkage, Inc. ( AsiaInfo-Linkage ). Starting in the third quarter of 2010, AsiaInfo-Linkage's financial statements consolidated the operating results and financial position of Linkage and its consolidated subsidiaries.

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( US GAAP ) for interim financial information and with the instructions to Form 10-Q and Regulation S-X, as promulgated by the Securities and Exchange Commission (the SEC ). Accordingly, they do not include all of the information and notes required by US GAAP for completing annual financial statements. However, management believes that the disclosures are adequate to ensure the information presented is not misleading. US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, contingencies and results of operations. While management has based its assumptions and estimates on the facts and circumstances existing as of June 30, 2011, final amounts may differ from these estimates.

In the opinion of the management of the Company, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results for the interim periods presented. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's audited financial statements included in its Form 10-K for the fiscal year ended December 31, 2010. The results of operations for the interim periods presented are not indicative of the operating results to be expected for any subsequent interim period or for the Company's fiscal year ending December 31, 2011.

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

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

All the assets of the Company's consolidated VIEs can be used to settle obligations of AsiaInfo-Linkage or its subsidiaries to settle obligations of these VIEs. As of June 30, 2011 and December 31, 2010, respectively, there were \$2,354 and \$2,876 of liabilities of the Company's consolidated VIEs for which creditors (or beneficial interest holders) did not have recourse to the general credit of AsiaInfo-Linkage or its subsidiaries.

---

## **Table of Contents**

(b) The accompanying unaudited condensed consolidated financial statements have been prepared using the same accounting policies as used in the preparation of the Company's consolidated financial statements on Form 10-K for the fiscal year ended December 31, 2010.

### **Accounting Pronouncements**

#### ***Recent accounting pronouncements not yet adopted***

In May 2011, the Financial Accounting Standard Board ( FASB ) issued an authoritative pronouncement on fair value measurement. The guidance is the result of joint efforts by the FASB and International Accounting Standards Board (the IASB ) to develop a single, converged fair value framework. The guidance is largely consistent with existing fair value measurement principles in US GAAP. The guidance expands the existing disclosure requirements for fair value measurements and makes other amendments, mainly including:

Highest-and-best-use and valuation-premise concepts for nonfinancial assets the guidance indicates that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of nonfinancial assets.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk the guidance permits an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position.

Premiums or discounts in fair value measure the guidance provides that premiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement.

Fair value of an instrument classified in a reporting entity's stockholders' equity the guidance prescribes a model for measuring the fair value of an instrument classified in stockholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

Disclosures about fair value measurements the guidance expands disclosure requirements, particularly for Level 3 inputs. Required disclosures include:

- (i) For fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation process in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.
- (ii) The level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed.

The guidance is to be applied prospective and effective for interim and annual periods beginning after December 15, 2011, for public entities. Early application by public entities is not permitted. The Company does not expect the adoption of this pronouncement to have a significant effect on its consolidated financial statements.

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

In June 2011, the FASB issued an authoritative pronouncement to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. These amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The guidance should be applied retrospectively. For public entities, the amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company is in the process of evaluating the effect of adoption of this guidance on its consolidated financial statements.

### **2. FINANCIAL INSTRUMENTS**

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

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



**Table of Contents**

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

The fair value of redeemable noncontrolling interest is not readily determinable. Redeemable noncontrolling interest is carried at higher of (1) the initial carrying amount, increased or decreased for the noncontrolling interest's share of net income or loss or (2) the accreted amount to the expected redemption value.

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

**3. CASH AND CASH EQUIVALENTS**

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

	June 30, 2011	December 31, 2010
Cash	\$ 86,761	\$ 103,744
Cash equivalents:		
Money market funds	74,792	119,001
Others	26,588	15,099
<b>Total cash and cash equivalents</b>	<b>\$ 188,141</b>	<b>\$ 237,844</b>

**4. SHORT-TERM INVESTMENTS**

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

As of June 30, 2011 and December 31, 2010, the Company's held-to-maturity securities consisted of term deposits carried at cost of \$0 and \$10,570, respectively. The term deposits were either not allowed to be redeemed early or were subject to penalty for early redemption before their maturity. The carrying amounts of the held-to-maturity securities approximate their fair values due to their short-term nature. As of June 30, 2011 and December 31, 2010, the Company did not hold trading securities.

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

	June 30, 2011				December 31, 2010			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Bond funds	\$ 17,739	\$ 2,803	\$ 0	\$ 20,542	\$ 17,334	\$ 2,853	\$ 0	\$ 20,187
Balance funds	2,025	67	(46)	2,046	2,733	588	0	3,321
Stock funds	7,680	1,915	0	9,595	5,995	1,949	0	7,944
Corporate stocks	624	0	(13)	611	215	15	0	230
<b>Total</b>	<b>\$ 28,068</b>	<b>\$ 4,785</b>	<b>\$ (59)</b>	<b>\$ 32,794</b>	<b>\$ 26,277</b>	<b>\$ 5,405</b>	<b>\$ 0</b>	<b>\$ 31,682</b>

Where applicable, the Company uses quoted prices in active markets for identical assets (Level 1 investments) to determine the fair value of trading and available-for-sale securities. If quoted prices in active markets for identical assets are not available to determine fair value, then the Company uses quoted prices for similar assets or inputs other than the quoted prices that are observable either directly or indirectly, which are included in Level 2 investments. The Company did not have Level 2 investments as of June 30, 2011 and December 31, 2010. The Company's Level 3 investments other than derivatives primarily include investments in certain mutual funds without quoted prices as of the date of

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

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

**Table of Contents**

The available-for-sale securities measured and recorded at fair value as of June 30, 2011 and December 31, 2010 were as follows:

	June 30, 2011				December 31, 2010			
	Fair Value Measurements at the Reporting Date Using Quoted Prices in Active Markets for Identical Instruments (Level 1)				Fair Value Measurements at the Reporting Date Using Quoted Prices in Active Markets for Identical Instruments (Level 1)			
	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance		
Bond funds	\$ 0	\$ 0	\$ 20,542	\$ 0	\$ 0	\$ 20,187	\$ 20,187	
Balance funds	0	2,046	2,046	0	3,321	3,321	3,321	
Stock funds	0	9,595	9,595	0	7,944	7,944	7,944	
Corporate stocks	611	0	611	230	0	230	230	
<b>Total</b>	<b>\$ 21,153</b>	<b>\$ 0</b>	<b>\$ 32,794</b>	<b>\$ 20,417</b>	<b>\$ 0</b>	<b>\$ 11,265</b>	<b>\$ 31,682</b>	

The following table presents changes in Level 3 investments measured on a recurring basis for the six-month periods ended June 30, 2011 and 2010:

	Six Months Ended June 30,	
	2011	2010
Beginning balance	\$ 11,265	\$ 9,293
Purchases	2,285	2,946
Redemption	(1,522)	(1,465)
Realized gain	(199)	(472)
Unrealized loss	(368)	(12)
Exchange difference	180	65
<b>Ending balance</b>	<b>\$ 11,641</b>	<b>\$ 10,355</b>

The following tables provide additional information on the realized gains of the Company during the three-month and six-month periods ended June 30, 2011 and 2010, respectively. For purpose of determining gross realized gains, the cost of securities sold is based on specific identification.

	Three Months Ended June 30,					
	2011			2010		
	Proceeds	Costs	Gains	Proceeds	Costs	Gains
Available-for-sale securities	\$ 0	\$ 0	\$ 0	\$ 1,937	\$ 1,465	\$ 472
<b>Total</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 1,937</b>	<b>\$ 1,465</b>	<b>\$ 472</b>

	Six Months Ended June 30,					
	2011			2010		
	Proceeds	Costs	Gains	Proceeds	Costs	Gains
Available-for-sale securities	\$ 1,721	\$ 1,522	\$ 199	\$ 1,937	\$ 1,465	\$ 472
<b>Total</b>	<b>\$ 1,721</b>	<b>\$ 1,522</b>	<b>\$ 199</b>	<b>\$ 1,937</b>	<b>\$ 1,465</b>	<b>\$ 472</b>

The Company reported no impairment losses for its short-term investments for the three and six months ended June 30, 2011 and 2010, respectively.

#### **5. ACCOUNTS RECEIVABLE**

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

**Table of Contents**

The Company generated service revenues by acting as a sales agent for International Business Machines Corporation ( IBM ) or its distributors, and for a few other hardware companies for certain products sold to the customers of the Company (each, an IBM Type Arrangement ). The components of the Company's accounts receivable as of June 30, 2011 and December 31, 2010, including amounts attributable to the IBM Type Arrangements, were as follows:

	June 30, 2011			December 31, 2010		
	IBM Type Arrangements	Non-IBM Type Arrangements	Total	IBM Type Arrangements	Non-IBM Type Arrangements	Total
Billed accounts receivable	\$ 40,745	\$ 80,414	\$ 121,159	\$ 24,561	\$ 71,355	\$ 95,916
Unbilled accounts receivable	39,935	135,649	175,584	48,738	115,859	164,597
Bank acceptance drafts	0	2,140	2,140	0	0	0
Commercial acceptance drafts	0	3,125	3,125	0	339	339
Less: accounts receivable allowance	(562)	(3,300)	(3,862)	(256)	(2,258)	(2,514)
Total accounts receivable, net	\$ 80,118	\$ 218,028	\$ 298,146	\$ 73,043	\$ 185,295	\$ 258,338

**6. INVENTORIES, NET**

The components of inventories, net as of June 30, 2011 and December 31, 2010 were as follows:

	June 30, 2011	December 31, 2010
Finished goods	\$ 6,368	\$ 9,902
Total	\$ 6,368	\$ 9,902

**7. LONG-TERM INVESTMENTS**

(a) In October 2005, the Company acquired five percent of the outstanding equity interests of Hinge. The investment is accounted for using the cost method as the Company does not have a significant influence over the business and operations of Hinge. Due to the effects of the global financial crisis in 2008, Hinge's business dropped significantly during 2008 causing a significant decline in fair value of Hinge. The Company determined that its investment in Hinge became worthless as of December 31, 2008 and that the decline in the fair value was other-than-temporary. Consequently, the Company recognized an impairment loss of \$2,042, which is equal to the carrying amount of the investment after foreign exchange adjustment from the initial investment cost.

(b) On September 12, 2008, the Company acquired 2,170,000 redeemable convertible Series B Preferred Shares of C-Platform Corporation ( C-Platform ), for a total cash consideration of \$4,696, including \$52 in transaction costs. The total consideration had been paid as of September 30, 2008. Following the transaction, the Company owned approximately 19.9% of C-Platform's issued and outstanding share capital, or 17% of C-Platform's share capital on a fully-diluted basis. Since the Company does not have the ability to exercise significant influence over the operating and financial policies of C-Platform, the Company uses the cost method of accounting to record its investment in C-Platform.

C-Platform is a Cayman Islands company, which, through its subsidiaries in China, provides data operating services, a form of value-added telecommunication services, to telecommunications carriers in China. The Company believes that the transaction furthers its ongoing strategy of expanding its market leading telecommunications software solutions business in China.

(c) On November 30, 2010, the Company acquired 3,562,500 Series A-1 Preferred Shares of Santen Corporation ( Santen ), for a total cash consideration of \$950 for 9.5% of Santen's issued and outstanding voting share capital. Since the Company does not have the ability to exercise significant influence over the operating and financial policies of Santen, the Company uses the cost method of accounting to record its investment in Santen.

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Santen is a Cayman Islands company, which, through its subsidiaries in China, provides a form of value-added telecommunication services, to telecommunications carriers in China. The Company believes that the transaction furthers its ongoing strategy of expanding its market leading telecommunications software solutions business in China.

**Table of Contents****8. GOODWILL**

The changes in the carrying amount of goodwill during the six months ended June 30, 2011 were as follows:

	June 30, 2011
<b>Gross amount:</b>	
Beginning balance at January 1, 2011	\$ 459,614
Exchange differences	187
Ending balance at June 30, 2011:	459,801
<b>Accumulated impairment loss:</b>	
Beginning balance at January 1, 2011:	(26,475)
Exchange differences	(11)
Ending balance at June 30, 2011:	(26,486)
Goodwill, net	\$ 433,315

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

The changes in the carrying amounts of the components of other acquired intangible assets, net as of June 30, 2011 and December 31, 2010 were as follows:

	June 30, 2011				December 31, 2010				Net carrying amount
	Gross carrying amount	Accumulated amortization	Foreign exchange difference	Net carrying amount	Gross carrying amount	Accumulated amortization	Disposal	Foreign exchange difference	
Core technologies	\$ 45,931	\$ (9,597)	\$ 0	\$ 36,334	\$ 45,931	\$ (5,964)	\$ 0	\$ 0	\$ 39,967
Trade names	21,037	(1,427)	0	19,610	21,041	(882)	(4)	0	20,155
Contract backlogs	12,474	(12,189)	12	297	12,474	(7,342)	0	12	5,144
Customer lists	131	(143)	12	0	131	(143)	0	12	0
Customer relationships	117,755	(18,196)	308	99,867	117,758	(8,272)	(3)	300	109,783
Distribution network	870	(870)	0	0	870	(870)	0	0	0
Software	1,721	(1,828)	162	55	1,758	(1,753)	(37)	160	128
Non-compete agreements	1,249	(483)	25	791	1,437	(373)	(188)	24	900
Corporate business agency agreement	2,037	(916)	3	1,124	2,037	(657)	0	2	1,382
Existing technology	38,396	(12,733)	0	25,663	38,328	(6,333)	0	0	31,995
In process research and development assets	104	0	0	104	172	0	0	0	172
	\$ 241,705	\$ (58,382)	\$ 522	\$ 183,845	\$ 241,937	\$ (32,589)	\$ (232)	\$ 510	\$ 209,626

The future amortization expenses for the net carrying amount of intangible assets with definite lives as of June 30, 2011 are expected to be as follows:

Six-month period ended December 31, 2011	\$ 20,812
2012	41,459

Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

2013	32,569
2014	23,445
2015 and thereafter	65,456
	\$ 183,741



**Table of Contents****10. PREPAYMENT FOR LAND USE RIGHT**

The Company has commenced the process to obtain land use rights for a piece of land in Beijing, on which the Company plans to construct a building for use as its new corporate headquarters. In October 2009, the Company entered into an agreement with Zhongguancun Software Park Development Co., Ltd. ( ZSPD ), pursuant to which ZSPD agreed to develop the land in preparation for construction of the building, for an aggregate consideration of approximately \$10,777, of which \$10,000 was paid in years 2009 and 2010. In connection with the agreement, the Company became eligible to enter into a land transfer agreement with relevant PRC government authorities in order to obtain land use rights with respect to such land. In May 2011, the Company entered into a land use right transfer agreement with the Beijing Municipal Bureau of Land and Resources pursuant to which the Company would acquire land use rights with a 50-year term, for a consideration of approximately \$2,870, which was paid in June 2011. As of June 30, 2011, the Company had paid approximately \$13,104 after an exchange rate effect of \$234 pursuant to the agreement with ZSPD, with the remaining amount payable in the remainder of 2011. The Company has recorded the \$13,104 as a prepayment for land use right on its consolidated balance sheets as of June 30, 2011. The Company expects to report land use rights at cost less accumulated amortization and to amortize the cost of the land use rights on a straight-line basis over the 50-year term upon obtaining the land use right certificate issued by Beijing Municipal Bureau of Land and Resources.

**11. COMPREHENSIVE INCOME**

The components of comprehensive income during the three and six months ended June 30, 2011 and 2010 were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Net income	\$ 32,251	\$ 13,471	\$ 49,760	\$ 23,393
Transfer to statements of operation of realized gain on available-for-sale investments net of tax effects of \$nil and \$35, \$30 and \$35 for the three and six months ended June 30, 2011 and 2010, respectively	0	(437)	(169)	(437)
Net unrealized (loss) gain on available-for-sale investments, net of tax effects of \$77 and \$47, \$81 and \$(147) for the three and six months ended June 30, 2011 and 2010, respectively	(282)	(322)	(397)	285
Change in cumulative foreign currency translation adjustment	4,590	1,073	7,951	1,124
<b>Comprehensive income</b>	<b>36,559</b>	<b>13,785</b>	<b>57,145</b>	<b>24,365</b>
Comprehensive loss attributable to noncontrolling interest	(698)	(435)	(1,029)	(858)
<b>Comprehensive income attributable to AsiaInfo-Linkage, Inc.</b>	<b>\$ 37,257</b>	<b>\$ 14,220</b>	<b>\$ 58,174</b>	<b>\$ 25,223</b>

**12. CREDIT FACILITIES**

As of June 30, 2011, the Company had short-term credit facilities for working capital purposes totaling \$114,521 expiring in September 2012. As of June 30, 2011, the credit facilities were secured by bank deposits of \$10,437 and credit facilities of \$17,205 were pledged as security for issuing standby letters of credit and accounts payable to hardware suppliers and customers. As of June 30, 2011, unused short-term credit facilities were \$97,316. In addition, the Company had standby letters of credit and bank acceptance drafts as of June 30, 2011, which were collateralized by bank deposits of \$5,704. Total bank deposits pledged as security for credit facilities, standby letters of credit, and bank acceptance drafts totaled \$16,141 as of June 30, 2011 and were presented as restricted cash in the consolidated balance sheets. As of December 31, 2010, the Company had total short-term credit facilities totaling \$95,968, which will expire in December 2011 and were secured by bank deposits of \$10,293.

**13. ACCOUNTS PAYABLE**

Accounts payable included bank acceptance drafts payable of \$3,845 and \$2,813 and commercial acceptances payable of \$nil and \$nil as of June 30, 2011 and December 31, 2010, respectively. These bank acceptance drafts and commercial acceptances were non-interest bearing and were due within six months of issuance.

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

As of June 30, 2011 and December 31, 2010, the Company's accounts payable balance related to the IBM Type Arrangements was approximately \$90,952 and \$75,278, respectively, under which the Company is contractually obligated to pay its vendor only when its customers pay the Company.

**Table of Contents****14. VALUE-ADDED TAXES REBATE**

Revenue from software products and solutions included the benefit of the rebate of value-added taxes on sales of software and services as part of the PRC government's policy of encouraging software development in the PRC. The rebate totaled \$4,435 and \$5,521 for the six months ended June 30, 2011 and 2010, respectively.

**15. INCOME TAXES**

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

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

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
U.S. federal rate	35%	35%
Difference between statutory rate and foreign effective tax rate	(20)	(28)
Subpart F income inclusion and other dividend income	0	4
Share-based compensation	0	2
Tax effect due to reduced rate granted for 2010	(13)	0
Discrete effect of change in tax rate of Linkage Nanjing	(57)	0
Others	1	2
	(54)%	15%

The tax rate for the six months ended as of June 30, 2011 was lower than that of the same period of year 2010 because the Company recognized the tax benefit of 2010 Key Software Enterprise upon receiving the Chinese government's approval in the first quarter of 2011. Pursuant to the relevant rules, a company with Key Software Enterprise status could apply a reduced rate of 10%. Two of the Company's subsidiaries, AsiaInfo-Linkage Technologies (China), Inc. and Linkage-AsiaInfo Technologies (Nanjing), Inc. ( Linkage Nanjing ), applied for this status for 2010 and received approvals in the first quarter of 2011 and thus tax benefit was reflected in the six months ended June 30, 2011.

The lower tax rate compared to the same period of 2010 was also because in the second quarter of 2011, Linkage Nanjing received a preliminary confirmation of its High-and-New Technology Enterprise ( HNTE ) status. The Company now believes that Linkage Nanjing will obtain its HNTE certificate and renew the status going forward and, accordingly, has re-calculated the balance of deferred tax relating to acquired intangible assets amortization and the social welfare accruals by applying a 15% rate instead of a 25% rate.

Aggregate undistributed earnings of approximately \$202,919 at June 30, 2011 of the Company's PRC subsidiaries and VIEs that are available for distribution to the Company are considered to be indefinitely reinvested under US GAAP and, accordingly, no provision has been made for the Chinese withholding taxes on dividend that would be payable upon the distribution of those amounts to AsiaInfo-Linkage. Additionally, the Chinese tax authorities have clarified that distributions to be made out of retained earnings from prior to January 1, 2008 would not be subject to the Chinese withholding tax. The Company has not quantified the deferred income tax liability that would arise if earnings in the six months ended June 30, 2011 were to be distributed or were determined to be no longer permanently reinvested.

The Company is subject to taxation in the U.S. and various states and foreign jurisdictions. There is no ongoing examination by any tax authority at this time. The Company did not change its position of recognizing uncertain tax benefit in the six months ended June 30, 2011 and does not foresee any material change to the amount of uncertain tax benefit. The Company's various tax years from 2000 to 2010 remain open in these taxing jurisdictions.

**Table of Contents****16. SHARE-BASED COMPENSATION****2002 Stock Option Plan and the Prior Plans**

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

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

Activities for the Option Plans are summarized as follows:

	Number of shares	Weighted average exercise price per share	Aggregate Intrinsic Value
Outstanding, January 1, 2011	520,924	\$ 5.74	
Forfeited	(730)	9.25	
Exercised	(133,864)	5.21	
Outstanding, March 31, 2011	386,330	5.91	\$ 6,485
Forfeited	(500)	7.77	
Exercised	(6,413)	6.29	
Outstanding, June 30, 2011	379,417	\$ 5.90	\$ 4,448
Vested and expected to vest, June 30, 2011	379,417	5.90	4,448
Exercisable, June 30, 2011	379,417	\$ 5.90	\$ 4,448

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of \$16.56 per share for the Company's common stock on the last trading day (June 30, 2011).

The total intrinsic value of options exercised for each of the three months ended June 30, 2011 and 2010 was \$86 and \$325, respectively.

As of June 30, 2011, there was no unrecognized share-based compensation cost relating to share options under the Option Plans.

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

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

A restricted stock unit ( "RSU") is an agreement to issue stock at the time when the award vests. The Company's RSUs under its 2005 Plan vested on an annual basis equally over four years, 25% on each anniversary of the grant date. The fair value of each RSU is measured on the grant date based on the market price of the stock on the grant date. The Company also has the right, in its sole discretion, to pay cash in lieu of the issuance of vested shares of common stock. No such cash payment right was exercised by the Company.



**Table of Contents**

RSUs as of June 30, 2011 and changes during the six months ended June 30, 2011 were as follows:

	Number of shares	Weighted average grant date fair value
Restricted stock units unvested at January 1, 2011	178,350	\$ 21.22
Granted	2,800	20.35
Vested	(35,090)	21.68
Forfeited	(1,500)	26.07
Restricted stock units unvested at March 31, 2011	144,560	\$ 21.05
Granted	2,000	22.65
Vested	(2,500)	18.80
Restricted stock units unvested at June 30, 2011	144,060	\$ 21.11

The total intrinsic value of RSUs vested for each of the three months ended June 30, 2011 and 2010 was \$35 and \$66, respectively.

As of June 30, 2011, there was \$2,385 in unrecognized share-based compensation cost related to RSUs, which is expected to be recognized in the Company's consolidated statements of operations over a weighted-average vesting period of 1.39 years. To the extent the actual forfeiture rate is different from the original estimate, the actual share-based compensation related to these awards may be different from the expectation.

**2008 Stock Incentive Plan**

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

As of June 30, 2011, 1,689,400 performance stock units ("PSUs") were granted under the 2008 Plan. These awards vest based on certain performance-based criteria, such as the Company's operating margin annual growth rate, provided the award holder continues to be an employee of the Company at the time the performance goals are met. Each PSU represents a contingent right of the participant to receive a payment in respect of a share of the Company's common stock, whether in shares, cash, or a combination thereof, subject to the terms and conditions of the participant's PSU agreement. The Company also has the right, in its sole discretion, to pay cash in lieu of the issuance of vested shares of common stock. No such cash payment right was exercised by the Company.

PSUs as of June 30, 2011 and changes during the six months ended June 30, 2011 were as follows:

	Number of shares	Weighted average grant date fair value
Performance-based restricted stock units unvested at January 1, 2011	487,088	\$ 13.33
Forfeited	(3,138)	13.10
Performance-based restricted stock units unvested at March 31, 2011	483,950	\$ 13.33
Forfeited	(4,488)	13.10
	479,462	\$ 13.34

Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Performance-based restricted stock units unvested at  
June 30, 2011

Total intrinsic value of the PSUs granted under the 2008 Plan and vested in each of the six months ended June 30, 2011 and 2010 was \$nil and \$nil, respectively.

**Table of Contents**

As of June 30, 2011, there was \$1,599 in unrecognized share-based compensation cost related to the PSUs, which is expected to be recognized in the Company's consolidated statements of operations over a weighted-average vesting period of 0.25 year. To the extent the actual forfeiture rate is different from the original estimate, the actual share-based compensation related to these awards may be different from the expectation.

**2011 Stock Incentive Plan**

In February 2011, the Board of Directors of the Company authorized the 2011 Stock Incentive Plan (the "2011 Plan"). The 2011 Plan was subsequently approved by the Company's stockholders on April 21, 2011 at the 2011 annual meeting of stockholders. Under the 2011 Plan, the Company is authorized to grant participants restricted stock awards, stock options, or other types of equity incentives. The number of shares authorized for issuance was (a) 7,501,752 shares plus (b) any authorized shares of the Company's common stock that, as of April 21, 2011, were available for issuance under the 2008 Plan, or that thereafter become available for issuance under the 2008 Plan in accordance with its terms.

Unless otherwise specified in the RSU award agreement, the Company's RSUs under its 2011 Plan vest on an annual basis equally over four years, 25% on each anniversary of the grant date. The fair value of each RSU is measured on the grant date based on the market price of the stock on the grant date. The Company also has the right, in its sole discretion, to pay cash in lieu of the issuance of vested shares of common stock.

RSUs as of June 30, 2011 and changes during the six months ended June 30, 2011 were as follows:

	Number of shares	Weighted average grant date fair value
Restricted stock units unvested at March 31, 2011	0	\$ 0
Granted	36,500	19.83
Vested	0	0
Restricted stock units unvested at June 30, 2011	36,500	\$ 19.83

The total intrinsic value of RSUs vested for each of the three months ended June 30, 2011 and 2010 was \$nil and \$nil, respectively.

As of June 30, 2011, there was \$695 in unrecognized share-based compensation cost related to RSUs, which is expected to be recognized in the Company's consolidated statements of operations over a weighted-average vesting period of 2.35 years. To the extent the actual forfeiture rate is different from the original estimate, the actual share-based compensation related to these awards may be different from the expectation.

The amount of share-based compensation attributable to cost of revenues, sales and marketing, general and administrative expenses, and research and development is included in those line items on the face of the Company's consolidated statements of operations. For the three months and six months ended June 30, 2011 and 2010, share-based compensation expenses related to stock options, RSUs and PSUs were allocated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Cost of revenues	\$ 470	\$ 480	\$ 949	\$ 1,000
Sales and marketing	405	566	835	1,112
General and administrative	739	604	1,453	1,223
Research and development	280	285	554	571
Total share-based compensation expense	\$ 1,894	\$ 1,935	\$ 3,791	\$ 3,906



**Table of Contents****17. EARNINGS PER SHARE**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
<b>Amounts attributable to AsiaInfo-Linkage, Inc. common stockholders (numerator)</b>				
Income from continuing operations, net of taxes	\$ 32,949	13,717	50,789	25,017
Income (loss) from discontinued operations, net of taxes	0	189	0	(766)
Net income	\$ 32,949	13,906	50,789	24,251
<b>Shares (denominator):</b>				
Weighted average common stock outstanding				
Basic	73,318,324	47,328,078	74,150,914	47,277,978
Dilutive effect of employee stock options and restricted stock units	643,237	997,327	616,049	986,144
Diluted	73,961,561	48,325,405	74,766,963	48,264,122
<b>Earnings per share</b>				
Net income from continuing operations attributable to AsiaInfo-Linkage, Inc. common stockholders				
Basic	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.53
Diluted	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.52
Net income from discontinued operations attributable to AsiaInfo-Linkage, Inc. common stockholders				
Basic	\$ 0.00	\$ 0.00	\$ 0.00	\$ (0.02)
Diluted	\$ 0.00	\$ 0.00	\$ 0.00	\$ (0.02)
Net income attributable to AsiaInfo-Linkage, Inc. common stockholders				
Basic	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.51
Diluted	\$ 0.45	\$ 0.29	\$ 0.68	\$ 0.50

As of June 30, 2011 and 2010, the Company had outstanding options to acquire 75,820 and 5,000 shares of common stock, respectively, that were excluded from the computation of diluted earnings per share (EPS), as their exercise prices exceeded the average market values in those periods. These options could potentially have a dilutive effect on the Company's EPS in the future.

**18. SEGMENT INFORMATION**

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

The Company's operations are currently organized into five business units by three telecommunication carriers in China, multiple Cable Television providers in China, and telecommunication carriers internationally. In accordance with FASB guidance, each of these five business units represents an operating segment, of which discrete financial information is available and is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The five operating segments are aggregated into one reportable segment because they meet the aggregation criteria of FASB that have same economic characteristics.

The Company's chief operating decision maker is the Company's Business Committee, comprising the Company's Chief Executive Officer, Chief Financial Officer and senior management team.

The Company primarily operates in the PRC and substantially all of the Company's long-lived assets are located in the PRC.

---

**Table of Contents****19. COMMITMENTS AND CONTINGENCIES****Commitments**

In May 2011, the Company entered into a land use right transfer agreement with the Beijing Municipal Bureau of Land and Resources, under which the Company acquired land use rights for a 50-year term. Pursuant to the agreement, the Company has committed a minimum of \$30,761 for capital expenditures to the building construction project, to commence construction by April 30, 2012, and to complete construction by April 30, 2014.

**Contingencies**

*Litigation* In December 2001, a securities class action case was filed in New York City against the Company, certain of its officers and directors and the underwriters of the Company's initial public offering (IPO). The lawsuit alleged violations of the U.S. federal securities laws and was docketed in the U.S. District Court for the Southern District of New York as *Hassan v. AsiaInfo Holdings, Inc., et al.* The lawsuit alleged, among other things, that the underwriters of the Company's IPO improperly required their customers to pay the underwriters excessive commissions and to agree to buy additional shares of the Company's common stock in the aftermarket as conditions of their purchasing shares in the Company's IPO. The lawsuit further claimed that the alleged practices of the underwriters should have been disclosed in the Company's IPO prospectus and registration statement. The suit seeks rescission of the plaintiffs' alleged purchases of the Company's common stock as well as unspecified damages. In addition to the case against the Company, various other plaintiffs have filed approximately 1,000 other, substantially similar class action cases (collectively, the IPO Allocation Cases) against approximately 300 other publicly traded companies and their IPO underwriters in New York City, which along with the case against the Company, have all been transferred to a single federal district judge for purposes of case management.

In April 2009, the Company and most of the other issuer defendants in the IPO Allocation Cases reached a definitive agreement with the plaintiffs and the underwriter defendants to settle the IPO Allocation Cases. The agreement was filed with the court in April 2009 and a final approval was granted by the court in October 2009. The final approval was subject to appeal until November 2009. Ten appeals were filed objecting to the definition of the settlement class and fairness of the settlement, five of which have been dismissed with prejudice. Two appeal briefs were filed by the remaining objector groups, one of which was dismissed and the other remanded to the District Court to determine whether the appellant has standing to object to the settlement. If the settlement is approved, the Company expects any damages payable to the plaintiffs to be fully funded by its directors' and officers' liability insurance policies. If the litigation proceeds, the Company intends to continue to defend the litigation vigorously. Moreover, if the litigation proceeds, the Company believes that the underwriters may have an obligation to indemnify the Company for the legal fees and other costs of defending this suit and that its directors' and officers' liability insurance policies would also cover the defense and potential exposure in the suit.

In addition, in June 2007 the Company received a letter from a putative stockholder demanding that the Company investigate and prosecute a claim for alleged short-swing trading in violation of Section 16(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), by the underwriters of the Company's IPO and certain of the Company's unidentified directors, officers and stockholders. In October 2007, the putative stockholder commenced a civil lawsuit in the U.S. District Court for the Western District of Washington against Morgan Stanley and Deutsche Bank, two of the lead underwriters of the Company's IPO, alleging violations of Section 16(b) of the Exchange Act. The complaint alleges that the combined number of shares of the Company's common stock beneficially owned by the lead underwriters and certain unnamed officers, directors and principal stockholders exceeded ten percent of the Company's outstanding common stock from the date of the Company's IPO in March 2000, for at least one year. It further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b), and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). None of the Company's directors, officers or stockholders is named as a defendant in this action, although the Company is named as a nominal defendant. In July 2008, the Company together with several other issuers who are also named as nominal defendants in the action filed a joint motion to dismiss the action. In March 2009, the court granted the motion, dismissing the complaint without prejudice on the ground that the plaintiff failed to make an adequate demand to the Company prior to filing the complaint. The plaintiff subsequently appealed the judgment to the Court of Appeals for the Ninth Circuit, and the underwriter defendants filed certain cross-appeals. In December 2010, the Ninth Circuit affirmed the dismissal of the case, but reversed and remanded certain claims relating to the underwriters. In January 2011, the Ninth Circuit denied certain petitions for rehearing and ordered that no further petitions for rehearing may be filed. In April 2011, the plaintiff requested review with the U.S. Supreme Court, seeking reversal of the Ninth Circuit's decision, and the underwriter defendants requested review with the U.S. Supreme Court regarding a statute of limitations issue. In June 2011, the U.S. Supreme Court denied plaintiff's request for review and granted the underwriter defendants' request for review.



## **Table of Contents**

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

### **20. STOCK REPURCHASE PROGRAM**

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

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

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

No stock repurchased during year 2009 or 2010.

On January 30, 2011, the Company announced the authorization of a new stock repurchase program, under which the Company may, from time to time for a period of twelve months, depending on market conditions, share price and other factors, make one or more purchases, on the open market or in privately negotiated transactions, of up to \$60,000 in aggregate value of the Company's outstanding common stock. As of June 30, 2011, the Company repurchased 3,166,500 shares of its common stock at a total cost of \$59,997 pursuant to this repurchase program. The Company has determined that it has completed the repurchases pursuant to the program.

All common stock repurchased by the Company has become part of its treasury stock.

### **21. NONCONTROLLING INTEREST**

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

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

**Table of Contents****22. REDEEMABLE NONCONTROLLING INTEREST**

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

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

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

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

These noncontrolling interests were recorded outside of the permanent equity on the consolidated balance sheets initially at the fair value of the noncontrolling interests as of the date of incorporation or the date of acquisition of these subsidiaries. Subsequently, each noncontrolling interest was carried at the higher of (1) the initial carrying amount, increased or decreased for the noncontrolling interest 's share of net income or loss or (2) the accreted amount to the expected redemption value. The change of the carrying amounts of the redeemable noncontrolling interest is recognized as net income attributable to noncontrolling interest in the consolidated statements of operations. For the three months ended March 31, 2011 and the three months ended June 30, 2011, the amounts charged to the net income attributable to noncontrolling interests were \$197 and \$398, respectively, which represents the noncontrolling interests ' share of net loss of these subsidiaries.

	<b>Redeemable Noncontrolling Interest</b>	
<b>Balance at December 31, 2010</b>	\$	1,918
Net loss		(197)
Adjustment to redemption value		0
<b>Balance at March 31, 2011</b>	\$	1,721
Net loss		(398)
Adjustment to redemption value		0
<b>Balance at June 30, 2011</b>	\$	1,323

**23. SUBSEQUENT EVENTS**

The Company evaluated events occurring after June 30, 2011 until the date the consolidated financial statements were issued.

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

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

In this report, the Company, we, us and our refer to AsiaInfo-Linkage, Inc. and its subsidiaries and consolidated variable interest entities, or VIEs, Linkage refers to Linkage Technologies International Holdings Limited, and AsiaInfo refers to the Company prior to its combination with Linkage.

**Overview**

We are the leading provider of high-quality communications software solutions and IT related services in China. Our software and services enable our customers to build, maintain, operate, manage and improve their communications infrastructure. Our largest customers are the major telecommunications carriers in China and their provincial subsidiaries, including China Mobile Communications Corporation, or China Mobile, China United Telecommunications Corporation, or China Unicom, and China Telecommunications Corporation, or China Telecom.

We commenced our operations in the United States, or the U.S., in 1993 and moved our major operations from the U.S. to China in 1995. We began generating significant network solutions revenues in 1996 and significant software revenues in 1998. We conduct the bulk of our business through our operating subsidiaries, most of which are Chinese companies. On July 1, 2010, we completed the combination with Linkage and, in connection with the closing, changed our corporate name to AsiaInfo-Linkage, Inc. On August 1, 2011, AsiaInfo-Linkage's board of directors and management team determined that the integration of the two combined companies had been completed.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of large telecommunications customers, such as China Mobile, China Unicom and China Telecom and their respective provincial subsidiaries. The following table shows our revenues and percentage of total revenues derived from those three customers (and their respective provincial subsidiaries) for the three months ended June 30, 2011 and 2010.

	Three Months Ended June 30,			
	2011		2010	
	Revenues (in thousands)	Percentage of Total Revenues	Revenues (in thousands)	Percentage of Total Revenues
China Mobile	\$ 59,406	51%	\$ 44,354	75%
China Telecom	21,623	19%	2,583	4%
China Unicom	33,353	29%	11,445	19%
Total	\$ 114,382	99%	\$ 58,382	98%

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

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Our telecom solutions business unit, encompassing our telecommunications business for financial reporting purposes, each of the business is further organized into three product lines:

Software products and solutions;

21



---

## Table of Contents

Services; and

Third-party hardware.

### **Recent Developments**

On July 1, 2010, we completed the combination with Linkage. Pursuant to the Business Combination Agreement dated December 4, 2009, as supplemented on June 5, 2010 by the Supplemental Agreement, by and among AsiaInfo, Linkage, certain shareholders of Linkage, and Mr. Libin Sun as agent for the shareholders of Linkage, we purchased from Linkage 100% of the outstanding share capital of its wholly-owned subsidiary, Linkage Technologies Investment Limited, or Linkage Technologies, for \$60 million in cash and 26,832,731 shares of our common stock, resulting in Linkage Technologies becoming our wholly-owned subsidiary. In the third quarter of 2010, we consolidated the operating results and financial position of Linkage and its consolidated subsidiaries. Our consolidated financial statements for periods before July 1, 2010 reflect the standalone operating results and financial position of AsiaInfo and its consolidated subsidiaries and VIEs.

On December 1, 2010, we entered into a Framework Agreement for Termination of Lenovo Security Control Structure with Messrs. Jian Qi and Kequan Liu, the management of Lenovo Security Technologies (Beijing), Inc., or Lenovo Security, and Lenovo-AsiaInfo Technologies, Inc., one of our wholly owned subsidiaries, whereby we sold our IT security business through the disposition of Lenovo Security to the management team of the IT security business, including our former executive officer Mr. Jian Qi. Under the terms of the agreement, we received approximately \$15.0 million in cash in exchange for 100% of our economic interest in Lenovo Security and settlement of certain inter-company liabilities. Since December 2010, we began reflecting the historical results of our IT security business as discontinued operations in our consolidated financial statements.

On January 30, 2011, we announced the authorization of a new stock repurchase program under which we may, from time to time for a period of twelve months, depending on market conditions, share price and other factors, make one or more purchases, on the open market or in privately negotiated transactions, of up to \$60.0 million in aggregate value of our outstanding common stock. As of June 30, 2011, we had repurchased 3,166,500 shares of our common stock at a total cost of approximately \$60.0 million pursuant to this repurchase program.

On April 5, 2011, AsiaInfo-Linkage announced that the Company has signed an agreement to provide Customer Relationship Management, or CRM, and Business Intelligence, or BI, systems to U Mobile Sdn Bhd, or U Mobile, in Malaysia.

On August 1, 2011, AsiaInfo-Linkage's board of directors and management team determined that the integration of the two combined companies had been completed. The main areas of focus during the integration included customer facing sales and service organizations, human resource policies, product and solution platforms as well as IT system, project management, accounting and financial reporting practices.

### **Revenues**

We report our revenues on the basis of the three principal types of revenues derived from our business: software products and solutions revenue, service revenue and third party hardware revenue.

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

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

**Table of Contents**

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

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

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

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Revenues net of hardware costs:</b>		
Software products and solutions revenue	\$ 102,849	\$ 51,773
Service revenue	7,140	6,288
Third-party hardware revenue net of hardware costs	310	62
<b>Total revenues net of hardware costs</b>	<b>110,299</b>	<b>58,123</b>
Total hardware costs	5,887	1,175
<b>Total revenues</b>	<b>\$ 116,186</b>	<b>\$ 59,298</b>

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Revenues net of hardware costs:</b>		
Software products and solutions revenue	\$ 204,233	\$ 105,528
Service revenue	14,017	10,122
Third-party hardware revenue net of hardware costs	621	145
<b>Total revenues net of hardware costs</b>	<b>218,871</b>	<b>115,795</b>
Total hardware costs	11,796	2,746
<b>Total revenues</b>	<b>\$ 230,667</b>	<b>\$ 118,541</b>

We believe total revenues net of hardware costs more accurately reflects our core business, which is the provision of software solutions and services, and provides transparency to our investors. We believe this measure provides transparency to our investors because it is the measure used by our management to evaluate the competitiveness and performance of our business in each of the segments. In addition, third-party

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

hardware revenue tends to fluctuate from period to period depending on the requirements of our customers. As a result, a presentation that excludes hardware costs allows investors to better evaluate the performance of our core business.

## **Table of Contents**

### **Cost of Revenues**

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

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

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

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

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

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

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

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

### **Operating (Income) Expenses**

Operating (income) expenses are comprised of sales and marketing expenses, general and administrative expenses, research and development expenses and government subsidy. Amortizations of acquired intangible assets expenses comprise a significant portion of our total operating (income) expenses.

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

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

General and administrative expenses include compensation expenses for employees in our general and administrative departments, consulting fees, as well as the depreciation expenses allocated to our general and administrative departments.

Government subsidy represents rewards from government for the high-tech software innovation.

### **Taxes**

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

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

Pursuant to related tax laws, a qualified High-and-New Technology Enterprise, or HNTE, is eligible for a reduced EIT rate of 15%. HNTE status is valid for three years. At the conclusion of the three-year period, the qualifying enterprise has the option to renew its HNTE status for additional three years through a simplified assessment if such enterprise's business operations continue to qualify for HNTE status. After the first six years, the enterprise would be subject to a new application process if it continues to renew its HNTE status. As of December 2008, we had received HNTE certification for AsiaInfo-Linkage Technologies (China), Inc., AsiaInfo-Linkage Technologies (Chengdu), Inc., and Linkage-AsiaInfo Technologies (Nanjing), Inc., or Linkage Nanjing, which allows those companies to compute tax at a reduced 15% tax rate starting January 1, 2008.

Linkage Nanjing obtained a preliminary confirmation of its HNTE status in the second quarter of 2011 and applied a 15% tax rate, while AsiaInfo-Linkage Technologies (China), Inc. and AsiaInfo-Linkage Technologies (Chengdu), Inc. have already filed or intend to file renewal applications with related authorities in the first half of 2011. We believe they are likely to pass the renewal assessment and have their HNTE certificates renewed.

**Table of Contents**

Both AsiaInfo-Linkage Technologies (China), Inc. and Linkage Nanjing were approved as Key Software Enterprise, or KSE, for 2010. Pursuant to the prevailing Chinese tax law, KSE's income tax rate would have been further reduced from 15% to 10% for 2010. Related approvals, however, were not announced until early 2011. As such, both companies include related tax benefit as a discrete item in the first quarter of 2011.

Sales of hardware procured in China are subject to 17% Value Added Tax, or VAT. Most of our sales of hardware procured outside of China are made through our U.S. parent company, AsiaInfo-Linkage, Inc., or one of its subsidiaries, Hong Kong AsiaInfo-Linkage Technologies Ltd., and thus are not subject to the VAT. We effectively pass VAT on hardware sales through to our customers and do not include them in revenue reported in our financial statements. Companies that develop their own software and register the software with relevant authorities in China are generally entitled to a VAT refund. If the net amount of the VAT payable exceeds 3% of software sales and software-related services, the excess portion of the VAT is refundable immediately. The policy was extended by a new tax circular issued in January 2011. The benefit of the VAT rebate is included in software revenue. Historically, the VAT refund received is not taxable for income tax purposes as long as the refund is used for research and development activities. However, according to a tax circular issued by the PRC State Administration of Taxation in January 2009, although the refund would remain non-taxable when the refund is used for purchases of or expenses associated with fixed assets, the expenses and depreciation associated with such fixed assets are not tax deductible for income tax purposes. This circular also stipulates that any VAT refund not spent within the five-year period following its receipt must be added back to taxable income in the sixth year. It is unclear how this new rule will be implemented and in the absence of specific guidance we are treating the VAT refund received as a non-taxable item for income tax purposes till the five-year period ends.

Our PRC subsidiaries and VIEs are subject to business tax, or BT, at the rate of 3% or 5%, respectively, on certain types of service revenues, which are presented in our statements of operations net of business tax incurred. Business taxes deducted from revenues during the six-month periods ended June 30, 2011 and 2010 were \$5.3 million and \$3.8 million, respectively. Effective from December 1, 2010, our PRC subsidiaries and VIEs are also subject to Urban Maintenance and Construction Tax as well as Education Fee Surcharge at the rate of 7% and 3% of VAT and BT paid.

In January 2011, the State Council issued a new circular providing an exemption from business tax for eligible software companies on software development and testing, system integration, consulting and maintenance services. The circular also retains various policies stipulated by previous circulars, including extending the policy of VAT rebate on sales of self-developed software. However, the implementation guidance of this new circular has not yet been issued, causing Chinese tax authorities to delay their processing of VAT rebates in the first six months of 2011.

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, AsiaInfo-Linkage, Inc., and interest income earned in the U.S.

**Foreign Exchange**

A majority of our revenues and expenses relating to the hardware, software and service components of our business are denominated in Renminbi, or RMB. The value of our shares will be affected by the foreign exchange rate between U.S. dollars and RMB because the value of our business is effectively denominated in RMB, while our shares are traded in U.S. dollars. Furthermore, an increase in the value of the RMB may require us to exchange more U.S. dollars into RMB in order to meet the working capital requirements of our subsidiaries in China. Depreciation of the value of the U.S. dollar will also reduce the value of the cash we hold in U.S. dollars, which we may use for purposes of future acquisitions or other business expansion. We actively monitor our exposure to these risks and adjust our cash position in the RMB and the U.S. dollar when we believe such adjustments will reduce our foreign exchange risks. For example, in February 2004 we exchanged approximately \$28.0 million cash from U.S. dollars to RMB in order to address concerns regarding a possible increase in the relative value of the RMB. We did not engage in any significant foreign exchange transactions in the six-month period ended June 30, 2011.

As of June 30, 2011, approximately 84.0%, or \$171.7 million, of our cash, cash equivalents and restricted cash were RMB-denominated and approximately 15.4%, or \$31.4 million, were U.S. dollar-denominated. Pursuant to the rate of exchange quoted by People's Bank of China as of June 30, 2011, the exchange rate between the U.S. dollar and the RMB was US\$1.00 = RMB6.4716, compared to the rate of US\$1.00=RMB6.7909 as of June 30, 2010.

---

## **Table of Contents**

### **Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, or US GAAP. 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, as well as the reported amount of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenues and cost of revenues under customer contracts, warranty obligations, bad debts, inventories, short-term investments, long-term investments, long-lived assets, income taxes, goodwill and other intangible assets, stock options, 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 involve the more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Revenue recognition.** Our revenue is derived from three primary sources: (i) software license and related services, including assistance in implementation, customization and integration, post-contract customer support, or PCS, training and consulting; (ii) professional services for systems design, planning, consulting, and system integration; and (iii) the procurement of hardware on behalf of our customers.

Revenues from customer orders requiring significant production, modifications, or customization of the software are recognized over the service period based on the percentage of completion method as prescribed by US GAAP. Software arrangements with significant production, modifications, or customization are sold with bundled PCS services. Because PCS services have never been sold separately in these arrangements, they do not have stand-alone fair value or vendor specific objective evidence of fair value. The percentage of completion method of revenue recognition is therefore applied to the period from the start of the significant production, modifications, or customization through the last element delivered, which is typically the end of the bundled PCS service period. Revisions in estimated contract costs 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.

Consulting and other professional services revenues are recognized when the services are performed. Sales of third-party hardware, if not bundled with other arrangements, are recognized when delivered if all other revenue recognition criteria are met. Costs associated with revenues are recognized when incurred.

We generated service revenues by acting as a sales agent pursuant to the IBM Type Arrangements. The service fee under our IBM Type Arrangements is determined as a percentage of the gross contract amount. We have evaluated the criteria outlined in guidance issued by FASB regarding reporting revenue gross as principal versus net as agent, when determining whether we would record as revenues the gross amount billed to our customers and related costs or the net amount earned after deducting hardware costs paid to the vendor, even though we bear inventory risks after the vendor ships the products to us and we bill gross amounts to our customers. We record the net amount earned after deducting hardware costs as agency service revenue because (1) the vendor is the primary obligor in these transactions, (2) we have no latitude in establishing the prices, (3) we are not involved in the determination of the product specifications, (4) we do not bear credit risk because we are contractually obligated to pay the vendor only when the customers pay us, and (5) we do not have the right to select suppliers.

Revenue recognized in excess of billings is recorded as unbilled receivables and is included in trade accounts receivable. Amounts billed but not yet collected are recorded as billed receivables and are included in trade accounts receivable. All billed and unbilled amounts are expected to be collected within one year. Billings for installation and customization services are rendered based on agreed upon milestones specified in customer contracts. Billings in excess of revenues recognized are recorded as deferred revenue.

**Revenue recognition policies for discontinued IT security business.** The information security products sold by our former Lenovo-AsiaInfo division have been accounted for under US GAAP accounting guidance regarding software revenue recognition for products with multiple deliverables. The related software contained in our information security products is considered to be more than incidental and is essential to the functionality of the related equipment. These information security products are sold bundled with PCS services over a term of one, two or three years.

For contracts entered into before December 31, 2008, we recognized the total arrangement fees for the information security products as revenue upon delivery assuming all other revenue recognition criteria were met regardless of whether the PCS services terms are one, two or three years because (a) PCS services primarily included telephone and online support, (b) PCS services were substantially provided within the first year of the arrangement term, (c) the costs of providing PCS services had historically been insignificant and were expected to be insignificant in the future, and (d) PCS services did not include upgrades or enhancements. PCS services provided beyond the first year of the service term had historically been negligible. We accrued the estimated costs of providing PCS services upon delivery of our security business's information security software products.





---

## **Table of Contents**

For contracts entered into after January 1, 2009, we extended PCS services terms to include unspecified upgrades. In addition, we have established vendor-specific objective evidence of fair value of the PCS services. Therefore, the security products revenue is now recognized upon delivery and the PCS services revenue is deferred and recognized ratably over the PCS services period.

**Income taxes.** Deferred income taxes are provided using the asset and liability method. Under this method, deferred income taxes are recognized for tax credits and net operating losses available for carry-forwards and significant temporary differences. Deferred tax assets and liabilities are classified as current or non-current based upon the classification of the related asset or liability in the financial statements or the expected timing of their reversal if they do not relate to a specific asset or liability.

The impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Interest and penalties on income taxes will be classified as a component of the provisions for income taxes.

AsiaInfo-Linkage Technologies (China), Inc. and AsiaInfo-Linkage Technologies (Chengdu), Inc.'s HNTe certificates are subject to renewal in 2011. Given the current law and the two companies' operations, we expect they will obtain renewals.

We have previously used the 25% statutory rate as the applicable rate to calculate the deferred tax balance of Linkage Nanjing after the expiration of its current HNTe certificate. In the second quarter of 2011, Linkage Nanjing received a preliminary confirmation of its HNTe status, we now believe that Linkage Nanjing will obtain its HNTe certificate and renew the status going forward and, accordingly, have re-calculated the balance of deferred tax relating to acquired intangible assets amortization and social welfare accrual by applying a 15% rate instead of a 25% rate. Such change resulted in a reduction of deferred tax balance and a net income tax credit to our consolidated statement of operations.

Under the EIT Law, a resident enterprise, which may include an enterprise established outside of the PRC with management located in the PRC, will be subject to PRC income tax. We believe we and our subsidiaries established outside the PRC are not resident enterprises under the EIT law.

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 assets in the future, an adjustment to the valuation allowance would be charged to income in the period such change occurred.

Interest and penalties on income taxes will be classified as a component of the provisions for income taxes.

**Goodwill.** The excess of the purchase price over the fair value of net assets acquired is recorded on our consolidated balance sheets as goodwill. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. We perform our annual goodwill impairment test on October 1 of each fiscal year for all reporting units. Goodwill is tested following a two-step process. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. We recognized no impairment loss on goodwill in the second quarter of 2011 and 2010.

**Impairment of long-term and short-term investments.** We review our long-term and short-term investments for other-than-temporary impairment in accordance with relevant accounting literature, based on the specific identification method. We consider available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds the investment's fair value, we consider, among other factors, general market conditions, government economic plans, the duration and the extent to which the fair value of the investment is less than the cost, and our intent and ability to hold the investment. We recognized no impairment loss on long-term investment in the second quarter of 2011 and 2010. We recognize \$nil and a \$nil million impairment loss on short-term investment in the second quarter of 2011 and 2010, respectively.



---

**Table of Contents****Consolidated Results of Operations**

**Revenues.** Total revenues were \$116.2 million for the three-month period ended June 30, 2011, representing a 95.9% increase over the year ago period and a 1.5% increase sequentially. Total revenue for the first half of 2011 was \$230.7 million, an increase of 94.6% year-over-year. Our revenues for the first half of 2011 are not comparable to those of prior periods before July 1, 2010 due to the combination with Linkage and we are not able to separately present the portion of revenues in this quarter contributed by AsiaInfo's historical business and Linkage's historical business as a result of our full integration strategy.

Software products and solutions revenue was \$102.8 million for the three-month period ended June 30, 2011, representing an increase of 98.7% over the comparable period in 2010 and a 1.4% sequential increase. Software products and solutions revenue was \$204.2 million for the six-month periods ended June 30, 2011, which was a year-over-year increase of 93.5%.

Service revenue was \$7.1 million in the three-month period ended June 30, 2011, representing an increase of 13.5% over the comparable period in 2010 and a 3.8% sequential increase. Service revenue was \$14.0 million in the six-month period ended June 30, 2011, representing an increase of 38.5% over the comparable period in 2010.

Third-party hardware revenue for the three-month period ended June 30, 2011 was \$6.2 million, representing a year-over-year increase of 401.0% and a sequential decrease of 0.4%. Third-party hardware revenue for the six-month period ended June 30, 2011 was \$12.4 million, representing an increase of 329.5% year-over-year.

During the second quarter, sales to our top three customers, China Mobile, China Unicom and China Telecom (and their respective provincial subsidiaries), accounted for approximately 99% of our total revenue.

**Cost of revenues.** Our cost of revenues was \$67.1 million in the three-month period ended June 30, 2011, representing an increase of 169.9% over the comparable period in 2010. Cost of revenues in the second quarter increased 7.8% compared to the preceding quarter. The year-over-year increase in cost of revenues was primarily related to Linkage combination and in line with the change in total revenues for the period. Our cost of revenues was \$129.3 million in the six-month period ended June 30, 2011, representing an increase of 169.5% over the comparable period in 2010.

**Gross profit.** Our gross profit margin in the three-month period ended June 30, 2011 was 42.2%, compared to 58.1% in the same period in 2010 and 45.6% in the preceding quarter. The year-over-year decrease in gross margin was primarily due to the amortization of acquired intangible assets related to the Linkage merger.

**Operating expenses.** Our operating expenses in the second quarter of 2011 were \$34.6 million, representing an increase of 71.6% over the comparable period in 2010 and 7.2% sequential decrease. Our operating expenses in the first half of 2011 were \$71.8 million, representing an increase of 63.2% over the comparable period in 2010. The year over year increase was primarily due to the amortization of acquired intangible assets related to the Linkage merger.

Sales and marketing expenses were \$19.2 million for the second quarter of 2011, representing an increase of 163.0% over the comparable period in 2010 and a 0.3% sequential decrease. Sales and marketing expenses were \$38.5 million for the first half of 2011, representing an increase of 157.9% over the comparable period in 2010.

General and administrative expenses were \$5.6 million for the second quarter of 2011, representing an increase of 26.2% over the comparable period in 2010 and a 29.8% sequential decrease. The sequential decrease is primarily due to a \$0.9 million accounts receivable provision for one provincial contract accrued in the first quarter of 2011. General and administrative expenses were \$13.6 million for the first half of 2011, representing an increase of 4.1% over the comparable period in 2010.

Research and development expenses were \$11.9 million for the second quarter of 2011, representing an increase of 41.4% over the comparable period in 2010 and an 18.9% sequential increase. Research and development expenses were \$21.8 million for the first half of 2011, representing an increase of 36.6% over the comparable period in 2010. The research and development expenses are in line with our strategy of continuing to invest in the research and development for overseas expansion and product standardization.

**Other income, net.** Other income, including interest income, dividend income, and other expenses, net, in the second quarter of 2011 was \$1.2 million, representing a decrease of 14.3% over the comparable period in 2010 and a decrease of 19.6% over the preceding quarter. Both decreases were primarily due to lower investment gains. Total other income in the first half of 2011 was \$2.7 million, representing an increase of 30.8% over the comparable period in 2010. The year-over-year increase was primarily due to higher yields from our bank deposits and

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

short-term investments in the first quarter of 2011.

**Net income.** Net income was \$32.3 million for the second quarter of 2011, representing an increase of 139.4% over the comparable period in 2010 and an increase of 84.2% sequentially. Net income was \$49.8 million for the first half of 2011, representing an increase of 112.7% over the comparable period in 2010.

---

## **Table of Contents**

***Net income attributable to AsiaInfo-Linkage, Inc.*** Net income attributable to AsiaInfo-Linkage, Inc. for the second quarter of 2011 was \$32.9 million, or \$0.45 per basic share, compared to \$13.9 million, or \$0.29 per basic share, for the year-ago period, and \$17.8 million, or \$0.24 per basic share, for the previous quarter. Net income attributable to AsiaInfo-Linkage, Inc. for the first half of 2011 was \$50.8 million, or \$0.68 per basic share, compared to \$24.3 million, or \$0.51 per basic share, for the year-ago period.

### **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. With respect to our billing cycle, we generally require our customers to pay 80% to 90% of the invoice value of the hardware upon delivery. We typically place orders for hardware against back-to-back orders from customers and seek favorable payment terms from hardware vendors. However, we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements. In addition to this careful management of our billing cycle, we have also historically financed working capital and other capital requirements through private placements of equity securities, our initial public offering in 2000 and, to a limited extent, bank loans.

For the second quarter of 2011, we had a net cash used in operating activities of \$21.8 million, primarily attributable to 2010 bonus payments made during the quarter amounting to US\$35.5 million.

Our net cash used in operating activities for the six-month period ended June 30, 2011 was \$3.1 million. This was primarily attributable to our net income of \$49.8 million, adjusted by net non-cash related expenses of \$32.0 million, the purchase of \$2.9 million for land use right, and a net increase in the components of our working capital of \$82 million.

Our accounts receivable balance as of June 30, 2011 was \$298.1 million, consisting of \$123.1 million in billed receivables and \$175.0 million in unbilled receivables. Our billed receivables are recorded based on agreed-upon milestones included in our customer contracts. Our unbilled receivables are based on the revenues that we have booked through the percentage completion method, but for which we have not yet billed the customer. Our accounts receivable balance as of June 30, 2011 related to the IBM Type Arrangements was approximately \$80.1 million. Our days sales outstanding, or DSO, as of June 30, 2011 was 159 days, which was also our DSO last quarter. When calculating our DSO, we have adjusted for the net effect of the IBM Type Arrangement.

Our inventory position at the end of the second quarter of 2011 was approximately \$6.4 million, as compared to \$9.9 million as of December 31, 2010.

Our accounts payable balance as of June 30, 2011 was approximately \$105.4 million, compared to \$89.9 million as of December 31, 2010. As of June 30, 2011, our accounts payable balance related to the IBM Type Arrangements was approximately \$91.0 million under which we are contractually obligated to pay our vendor only when our customers pay us.

Our net cash provided by investing activities for the six-month period ended June 30, 2011 was \$6.0 million. This was primarily due to our purchase of \$12.6 million in short-term investments and purchase of \$1.7 million in property and equipment, which was partially offset by the proceeds from sales of short-term investments for \$22.4 million.

Our net cash used in financing activities for the six-month period ended June 30, 2011 was \$59.3 million. This was primarily due to our repurchase of shares of our common stock pursuant to our share repurchase program.

As of June 30, 2011, we had cash and cash equivalents and restricted cash totaling \$204.3 million and short-term investments totaling \$32.8 million.

As of June 30, 2011, we had total short-term credit facilities of \$114.5 million for working capital purposes, expiring in September 2012, which were secured by bank deposits of \$10.4 million. As of June 30, 2011, unused short-term credit facilities were \$97.3 million and used facilities totaled \$17.2 million. The used facilities were pledged as security for issuing standby letters of credit and trade notes payable to hardware suppliers and customers. Additional bank deposits of \$5.7 million were used for issuing standby letters of credit and bank acceptance drafts as of June 30, 2011. Total bank deposits pledged as security for these credit facilities totaled \$16.1 million as of June 30, 2011 and are presented as restricted cash in our consolidated balance sheets. During the three-month period ended June 30, 2011, the largest aggregate amount that we had used of our short-term credit facilities was \$17.2 million.

## Edgar Filing: ASIAINFO-LINKAGE, INC - Form 10-Q

In May 2011, we entered into a land use right transfer agreement with the Beijing Municipal Bureau of Land and Resources, under which we acquired land use rights for a 50-year term. Pursuant to the agreement, we have committed a minimum of \$30.8 million for capital expenditures to the building construction project, to commence construction by April 30, 2012, and to complete construction by April 30, 2014.

---

## **Table of Contents**

We anticipate that our 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 2011. 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 for larger projects involving higher levels of hardware purchases, or if our business otherwise grows more rapidly than we currently predict. We anticipate that we would raise additional funds, if necessary, through new issuances of shares of our equity securities in one or more public offerings or private placements, or through credit facilities extended by lending institutions.

In the event that we decide to pay dividends to our stockholders, our ability to pay dividends will depend in part on our ability to receive dividends from our operating subsidiaries in China. Foreign exchange and other regulations in China may restrict our ability to distribute retained earnings from our operating subsidiaries in China or convert those payments from RMB into foreign currencies.

### **Off-Balance Sheet Arrangements**

We have not entered into any transactions, agreements or other contractual arrangements to which an entity unconsolidated with us is a party and under which we have (i) any obligation under a guarantee, (ii) any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity, (iii) any obligation under derivative instruments that are indexed to our shares and classified as equity in our consolidated balance sheets, or (iv) any obligation arising out of a variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

As of June 30, 2011, we had short-term credit facilities for working capital purposes totaling \$114.5 million, expiring in September 2012, of which \$17.2 million had been used for issuing standby letters of credit and trade notes payable to hardware suppliers and customers. Unused short-term credit facilities were \$97.3 million.

### **Accounting Pronouncements**

#### ***Recent accounting pronouncements not yet adopted***

In May 2011, the FASB issued an authoritative pronouncement on fair value measurement. The guidance is the result of joint efforts by the FASB and International Accounting Standards Board, or IASB, to develop a single, converged fair value framework. The guidance is largely consistent with existing fair value measurement principles in US GAAP. The guidance expands the existing disclosure requirements for fair value measurements and makes other amendments, mainly including:

Highest-and-best-use and valuation-premise concepts for nonfinancial assets – the guidance indicates that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of nonfinancial assets.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk – the guidance permits an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position.

Premiums or discounts in fair value measure – the guidance provides that premiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement.

Fair value of an instrument classified in a reporting entity's stockholders' equity – the guidance prescribes a model for measuring the fair value of an instrument classified in stockholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

Disclosures about fair value measurements the guidance expands disclosure requirements, particularly for Level 3 inputs. Required disclosures include:

- (i) For fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation process in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.
  
- (ii) The level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed.



---

## **Table of Contents**

The guidance is to be applied prospective and effective for interim and annual periods beginning after December 15, 2011, for public entities. Early application by public entities is not permitted. We do not expect the adoption of this pronouncement to have a significant effect on our consolidated financial statements.

In June 2011, the FASB issued an authoritative pronouncement to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. These amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The guidance should be applied retrospectively. For public entities, the amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. We are in the process of evaluating the effect of adoption of this guidance on our consolidated financial statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to interest rate risk primarily associated with our cash and short-term investments. To date, we have not entered into any types of derivatives to hedge against interest rate changes. There have been no significant changes in our exposure to changes in interest rates for the quarter ended June 30, 2011. Our exposure to interest rate changes is limited as we do not have any material borrowings.

We are exposed to exchange rate risk in connection with the relative value of the U.S. dollar and the RMB. Substantially all of our revenues and expenses relating to the service and software components of our business are denominated in RMB. As of June 30, 2011, approximately 84.0%, or \$171.7 million, of our cash, cash equivalents and restricted cash were RMB-denominated and approximately 15.4%, or \$31.4 million, were U.S. dollar-denominated. As of that date, the rate of exchange quoted by the People's Bank of China was US\$1.00 = RMB6.4716. If the exchange rate were to increase by 10% to US\$1.00 = RMB7.1188, our net assets would potentially decrease by \$38.7 million. If the exchange rate were to decrease by 10% to US\$1.00 = RMB5.8244, our net assets would potentially increase by \$47.4 million.

The value of our shares may be affected by the foreign exchange rate between U.S. dollars and RMB because the value of our business is effectively denominated in RMB, while our shares are traded in U.S. dollars. Furthermore, an increase in the value of the RMB may require us to exchange more U.S. dollars into RMB to meet the working capital requirements of our subsidiaries and VIEs in China. Depreciation of the value of the U.S. dollar will also reduce the value of the cash we hold in U.S. dollars, which we may use for purposes of future acquisitions or business expansion. We actively monitor our exposure to these risks and adjust our cash position in the RMB and the U.S. dollar when we believe such adjustments will reduce our foreign exchange risk. For example, in February 2004 we exchanged approximately \$28 million cash in U.S. dollars into RMB in anticipation of increases in the value of the RMB. We did not engage in any significant foreign exchange transactions during the six-month period ended June 30, 2011.

As in any other business, we are subject to the risk of macroeconomic changes such as recessions and inflation.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

#### **Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

In December 2001, a securities class action case was filed in New York City against us, certain of our officers and directors and the underwriters of our initial public offering, or our IPO. The lawsuit alleged violations of the U.S. federal securities laws and was docketed in the U.S. District Court for the Southern District of New York as *Hassan v. AsiaInfo Holdings, Inc., et al.* The lawsuit alleged, among other things, that the underwriters of our IPO improperly required their customers to pay the underwriters excessive commissions and to agree to buy additional shares of our common stock in the aftermarket as conditions of their purchasing shares in our IPO. The lawsuit further claimed that the alleged practices of the underwriters should have been disclosed in our IPO prospectus and registration statement. The suit seeks rescission of the plaintiffs' alleged purchases of our common stock as well as unspecified damages. In addition to the case against us, various other plaintiffs have filed approximately 1,000 other, substantially similar class action cases, or the IPO Allocation Cases, against approximately 300 other publicly traded companies and their IPO underwriters in New York City, which along with the case against us have all been transferred to a single federal district judge for purposes of case management.

In April 2009, we and most of the other issuer defendants in the IPO Allocation Cases reached a definitive agreement with the plaintiffs and the underwriter defendants to settle the IPO Allocation Cases. The agreement was filed with the court in April 2009 and a final approval was granted by the court in October 2009. The final approval was subject to appeal until November 2009. Ten appeals were filed objecting to the definition of the settlement class and fairness of the settlement, five of which have been dismissed with prejudice. Two appeal briefs were filed by the remaining objector groups, one of which was dismissed and the other remanded to the District Court to determine whether the appellant has standing to object to the settlement. If the settlement is approved, we expect any damages payable to the plaintiffs to be fully funded by our directors' and officers' liability insurance policies. If the litigation proceeds, we intend to continue to defend the litigation vigorously. Moreover, if the litigation proceeds, we believe that the underwriters may have an obligation to indemnify us for the legal fees and other costs of defending this suit and that our directors' and officers' liability insurance policies would also cover the defense and potential exposure in the suit.

In addition, in June 2007 we received a letter from a putative stockholder demanding that we investigate and prosecute a claim for alleged short-swing trading in violation of Section 16(b) of the Exchange Act by the underwriters of our IPO and certain of our unidentified directors, officers and stockholders. In October 2007, the putative stockholder commenced a civil lawsuit in the U.S. District Court for the Western District of Washington against Morgan Stanley and Deutsche Bank, two of the lead underwriters of our IPO, alleging violations of Section 16(b) of the Exchange Act. The complaint alleges that the combined number of shares of our common stock beneficially owned by the lead underwriters and certain unnamed officers, directors and principal stockholders exceeded ten percent of our outstanding common stock from the date of our IPO in March 2000, for at least one year. It further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b), and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). None of our directors, officers or stockholders is named as a defendant in this action, although we are named as a nominal defendant. In July 2008, we, together with several other issuers who are also named as nominal defendants in the action, filed a joint motion to dismiss the action. In March 2009, the court granted our motion, dismissing the complaint without prejudice on the ground that the plaintiff failed to make an adequate demand to us prior to filing the complaint. The plaintiff subsequently appealed the judgment to the Court of Appeals for the Ninth Circuit, and the underwriter defendants have filed certain cross-appeals. In December 2010, the Ninth Circuit affirmed the dismissal of the case, but reversed and remanded certain claims relating to the underwriters. In January 2011, the Ninth Circuit denied certain petitions for rehearing and ordered that no further petitions for rehearing may be filed. In April 2011, the plaintiff requested review with the U.S. Supreme Court, seeking reversal of the Ninth Circuit's decision, and the underwriter defendants requested review with the U.S. Supreme Court regarding a statute of limitations issue. In June 2011, the U.S. Supreme Court denied plaintiff's request for review and granted the underwriter defendants' request for review.

We intend to continue to defend vigorously the two litigation matters described above. While we cannot guarantee the outcome of these proceedings, we believe that the final results of these lawsuits will have no material effect on our consolidated financial condition, results of operations, or cash flows.

During the fiscal quarter ended June 30, 2011, we did not have any other material legal proceedings brought against us. No further material developments occurred in connection with any previously reported legal proceedings against us during the last fiscal quarter.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table presents information with respect to purchases during the three months ended June 30, 2011 made by us or any affiliated purchaser (as defined in Rule 10b-18(a)(3)) of equity securities that are registered pursuant to Section 12 of the Exchange Act.

**ISSUER PURCHASES OF EQUITY SECURITIES**

Three months ended June 30, 2011

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Dollar Value of Shares Purchased as Part of Publicly Announced Plans or Programs (in thousands)	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
April 1, 2011 to April 30, 2011	773,200	19.4529	15,041	40,003
May 1, 2011 to May 31, 2011	1,284,200	19.4674	25,000	15,003
June 1, 2011 to June 30, 2011	860,200	17.4378	15,000	3 <sup>(2)</sup>
<b>Total</b>	2,917,600	\$ 18.8652	\$ 55,041	\$ 3 <sup>(2)</sup>

- (1) Represents repurchases of shares of our common stock by us pursuant to a stock repurchase program we publicly announced on January 30, 2011. The program permitted us, from time to time for a period of twelve months, depending on market conditions, share price and other factors, to make one or more purchases, on the open market or in privately negotiated transactions, of up to \$60 million in aggregate value of our outstanding common stock.
- (2) The Company has determined that it has completed the repurchases pursuant to the program.

**ITEM 6. EXHIBITS**

Please see Exhibit Index.

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, AsiaInfo-Linkage, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AsiaInfo-Linkage, Inc.

Date: August 8, 2011

By: */s/ Jun Wu*  
Name: Jun Wu  
Title: Vice President and Chief Financial Officer  
(signing on behalf of the registrant and as principal financial officer)

**Table of Contents****EXHIBIT INDEX**

The following exhibits are filed as a part of this Report.

Exhibit No.	Exhibit Title	Filed Herewith	Incorporated by Reference		
			Form	Exhibit No.	File No.
31.1	Certification of Principal Executive Officer required by Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 8, 2011	X			
31.2	Certification of Principal Financial Officer required by Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 8, 2011	X			
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 8, 2011	X			
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 8, 2011	X			