CADIZ INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

# FORM 10-Q

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2006

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 0-12114

CADIZ INC.

(Exact name of registrant specified in its charter)

| DELAWARE | 77-0313235 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 777 S. FIGUEROA STREET, SUITE 4250 LOS ANGELES, CALIFORNIA | 90017 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (213) 271-1600

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

YES X NO
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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2).

LARGE ACCELERATED FILER ___ ACCELERATED FILER X

NON-ACCELERATED FILER ___

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2).

YES ___ NO X___

As of November 2, 2006 the Registrant had 11,526,181 shares of common stock, par value $0.01 per share, outstanding.



CADIZ INC.

INDEX

FOR THE THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2006 PAGE

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CADIZ INC. CONSOLIDATED FINANCIAL STATEMENTS

Unaudited Statements of Operations for the three months ended September 30, 2006 and 2005. . . . . . . . . . . . . . . .1

Unaudited Statements of Operations for the nine months ended September 30, 2006 and 2005. . . . . . . . . . . . . . . . . . .2

Unaudited Balance Sheets as of September 30, 2006 and December 31, 2005. . . . . . . . . . . . . . . . . . . . . . . . .3

Unaudited Statements of Cash Flows for the nine months ended September 30, 2006 and 2005. . . . . . . . . . . . . . . . . . .4

Unaudited Statement of Stockholders' Equity for the nine months ended September 30, 2006. . . . . . . . . . . . . . . . .5

Unaudited Notes to the Consolidated Financial Statements. . . 6

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. . . . . . . . . . . 18

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK. . . . . . . . . . . . . . . . . . . . . . . . 28

ITEM 4. CONTROLS AND PROCEDURES. . . . . . . . . . . . . . . . . . 28

PART II - OTHER INFORMATION. . . . . . . . . . . . . . . . . . . . . .29



CADIZ INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| ($ IN THOUSANDS EXCEPT PER SHARE DATA) | FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006 | 2005 |
|---|---|---|
| Revenues | $ 37 | $ 15 |
| Costs and expenses: | | |
| Cost of Sales | - | - |
| General and administrative | 1,317 | 1,054 |
| Compensation costs from stock and option awards | 768 | 2,305 |
| Depreciation and amortization | 38 | 67 |
| Total costs and expenses | 2,123 | 3,426 |
| Operating loss | (2,086) | (3,411) |
| Other income (expense) | | |
| Interest expense, net | (702) | (479) |
| Change in fair value of derivative liability | (2,919) | - |
| Other income | 23 | - |
| Other income (expense), net | (3,598) | (479) |
| Loss before income taxes | (5,684) | (3,890) |
| Income tax provision | - | (27) |
| Net loss | $ (5,684) | $ (3,863) |
| Net loss applicable to common stock | $ (5,684) | $ (3,863) |
| Basic and diluted net loss per common share | $ (0.50) | $ (0.35) |
| Basic and diluted weighted average shares outstanding | 11,331 | 10,966 |

See accompanying notes to the consolidated financial statements.



CADIZ INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| ($ IN THOUSANDS EXCEPT PER SHARE DATA) | FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 | 2005 |
|---|---|---|
| Revenues | $ 446 | $ 45 |

| | | |
|---|---|---|
| Costs and expenses: | | |
| Cost of Sales | 341 | - |
| General and administrative | 4,128 | 2,885 |
| Compensation costs from stock and option awards | 1,826 | 13,554 |
| Depreciation and amortization | 117 | 201 |
| Total costs and expenses | 6,412 | 16,640 |
| Operating loss | (5,966) | (16,595) |
| Other income (expense) | | |
| Interest expense, net | (1,679) | (1,433) |
| Loss on early extinguishment of debt | (868) | - |
| Change in fair value of derivative liability | (2,919) | - |
| Other income | 373 | - |
| Other income (expense), net | (5,093) | (1,433) |
| Loss before income taxes | (11,059) | (18,028) |
| Income tax provision | 1 | 29 |
| Net loss | $(11,060) | $(18,057) |
| Net loss applicable to common stock | $(11,060) | $(18,057) |
| Basic and diluted net loss per common share | $ (0.98) | $ (1.69) |
| Basic and diluted weighted average shares outstanding | 11,331 | 10,679 |

See accompanying notes to the consolidated financial statements.



CADIZ INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| ($ IN THOUSANDS) | SEPTEMBER 30, 2006 | DECEMBER 31, 2005 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 12,012 | $ 5,302 |
| Accounts receivable | 16 | 170 |
| Prepaid interest expense | - | 740 |
| Prepaid expenses and other | 566 | 34 |

| | | |
|---|---|---|
| Total current assets | 12,594 | 6,246 |
| Property, plant, equipment and water programs, net | 35,227 | 35,323 |
| Goodwill | 3,813 | 3,813 |
| Other assets | 396 | 664 |
| Total Assets | $ 52,030 | $ 46,046 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 326 | $ 369 |
| Accrued liabilities | 755 | 819 |
| Current portion of long term debt | 9 | 8 |
| Total current liabilities | 1,090 | 1,196 |
| Long-term debt, net of $11,868 unamortized discounts on September 30, 2006 | 24,997 | 25,883 |
| Total Liabilities | 26,087 | 27,079 |
| Commitments and contingencies (Note 7) | | |
| Stockholders' equity: | | |
| Series F convertible preferred stock - $.01 par value; 100,000 shares authorized; shares issued and outstanding - 1,000 at September 30, 2006 and December 31, 2005 | - | - |
| Common stock - $.01 par value; 70,000,000 shares authorized; shares issued and outstanding - 11,400,402 at September 30, 2006 and 11,330,463 at December 31, 2005 | 115 | 114 |
| Additional paid-in capital | 244,773 | 226,738 |
| Accumulated deficit | (218,945) | (207,885) |
| Total stockholders' equity | 25,943 | 18,967 |
| Total Liabilities and Stockholders' equity | $ 52,030 | $ 46,046 |

See accompanying notes to the consolidated financial statements.



CADIZ INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| ($ IN THOUSANDS EXCEPT PER SHARE DATA) | FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 | 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $(11,060) | $(18,057) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Depreciation and amortization | 117 | 201 |
| Amortization of debt discount & issuance costs | 400 | 21 |
| Interest expense added to loan principal | 1,251 | 893 |
| Loss on early extinguishment of debt | 868 | - |
| Change in value of derivative liability | 2,919 | - |
| Compensation charge for stock awards and share options | 1,826 | 13,554 |
| Stock issued for services | - | 469 |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in accounts receivable | 154 | (16) |
| Decrease (increase) in prepaid borrowing expense | 522 | 851 |
| Decrease (increase) in prepaid expenses and other | (532) | 28 |
| Increase (decrease) in accounts payable | (43) | (96) |
| Increase (decrease) in accrued liabilities | (64) | (396) |
| Net cash used for operating activities | (3,642) | (2,548) |
| Cash flows from investing activities: | | |
| Additions to property, plant and equipment | (20) | (53) |
| Proceeds from asset disposition | - | 24 |
| Decrease (increase) in other assets | - | 11 |
| Net cash provided by (used by) investing activities | (20) | (18) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock | 1,050 | - |
| Proceeds from issuance of long-term debt | 36,375 | - |
| Debt issuance costs | (409) | - |
| Principal payments on long-term debt | (26,644) | - |
| Net cash provided by (used by) financing activities | 10,372 | - |
| Net increase (decrease) in cash and cash equivalents | 6,710 | (2,566) |
| Cash and cash equivalents, beginning of period | 5,302 | 9,031 |
| Cash and cash equivalents, end of period | $ 12,012 | $ 6,465 |

Supplemental disclosure of non-cash investment and financing activities:

| | | |
|---|---|---|
| Reclassification of loan conversion option fair value from liabilities to stockholder's equity | $ 15,160 | $ - |

See accompanying notes to the consolidated financial statements.



CADIZ INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006
($ IN THOUSANDS)

| | PREFERRED STOCK | | COMMON STOCK | | ADDITIONAL PAID-IN | ACCUM. | TOTAL STOCKHOLDERS' |
|---|---|---|---|---|---|---|---|
| | SHARES | AMOUNT | SHARES | AMOUNT | CAPITAL | DEFICIT | EQUITY |
| Balance as of December 31, 2005 | 1,000 | $ - | 11,330,463 | $ 114 | $ 226,738 | $(207,885) | $ 18,967 |
| Convertible term loan conversion option | - | - | - | - | 15,160 | - | 15,160 |
| Stock compensation expense | - | - | - | - | 1,826 | - | 1,826 |
| Common stock issued due to warrant exercise | - | - | 70,000 | 1 | 1,049 | - | 1,050 |
| Fractional shares retired | - | - | (61) | - | - | - | - |
| Net loss | - | - | - | - | - | (11,060) | (11,060) |
| Balance as of September 30, 2006 | 1,000 | $ - | 11,400,402 | $ 115 | $ 244,773 | $(218,945) | $ 25,943 |

See accompanying notes to the consolidated financial statements.

CADIZ INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - BASIS OF PRESENTATION

GENERAL

The Consolidated Financial Statements have been prepared by Cadiz Inc., sometimes referred to as "Cadiz" or "the Company", without audit and should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2005. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The foregoing Consolidated Financial Statements include the accounts of the Company and contain all adjustments, consisting only of normal recurring adjustments, which the Company considers necessary for a fair presentation of the Company's financial position, the results of its operations and its cash flows for the periods presented and have been prepared in accordance with generally accepted accounting principles.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates and such differences may be material to the financial statements. This quarterly report on Form 10-Q should be read in conjunction with the Company's Form 10-K for the year ended December 31, 2005. The results of operations for the nine months ended September 30, 2006 are not necessarily indicative of results for the entire fiscal year ending December 31, 2006.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared using accounting principles applicable to a going concern, which assumes realization of assets and settlement of liabilities in the normal course of business. The Company incurred losses of $11.1 million for the nine months ended September 30, 2006 and $18.1 million for the nine months ended September 30, 2005. The Company had working capital of $11.5 million at September 30, 2006 and used cash in operations of $3.6 million for the nine months ended September 30, 2006 and $2.5 million for the nine months ended September 30, 2005. Currently, the Company's sole focus is the development of its land and water assets.

During the nine months ended September 30, 2006, the Company raised $36.4 million through the private placement of a five year zero coupon convertible term loan with Peloton Partners LLP ("Peloton"), as administrative agent, and an affiliate of Peloton and another investor, as lenders. The proceeds of the new term loan were partially used to repay the Company's prior term loan facility with ING Capital LLC ("ING").

The Company's current resources do not provide the capital necessary to fund a water or real estate development project should the Company be required to do so. There is no assurance that additional financing (public or private) will be available on acceptable terms or at all. If the Company issues additional equity or equity linked securities to raise funds, the ownership percentage of the Company's existing stockholders would be reduced. New



investors may demand rights, preferences or privileges senior to those of existing holders of common stock. If the Company cannot raise needed funds, it might be forced to make further substantial reductions in its operating expenses, which could adversely affect its ability to implement its current business plan and ultimately its viability as a company. These financial statements do not include any adjustments that might result from these uncertainties.

PRINCIPLES OF CONSOLIDATION

In December 2003, the Company transferred substantially all of its assets with the exception of its office sublease, certain office furniture and equipment and the investment in Sun World International Inc.("Sun World") to Cadiz Real Estate LLC, a Delaware limited liability company ("Cadiz Real Estate"). The Company holds 100% of the equity interests of Cadiz Real Estate, and therefore continues to hold 100% beneficial ownership of the properties that it transferred to Cadiz Real Estate. Because the transfer of the Company's properties to Cadiz Real Estate has no effect on its ultimate beneficial ownership of these properties, the properties owned of record either by Cadiz Real Estate or by the Company are treated as belonging to the Company.

On January 30, 2003, Sun World and certain of its subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The financial statements of Sun World were no longer consolidated with those of Cadiz due to the Company's loss of control over the operations of Sun World on that date. Cadiz also wrote off its net investment in Sun World of $195 thousand at the Chapter 11 filing date because it did not anticipate being able to recover its investment.

Further, in February 2005, Sun World completed the sale of substantially all of its assets. Sun World's consensual plan of reorganization was confirmed by the U.S. Bankruptcy Court in August, 2005 and became effective on September 6, 2005. Cadiz also reached a settlement with Sun World regarding certain tax matters that became effective on September 6, 2005. With the final bankruptcy plan confirmation and settlement, Cadiz has no further rights and obligations relating to Sun World assets or indebtedness, and supplemental disclosure of Sun World financial information is no longer included in Cadiz filings.

As discussed above, subsequent to the effective date of the plan of reorganization of Sun World, the Company's primary activities are limited to the development of its water resource programs and real estate assets. From the effective date of the plan of reorganization through September 30, 2006, the Company incurred losses of approximately $16.3 million and used cash in operations of approximately $4.9 million.

GOODWILL

The Company has $3.8 million of goodwill which resulted from a merger in May 1988 between two companies, which eventually became known as Cadiz Inc. Goodwill is not amortized but is tested for impairment annually in the first quarter, or earlier if events occur which require an impairment analysis to be performed. The Company performed an impairment test of its goodwill in the first quarter of 2006 and determined that its goodwill was not impaired.



INTANGIBLE AND OTHER LONG-LIVED ASSETS

Property, plant and equipment, intangible and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards Number 123 (revised 2004), "Share Based Payment" ("SFAS 123R"). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant date fair values. SFAS 123R replaces SFAS No. 123, "Accounting for Stock Based Compensation," ("SFAS 123") and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees."

In January 2006, the Company adopted the new requirements using the modified prospective transition method in the first quarter of fiscal 2006, and, as a result, will not retroactively adjust the results from prior periods. Under this transition method, compensation expense associated with stock options recognized in the first nine months of fiscal 2006 included $697,000 related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. The Company applied the Black-Scholes valuation model in determining the fair value of share-based payments to employees, which is then amortized on a straight-line basis over the requisite service period. In addition to the $697,000 of stock option related expense due to the adoption of SFAS 123R, the Company recognized $1,129,000 of expense related to stock awards previously granted under the Management Equity Incentive Plan.

In June 2006, the FASB issued FSP FIN 48 which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. This Interpretation also provides guidance on derecognition, classification, interest, penalties, accounting in interim

periods, disclosure and transition. The evaluation of a tax position in accordance with this Interpretation will be a two-step process. The first step will determine if it is more likely than not that a tax position will be sustained upon examination and should therefore be recognized. The second step will measure a tax position that meets the more likely than not recognition threshold to determine the amount of benefit to recognize in the financial statements. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this Statement.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 was issued in order to eliminate the diversity of practice



surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" method and the "iron curtain" method. The roll-over method focuses primarily on the impact of a misstatement on the income statement-including the reversing effect of prior year misstatements-but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. We currently use the iron curtain method for quantifying identified financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires uantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification of errors under both the iron curtain and the roll-over methods.

SAB 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Use of the "cumulative effect" transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose.

The Company will initially apply the provisions of SAB 108 using the cumulative effect transition method in connection with the preparation of our annual financial statements for the year ending December 31, 2006. The Company is currently assessing the impact of this statement.

STOCK-BASED COMPENSATION

Prior to the January 2006 adoption of SFAS 123R, the Company accounted for grants of options to employees to purchase its

common stock using the intrinsic value method in accordance with APB Opinion No. 25 and FIN No. 44, "Accounting for Certain Transactions Involving Stock Compensation". As permitted by SFAS 123 and as amended by SFAS No. 148, the Company chose to continue to account for such option grants under APB Opinion No. 25 and provide the expanded disclosures specified in SFAS 123, as amended by SFAS No. 148.

Had compensation cost for the Company's option grants been determined based on their fair value at the grant date for awards consistent with the provisions of SFAS 123R, the Company's net loss per share for the three months and nine months ended September 30, 2005 would have been the adjusted pro forma amounts indicated below (dollars in thousands):



| | PERIOD ENDING SEPTEMBER 30, 2005 | |
|---|---|---|
| | THREE MONTHS | NINE MONTHS |
| | (UNAUDITED) | |
| Net loss applicable to common stock, as reported | $ (3,863) | $(18,057) |
| Stock based employee compensation cost, net of tax effects, included in the determination of net income, as reported | 2,305 | 13,554 |
| Stock based employee compensation cost, net of tax effects, under the fair value method if the fair value method had been applied | (2,482) | (14,463) |
| Proforma net loss if the fair value method had been applied | $ (4,040) | $(18,966) |

| | PERIOD ENDING SEPTEMBER 30, 2005 | |
|---|---|---|
| | THREE MONTHS | NINE MONTHS |
| | (UNAUDITED) | |
| Net loss applicable to common stock: as reported per basic and diluted common share | $ (.35) | $ (1.69) |
| Stock based employee compensation cost, net of tax effects, included in the determination of net income as reported | 0.21 | 1.26 |
| Stock based employee compensation cost, net of tax effects, under the fair value method if the fair value method had been applied | (0.23) | (1.35) |
| Proforma net loss if the fair value method had been applied | $ (0.37) | $ (1.78) |

For purposes of computing the pro forma disclosures required by SFAS 123, the fair value of each option granted to employees and directors is estimated using the Black-Scholes option pricing model.

The Company has issued options pursuant to its 2003 Management Equity Incentive Plan. Options issued under the Management Equity Incentive Plan were granted during 2005 and have a ten year term with vesting periods ranging from issuance date to three years. Certain of these options have strike prices that are below the fair market value of the stock on the date of grant. All options have been issued to directors, officers, consultants and employees of the Company.



The Management Equity Incentive Plan provides for the granting of up to 377,339 options to purchase one share of common stock. 365,000 options were granted under the plan during 2005. These options remain unexercised and outstanding on September 30, 2006. There were no additional option grants during the 9 month period ended September 30, 2006.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), "Share-Based Payment", which requires all share-based payments to employees, including grants of employee stock options, be recognized in the financial statements based on their grant date fair values. SFAS No. 123R replaces SFAS No. 123, "Accounting for Stock-based Compensation," ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Company adopted the new requirements using the modified prospective transition method during the first quarter of 2006, and as a result, will not retroactively adjust results from prior periods. Under this transition method, compensation expense associated with stock options recognized in the first quarter of fiscal 2006 included: 1) expenses related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and 2) expenses related to all stock option awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. The Company will apply the Black-Scholes valuation model in determining the fair value of share-based payments to employees, which will then be amortized on a straight-line basis over the requisite service period. No stock options were granted during the first nine months of 2006.

As a result of the adoption of SFAS 123R, the Company recorded expense in the amount of $697,000 in the first 9 months of 2006 related to the fair value of options, all of which were granted in 2005. SFAS 123R also requires the Company to estimate forfeitures in calculating the expense related to stock-based compensation as opposed to only recognizing these forfeitures and the corresponding reduction in expense as they occur. The remaining vesting periods are relatively short, and the potential impact of forfeitures is not material. The Company is in a tax loss carryforward position and is not expected to realize a benefit from any additional compensation expense recognized under SFAS 123R. See Note 4 - Income Taxes.

All outstanding stock options were issued in May and October of fiscal 2005 under the Management Equity Incentive Plan. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | |
|---|---|
| Risk free interest rate | 4.20% |
| Expected life | 9.6 years |
| Expected volatility | 46% |
| Expected dividend yield | 0.0% |
| Weighted average vesting period | 0.7 years |

The Company recognized stock option related compensation costs of $697,000 in the first nine months of fiscal 2006 relating to these options. At September 30, 2006, the unamortized compensation expense related to these options amounted to $199,000. No stock options were exercised during fiscal 2005 and during the first nine months of fiscal 2006.



A summary of option activity under the plan as of September 30, 2006 and changes during the current fiscal year is presented below:

| OPTIONS | SHARES | WEIGHTED-AVERAGE EXERCISE PRICE | WEIGHTED-AVERAGE REMAINING CONTRACTUAL TERM | AGGREGATE INTRINSIC VALUE ($000'S) |
|---|---|---|---|---|
| Outstanding January 1, 2006 | 365,000 | $ 12.71 | 9.4 | $ 3,842 |
| Granted | - | - | - | - |
| Exercised | - | - | - | - |
| Forfeited or expired | - | - | - | - |
| Outstanding on September 30, 2006 | 365,000 | $ 12.71 | 8.6 | $ 3,842 |
| Exercisable at September 30, 2006 | 238,335 | $ 12.50 | 8.6 | $ 2,435 |

The weighted-average grant-date fair value of options granted during the year 2005 was $10.53.

The Company has also granted stock awards pursuant to its Management Equity Incentive Plan and 2004 Management Bonus Plan. The Management Equity Incentive Plan provided for the granting of 1,094,712 shares of common stock in May 2005, and the 2004 Management Bonus Plan provided for the granting of 10,000 shares of common stock valued at $12.00 per share in December 2004. Compensation cost for stock granted to employees is measured at the quoted market price of the Company's stock at the date of the grant. For the nine months ended September 30, 2006, the accompanying consolidated statement of operations includes approximately $1,129,000 of stock based compensation expense related to these stock awards. At September 30, 2006, the

compensation expense relating to these stock awards was fully amortized.

A summary of stock awards activity under the plan as of September 30, 2006 and changes during the current quarter is presented below:

| | SHARES | WEIGHTED-AVERAGE GRANT-DATE FAIR VALUE ($000's) |
|---|---|---|
| Nonvested at December 31, 2005 | 125,779 | $ 1,950 |
| Granted | - | - |
| Forfeited or canceled | - | - |
| Vested | - | - |
| Nonvested at September 30, 2006 | 125,779 | $ 1,950 |

See Note 2 to the Consolidated Financial Statements included in the Company's Form 10-K for further discussion of the Company's accounting policies.



## NOTE 2 - PROPERTY, PLANT, EQUIPMENT AND WATER PROGRAMS

Property, plant, equipment and water programs consist of the following (in thousands):

| | SEPTEMBER 30, 2006 | DECEMBER 31, 2005 |
|---|---|---|
| Land and land improvements | $ 21,986 | $ 21,986 |
| Water programs | 14,274 | 14,274 |
| Buildings | 1,191 | 1,191 |
| Machinery and equipment | 2,123 | 2,103 |
| | 39,574 | 39,554 |
| Less accumulated depreciation | (4,347) | (4,231) |
| | $ 35,227 | $ 35,323 |

Depreciation expense totaled $38 thousand and $67 thousand during the three months ended September 30, 2006 and 2005, and $117 thousand and $201 thousand for the nine months ended September 30, 2006 and 2005.

## NOTE 3 - DEBT

In June, the Company entered into a $36.4 million five year zero coupon convertible term loan with Peloton Partners LLP, as administrative agent for the loan, and with an affiliate of Peloton and another investor, as lenders. Certain terms of the loan were subsequently amended pursuant to Amendment #1 to the Credit Agreement, which was effective September 29, 2006. Under the terms of the loan, interest accrues at a 5% annual rate for the first 3 years and 6% thereafter, calculated on the basis of a 360 day year and actual days elapsed. The entire amount of accrued interest is due at the final maturity of the loan in September, 2011. The term loan is secured by substantially all the assets of the Company and contains representations, warranties and covenants that are typical for agreements of this type, including restrictions that would limit the Company's ability to incur additional indebtedness, incur liens, pay dividends or make restricted payments, dispose of assets, make investments and merge or consolidate with another person. However, there are no financial maintenance covenants and no restrictions on the Company's ability to issue additional common stock to fund future working capital needs.

At the lender's option, principal plus accrued interest is convertible into the Company's $0.01 par value common stock. The loan is divided into two tranches: the $10 million Tranche A is convertible at $18.15 per share, and the $26.4 million Tranche B is convertible at $23.10 per share. Lenders may not, unless and until stockholder approval is received, exercise these conversion rights to the extent that a lender would own more than 19.99% of the Company's common stock outstanding after such conversion. A maximum of 2,221,909 shares are issuable pursuant to these conversion rights, with this maximum number applicable if the loan is

Page 13

converted on the final maturity date. The Company has more than sufficient authorized common shares available for this purpose.

In the event of a change in control, the conversion prices are adjusted downward by a discount that declines over time such that, under a change in control scenario, both the Tranche A and Tranche B conversion prices are initially $16.50 per share and increase in a linear manner over time to the full $18.15 Tranche A conversion price and $23.10 Tranche B conversion price on the final maturity date. In no event does the maximum number of shares issuable to lenders pursuant to these revised conversion formulas exceed the 2,221,909 shares that would be issued to lenders pursuant to a conversion in full on the final maturity date in the absence of a change in control.

The respective tranches of the loan can be prepaid if the price of the Company's stock on the NASDAQ Global Market exceeds the conversion price by 40% or if the Company obtains a certified environmental impact report for the Cadiz groundwater storage and dry year supply program, a pipeline right-of-way and permits for pipeline construction and financing commitments sufficient to construct the project.

The Company has filed a registration statement on Form S-3 covering the resale of all the securities issuable upon conversion of the loan. The Company is required to maintain the effectiveness of this registration statement for at least 180

days after it has been declared effective. The Company is subject to a 0.5% monthly penalty assessed on the initial principal balance of the loan for each 30 day period (or portion thereof) during which any such requirements are not satisfied.

The Company has analyzed all of the above provisions of the convertible loan and related agreements for embedded derivatives under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and related Emerging Issues Task Force (EITF) interpretations and SEC rules. The Company concluded that certain provisions of the convertible loan agreement, which were in effect prior to the first amendment date, may be deemed to be derivatives for purposes of the application of FASB Statement No. 133 and EITF 00-19: Accounting for Derivative Financial Instruments to, and Potentially Settled in, a Company's Own Stock. Therefore, in accordance with FASB Statement No. 133, these embedded instruments were bifurcated from the host debt instrument and classified as a liability in the Company's financial statements. The Company prepared valuations for each of the deemed derivatives using a Black-Scholes option pricing model and recorded a liability of approximately $12 million on the June 30 loan funding date, with an offsetting discount to the convertible term loan.

On June 30, 2006, the derivative liability was classified and recorded as part of long term debt in the balance sheet.



The debt discount will be amortized to interest expense over the life of the loan using the interest amortization method. The principal valuation assumptions are as follows:

| | |
|---|---|
| Loan balance available for conversion: | $36.4 million |
| Expected term: | 5 years |
| Cadiz common share price: | $17.01 |
| Volatility: | 46% |
| Risk-free Interest Rate: | 5.18% |
| Change in control probability: | 10% |

On September 29, 2006 the terms of the loan were amended, and it was determined that bifurcation of the imbedded equity conversion option is no longer required. The derivative liability was adjusted to fair value on the amendment date, and the $2,919,000 increase in fair value was recorded as an "Other Expense" item in the Consolidated Statement of Operations. The $15.2 million fair value of the derivative liability was then transferred to the Additional Paid-in Capital component of Stockholder's Equity in accordance with the tentative conclusion reached by the Emerging Issues Task Force at the task force's September 7, 2006 meeting.

The Company incurred $408,000 of outside legal expenses related to the negotiation and documentation of the loan, which will be amortized over the life of the loan using the interest amortization method

The proceeds of the new loan were applied to repay in full the Company's term loan facility with ING described below. As a result, ING retained the $762,000 remaining balance of the prepaid interest credit account described below, and the write-off of this asset was reflected in the "Other Expense" caption of

the Statement of Operations. The write-off of $106,000 of unamortized debt issuance costs related to the ING loan was also reflected under "Other Expense".

On November 30, 2004 the Company entered into an amendment of its senior term loan agreement with ING whereby it repaid in full the senior term loan portion of the facility with ING of $10 million and reduced to $25 million the outstanding principal balance under the existing revolving portion of the loan. The terms and conditions of the loan facility with ING were amended in order to extend the maturity date of the debt until March 31, 2010, with a $10 million mandatory principal repayment due on or before March 31, 2008, and an interest rate through March 31, 2008 of 4% cash plus 4% paid in kind ("PIK") increasing to 4% cash plus 6% PIK for interest periods commencing on and after April 1, 2008.

As part of the private sale of common shares on November 30, 2004, the Company issued to its lender $2.4 million of units as prepaid interest under the Company's $25 million borrowing from ING. The current portion of this interest was included in Prepaid Interest Expense and the non-current portion was included in Other Assets in the Consolidated Balance Sheet. The total amount of prepaid interest was $1.5 million on September 30, 2005. No balance was outstanding after the ING loan repayment in June, 2006.



## NOTE 4 - INCOME TAXES

As of September 30, 2006, the Company had net operating loss (NOL) carryforwards of approximately $73.7 million for federal income tax purposes. Such carryforwards expire in varying amounts through the year 2026. This amount reflects the effective reduction of the NOL carryforwards as a result of ownership change annual limitation amounts, of approximately $6.6 million annually. Because it is more likely than not that the Company will not realize its net deferred tax assets, it has recorded a full valuation allowance against these assets. Accordingly, no deferred tax asset has been recorded in the accompanying balance sheet.

## NOTE 5 - NET LOSS PER COMMON SHARE

Basic earnings per share (EPS) is computed by dividing the net loss, after deduction for preferred dividends either accrued or imputed, if any, by the weighted-average common shares outstanding. Options, deferred stock units, warrants, convertible debt, and preferred stock that are convertible into shares of the Company's common stock were not considered in the computation of diluted EPS because their inclusion would have been antidilutive. Had these instruments been included, the fully diluted weighted average shares outstanding would have increased by approximately 2,618,000 and 1,208,000 shares for the three months ended September 30, 2006 and 2005, respectively. For the nine months ended September 30, 2006 and 2005, weighted average shares outstanding would have increased by approximately 1,488,000 and 846,000 shares, respectively.

NOTE 6 - PREFERRED AND COMMON STOCK

During the quarter ended March 31, 2005, we issued 27,200 shares of common stock and 5,440 common stock purchase warrants in consideration for services valued at $326,400. The shares and warrants were issued on the same terms as the November 2004 private placement, at which time the issue of the shares was authorized, the services rendered and the amounts accrued.

On November 30, 2004 the Company completed a private placement of 400,000 Units at the price of $60.00 per Unit. Each Unit consisted of five (5) shares of the Company's common stock and one (1) common stock purchase warrant. Each Warrant entitles the holder to purchase one (1) share of common stock at an exercise price of $15.00 per share. The warrants have a term of three years, expiring on November 30, 2007, and may be cancelled at the Company's option if the closing market price of the Company's common stock exceeds $18.75 for 10 consecutive trading days.

During September, 2006, certain warrant holders exercised rights to purchase 70,000 shares of the Company's common stock for $15.00 per share. 335,440 warrants remain outstanding on September 30, 2006.



NOTE 7 - COMMITMENTS AND CONTINGENCIES

On April 7, 2003, the Company filed an administrative claim against The Metropolitan Water District of Southern California ("Metropolitan"), asserting the breach by Metropolitan of various obligations specified in our 1998 Principles of Agreement with Metropolitan and other related contracts. The Company believed that by failing to complete the environmental review process for the Cadiz Project, failing to accept the Right of Way grant offered by the Department of Interior and for taking other actions inconsistent with their obligations, Metropolitan violated the contracts between the parties, breached its fiduciary duties to the Company and interfered with our prospective economic advantages. The filing was made with the Executive Secretary of Metropolitan.

When settlement negotiations failed to produce a resolution, the Company filed a lawsuit against Metropolitan in Los Angeles Superior Court on November 17, 2005 seeking recovery of damages. Metropolitan counsel responded with a demurrer, seeking to have certain claims disallowed. On October 18, 2006 the Court ruled in favor of Cadiz and overruled the demurrer to the claims for breach of fiduciary duty, promissory estoppel, breach of implied contract and specific performance. As a result, these claims will all go forward to trial, along with the breach of express contract claim, which was not addressed by the demurrer.

See "Legal Proceedings" included in the Company's latest Form 10-K for a complete discussion.

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

In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the following discussion contains trend analysis and other forward-looking statements. Forward-looking statements can be identified by the use of words such as "intends", "anticipates", "believes", "estimates", "projects", "forecasts", "expects", "plans" and "proposes". Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there are a number of risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. These include, among others, our ability to maximize value from our Cadiz, California land and water resources; and our ability to obtain new financings as needed to meet our ongoing working capital needs. See additional discussion under the heading "Certain Trends and Uncertainties" in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2005.

OVERVIEW

The Company's primary asset consists of land holdings located in three areas of eastern San Bernardino County, California totaling approximately 45,000 acres. Virtually all of this land is underlain by high-quality groundwater resources with demonstrated potential for various applications, including water storage and supply programs and recreational, residential, and agricultural development. Two of the three properties are located in proximity to the Colorado River Aqueduct, the major source of imported water for southern California. The third property is located near the Colorado River.

The value of these assets derives from a combination of projected population increases and limited water supplies throughout southern California. In addition, most of the major population centers in southern California are not located where significant precipitation occurs, requiring the importation of water from other parts of the state. We therefore believe that a competitive advantage exists for companies that can provide high quality, reliable, and affordable water to major population centers.

In 1997 we commenced discussions with the Metropolitan Water District of Southern California ("Metropolitan") in order to develop a long-term agreement for a joint venture groundwater storage and supply program on our land in the Cadiz and Fenner Valleys of eastern San Bernardino County (the "Cadiz Project"). Under the Cadiz Project, surplus water from the Colorado River would be stored in the aquifer system underlying our land during wet years. When needed, the stored water, together with indigenous groundwater, could be returned to the Colorado River Aqueduct for distribution to Metropolitan's member agencies throughout six southern California counties.

Between 1997 and 2002, Metropolitan staff and the Company received substantially all of the various permits required to construct and operate the project, including a federal Record of Decision from the U.S. Department of Interior, which endorsed the Cadiz Project and granted a right-of-way for construction of project facilities. The federal government also approved a Final

Environmental Impact Statement ("FEIS") in compliance with the National Environmental Policy Act ("NEPA").



Despite the significant progress made in the federal environmental review process, in October 2002 Metropolitan's Board refused to consider whether or not to certify the Final Environmental Impact Report ("FEIR"), which was a necessary action to authorize implementation of the Cadiz Project in accordance with the California Environmental Quality Act ("CEQA").

Regardless of the Metropolitan Board's actions in October 2002, Southern California's need for water storage and supply programs has not abated, and the advantages of underground water storage facilities are increasingly evident. Therefore we continue to pursue the completion of the environmental review process for the Cadiz Project. To that end, the County of San Bernardino has agreed to serve as the CEQA lead agency for the completion of the environmental review of the Cadiz Project and issue any outstanding permits required under California law once the review is completed. We are also working with the U.S. Department of Interior to have the permits that were approved during the federal environmental review process, including the right-of-way granted in the Record of Decision to Metropolitan, issued directly to the Company for the benefit of any participating public agency. Additionally, we are in discussions with several other public agencies regarding their interest in participating in the Cadiz Project. All of these agencies have access to independent sources of water that can be stored in the Cadiz Project.

Due to significant population growth in Southern California, where our properties are located, we have also begun to explore additional uses of our land assets. To this end, we retained an outside service firm and obtained a detailed analysis which confirmed the future development potential of our land. We will continue to explore strategies to maximize the value of these properties over the longer term.

We expect that these alternative scenarios will have different capital requirements and implementation periods than those previously established for the Cadiz Project. After Metropolitan's actions in 2002, we first entered into a series of agreements with our senior secured lender, ING, to reduce our debt to ING to $25 million and extended the final maturity date. We have recently repaid the ING debt using proceeds from a new $36.4 million zero coupon convertible term loan with other lenders that matures on September 29, 2011. During 2003 and 2004, we raised approximately $35 million of equity through private placements. On November 30, 2004, we completed a private placement of 400,000 Units at the price of $60.00 per Unit. Each Unit consisted of five (5) shares of the Company's common stock and one (1) common stock purchase warrant. Each Warrant entitled the holder to purchase one (1) share of common stock at an exercise price of $15.00 per share. Each Warrant has a term of three (3) years, expiring on November 30, 2007, and is callable by us if the closing market price of our common stock exceeds $18.75 for 10 consecutive trading days. Under the terms of our current loan agreement, the Company would retain any proceeds associated with a decision by holders to exercise the warrants.

With the implementation of these steps, we have been able to retain ownership of all of our land assets and assets relating to our water programs and also to obtain the working capital needed to continue our efforts to develop our water programs. Because many of our pre-existing common stockholders have participated in the 2003 and 2004 private placements, our base of common stockholders remains largely the same as before these placements.



Further, in 2005 the U.S. Bankruptcy Court confirmed a consensual plan of reorganization for our wholly owned subsidiary Sun World International, Inc. ("Sun World"). The plan became effective on September 6, 2005, and Cadiz has no further interest in the business or operations of Sun World. Cadiz retains the rights to use certain Sun World net operating loss carryovers for income tax purposes. See Note 4 to the Consolidated Financial Statements - Income Taxes.

We conduct limited agricultural operations on our Cadiz Valley properties, where there are approximately 1,060 acres of vineyards and lemon groves. Historically, we have leased these crops to Sun World and other third parties. In the fourth quarter of 2004, the lease with Sun World expired. We leased approximately 800 acres of vineyards to a third party for the 2005 growing season, and the amount of acreage under lease was reduced to 160 acres in 2006. The remaining crop lease is renewable on a year to year basis with annual revenues of approximately $12,000. We operate the remaining vineyards and lemon groves, subcontracting the labor, harvesting and marketing of these crops to third parties. Agriculture related revenues and expenses are higher in 2006 than in prior years because the Company is operating a larger portion of the property.

We remain committed to our land and water assets, and we continue to explore all opportunities for development of these assets. We cannot predict with certainty which, if any, of these various opportunities will ultimately be realized.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2005

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We have not received significant revenues from our water resource activity to date. As a result, we have historically incurred a net loss from operations. We had revenues of $60 thousand for the three months ended September 30, 2006 and $15 thousand for the three months ended September 30, 2005. Our net loss totaled $5.7 million for the three months ended September 30, 2006 (including a $2.9 million charge for the increase of the fair value of bifurcated equity conversion options embedded in our zero coupon secured convertible term loan), compared with $3.9 million for the three month period ended September 30, 2005.

Our primary expenses are our ongoing costs to develop our real estate and water assets and to secure the remaining entitlements needed to continue developing the Cadiz Program. These costs consist primarily of project management, legal, consulting, engineering and administrative expenses, which are

characterized as general and administrative expenses for financial statement reporting purposes. We also have expenses related to the limited farming activities that we conduct at the Cadiz Ranch. Other costs include interest expense and compensation costs resulting from the grant of options under the Cadiz 2003 Management Equity Incentive Plan and the revaluation of equity conversion options embedded in our zero coupon secured convertible term loan.

REVENUES Cadiz had revenues of $37 thousand for the three months ended September 30, 2006 and $15 thousand for the three months ended September 30, 2005. The $22 thousand increase resulted primarily from non-recurring revenues at the Cadiz Ranch.

Page 20

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses during the three months ended September 30, 2006 totaled $1.3 million compared to $1.1 million for the three months ended September 30, 2005. The increase in expenses is primarily due to higher legal and consulting costs related to the ongoing Cadiz Program entitlement process and the lawsuit the Company has filed against the Metropolitan Water District of Southern California. Farming related expenses were also higher as the Company assumed responsibility for operating a larger portion of the Cadiz ranch properties in 2006.

COMPENSATION COSTS FROM STOCK AND OPTION AWARDS. During the three months ended September 30, 2006, the Company recognized $768 thousand of expenses relating to stock and options issued under the Cadiz 2003 Management Equity Incentive Plan, compared with $2.3 million of expenses recognized during the comparable 2005 period. The 2006 expenses relate to the unvested portion of stock and option awards granted during 2005, and, to date, no stock or option grants have been awarded in 2006. Shares and options issued under the Plan vest over varying periods from the date of issue to October 2007. These expenses include the adoption and application of Statement of Financial Accounting Standards No. 123(R), "Share -Based Payments" effective January 1, 2006.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization expense for the three months ended September 30, 2006 and 2005 totaled $38 thousand and $67 thousand, respectively.

INTEREST EXPENSE, NET. Net interest expense totaled $0.7 million during the three months ended September 30, 2006, compared to $0.5 million during the same period in 2005. The following table summarizes the components of net interest expense for the two periods (in thousands):

| | THREE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|
| | 2006 | 2005 |
| Interest on outstanding debt | $ 464 | $ 513 |
| Amortization of debt discounts | 373 | - |
| Amortization of financing costs | 13 | 7 |

| | | |
|---|---|---|
| Interest income | (148) | (41) |
| | $ 702 | $ 479 |

Higher amortization of debt discounts and debt issuance costs was partially offset by higher interest income from the Company's short-term cash investments. The higher amortization of debt discounts and debt issuance costs were related to the new June, 2006 Peloton loan, and the higher interest income on the Company's short-term cash investments reflected higher cash balances and the higher money market rates available in 2006. See Note 3 of the Consolidated Financial Statements - Debt.

OTHER INCOME (EXPENSE). The Company prepaid its existing indebtedness with ING in June, 2006 with the proceeds of a new five year zero coupon convertible term loan. Prior to an amendment to this new loan on September 29, 2006, the new loan contained certain "embedded derivatives" which were bifurcated from the host debt instrument and were recorded



at fair value as liabilities on the Company's consolidated balance sheet under GAAP. These embedded derivatives were subject to periodic revaluation based on changes in the fair market value of our common stock, with changes in fair value resulting from this revaluation reflected as an other income or expense item. On September 29, 2006 certain terms and conditions of the credit agreement and the embedded derivatives were amended. The fair value of the equity conversion options were recalculated, and a $2.9 million expense was recognized due to an increase in fair value. The primary reason for the higher fair value was the increase in the trading price of our common stock from June 30, 2006 to September 29, 2006. Following the September 29, 2006 amendment, bifurcation of the imbedded equity conversion option is no longer required. As a result, the fair value of the imbedded derivatives has been transferred from the liability accounts to stockholder's equity, and no further fair value adjustments will be required. See Note 3 to the Consolidated Financial Statements - Debt.

## NINE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2005

We had revenues of $469 thousand for the nine months ended September 30, 2006 and $45 thousand for the nine months ended September 30, 2005. Our net loss totaled $11.1 million for the nine months ended September 30, 2006 compared to $18.1 million for the nine months ended September 30, 2005.

Our primary expenses are our ongoing costs to develop our real estate and water assets and to secure the remaining entitlements needed to continue developing the Cadiz Program. These costs consist primarily of project management, legal, consulting, engineering and administrative expenses, which are characterized as general and administrative expenses for financial statement reporting purposes. We also have expenses related to the limited farming activities that we conduct at the Cadiz Ranch. Other costs include interest expense and

compensation costs resulting from the grant of options under the Cadiz 2003 Management Equity Incentive Plan and the revaluation of equity conversion options embedded in our zero coupon secured convertible term loan.

REVENUES Cadiz had revenues of $446 thousand for the nine months ended September 30, 2006 and $45 thousand for the nine months ended September 30, 2005. Higher revenues resulted primarily from the sale of citrus crops, as during 2006 we farmed certain lemon groves at the Cadiz Ranch that had been leased to a third party during 2005.

COST OF SALES. Cost of Sales totaled $341 thousand during the nine months ended September 30, 2006, reflecting the production, harvesting and sale of citrus crops at the Cadiz Ranch property. Cadiz leased these crops to Sun World during the growing season ending in early 2005 and did not include Sun World's cost of sales in the consolidated financial statements because Sun World was in bankruptcy.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses during the nine months ended September, 2006 totaled $4.1 million compared to $2.9 million for the nine months ended September 30, 2005. The increase in expenses is primarily due to higher legal and consulting costs related to the ongoing Cadiz Program entitlement process and the lawsuit the Company has filed against the Metropolitan Water District of Southern California. Accounting and audit expenses were higher, due to the documentation and additional audit work required by Section 404 of the Sarbanes Oxley Act of 2002.



COMPENSATION COSTS FROM STOCK AND OPTION AWARDS. During the nine months ended September 30, 2006, the Company recognized $1.8 million of expenses relating to stock and options previously issued under the Cadiz 2003 Management Equity Incentive Plan, compared with $13.6 million of expenses recognized during the nine month period ending September 30, 2005. The 2006 expenses relate to the unvested portion of stock and option awards granted during 2005, and, to date, no stock or option grants have been awarded in 2006. Shares and options issued under the Plan vest over varying periods from the date of issue to October 2007. These expenses include the adoption and application of Statement of Financial Accounting Standards No. 123(R), "Share -Based Payments" effective January 1, 2006.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization expense for the nine months ended September 30, 2006 and 2005 totaled $117 thousand and $201 thousand, respectively.

INTEREST EXPENSE, NET. Net interest expense totaled $1.7 million during the nine months ended September 30, 2006, compared to $1.4 million during the same period in 2005. The following table summarizes the components of net interest expense for the two periods (in thousands):

| | NINE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|
| | 2006 | 2005 |

| | | |
|---|---|---|
| Interest on outstanding debt | $ 1,510 | $ 1,531 |
| Amortization of debt discounts | 373 | - |
| Amortization of financing costs | 27 | 21 |
| Interest income | (231) | (119) |
| | $ 1,679 | $ 1,433 |

Higher amortization of debt discounts and debt issuance costs was partially offset by higher interest income from the Company's short-term cash investments. The higher amortization of debt discounts and debt issuance costs were related to the new June, 2006 Peloton loan, and the higher interest income on the Company's short-term cash investments reflected higher cash balances and the higher money market rates available in 2006. See Note 3 of the Consolidated Financial Statements - Debt.

OTHER INCOME (EXPENSE). During the nine month period ended September 30, 2006, one of our stockholders determined that it had, at a time when it was the beneficial holder of more than 10% of our outstanding equity securities, inadvertently engaged in trades which resulted in automatic short swing profit liability to the Company pursuant to Section 16(b) of the Securities Exchange Act of 1934. After becoming aware of the situation, the stockholder promptly made payments totaling $350,000 to the Company to settle the entire short swing profit liability owed as a consequence of these trades.

The Company prepaid its existing indebtedness with ING in June, 2006 with the proceeds of a new five year zero coupon convertible term loan. Prior to an amendment to this new loan on September 29, 2006, the new loan contained certain "embedded derivatives" which



were bifurcated from the host debt instrument and were recorded at fair value as liabilities on the Company's consolidated balance sheet under GAAP. These embedded derivatives were subject to periodic revaluation based on changes in the fair market value of our common stock, with changes in fair value resulting from this revaluation reflected as an other income or expense item. On September 29, 2006 certain terms and conditions of the credit agreement and the embedded derivatives were amended. The fair value of the equity conversion options were recalculated, and a $2.9 million expense was recognized due to an increase in fair value. The primary reason for the higher fair value was the increase in the trading price of our common stock from June 30, 2006 to September 29, 2006. Following the September 29, 2006 amendment, bifurcation of the imbedded equity conversion option is no longer required. As a result, the fair value of the imbedded derivatives has been reclassified from the liability accounts to stockholder's equity, and no further fair value adjustments will be required. See Note 3 to the Consolidated Financial Statements - Debt.

LIQUIDITY AND CAPITAL RESOURCES

(a) CURRENT FINANCING ARRANGEMENTS

As we have not received significant revenues from our water resource and real estate development activities to date, we have been required to obtain financing to bridge the gap between the time development expenses are incurred and the time that revenue will commence. Historically, we have addressed these needs primarily through secured debt financing arrangements with our lenders, private equity placements and the exercise of outstanding stock options.

In June 2006 we entered into a new convertible term loan with Peloton Partners LLP ("Peloton") and subsequently amended certain terms of the loan in September 2006. Under the terms of this financing arrangement, Peloton (through an affiliate) and another participating lender have invested $36.4 million in a five year zero coupon secured convertible loan with an initial interest rate of 5% per annum. After three years, the interest rate will increase to 6% per annum for the remainder of the term. Interest is capitalized quarterly, and all interest payments are deferred until the final maturity date in September 2011. At the lenders' option, $10 million of principal and accrued interest thereon may be converted into Cadiz common stock at $18.15 per share, and $26.4 million of principal and accrued interest thereon may be converted into Cadiz common stock at $23.10 per share. See Note 3 of the Notes to the Consolidated Financial Statements - Debt and Exhibit 10.1 to this Report.

In addition to allowing us to prepay our former credit facility with ING, the new term loan provided us with $9.3 million of additional working capital and the total facility has a significantly lower interest rate than the former credit facility with ING. Furthermore, the current loan, unlike the ING facility, permits us to retain any proceeds received from the future exercise of warrants to purchase our common stock for $15.00 per share. See Note 6 of the Notes to the Consolidated Financial Statements - Common and Preferred Stock. However, our ability to prepay the loan is more limited than was the case under the ING facility.

In September 2006, certain holders of our warrants chose to exercise their rights to purchase a total of 70,000 shares our common stock at $15.00 per share. Net proceeds of $1,050,000 were received during the month of September from the warrant holders. 335,440



warrants remain outstanding. See Note 6 of the Notes to the Consolidated Financial Statements - Preferred and Common Stock.

As we continue to actively pursue our business strategy, additional financing specifically in connection with our water programs will be required. As the parties anticipate this need, the restrictive covenants in our credit facility are crafted in a way that, in our view, should not materially limit our ability to undertake debt or equity financing in order to finance our water development activities.

We have no other outstanding credit facilities of material size or preferred stock other than the Series F preferred stock held by ING as described in our 10-K for the year ended December 31, 2005.

CASH USED FOR OPERATING ACTIVITIES. Cash used for operating activities was $3.6 million for the nine months ended September 30, 2006, as compared to $2.5 million for the nine months ended September 30, 2005. The increased cash usage is primarily due to higher general and administrative expenses, which are primarily due to higher legal and consulting costs related to the entitlement of the Cadiz Program and the lawsuit the Company has filed against the Metropolitan Water District of Southern California. Accounting expenses were also higher, as the 2005 year-end audit included a Sarbanes-Oxley Section 404 review for the first time.

CASH FLOW FROM INVESTING ACTIVITIES. During the nine months ended September 30, 2006, net cash flow used in investing activities was $20 thousand, primarily due to expenditures for plant and equipment at the Cadiz Ranch.

CASH FLOW FROM FINANCING ACTIVITIES. During the nine months ended September 30, 2006, net cash provided by financing activities was $10.4 million, representing the proceeds remaining from our new $36.4 million convertible debt facility, after repayment of the ING credit facility and debt issuance costs, and the issuance of common stock to warrant holders that exercised their right to purchase our common stock for $15.00 per share during September 2006.

OUTLOOK

SHORT TERM OUTLOOK. The proceeds of our new $36.4 million convertible term loan and our 2003 and 2004 private placements, in which we have raised approximately $45 million, provide us with sufficient funds to meet our expected working capital needs for the next 12 months. The Company contemplates continuing with its historical practice of structuring its financing arrangements to match the anticipated needs of its development activities. See "Long Term Outlook", below. No assurances can be given, however, as to the availability or terms of any new financing.

LONG TERM OUTLOOK. In the longer term, we will need to raise additional capital to finance working capital needs and any payments due under our convertible term loan at maturity. See "Current Financing Arrangements" above. Payments will be due under the convertible term loan only to the extent that lenders elect not to exercise equity conversion rights prior to the loan's final maturity. Our future working capital needs will depend upon the specific measures we pursue in the entitlement and development of our real estate and water resources. We will evaluate the amount of cash needed, and the manner in which such cash will be raised, on an ongoing basis. We may meet any future cash



requirements through a variety of means, including equity or debt placements, or the sale or other disposition of assets. Equity placements would be undertaken only to the extent necessary, so as to minimize the dilutive effect of any such placements upon our existing stockholders.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board

issued SFAS No. 123R (revised 2004), "Share-Based Payment" which amends SFAS Statement 123 and was effective for the Company beginning January 1, 2006. The new standard requires the Company to recognize compensation costs in its financial statements in an amount equal to the fair value of share-based payments granted to employees and directors. The Company recognized $697,000 of stock based compensation expense in connection with the adoption of SFAS No. 123R.

In June 2006, the FASB issued FSP FIN 48 which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. This Interpretation also provides guidance on derecognition, classification, interest, penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this Interpretation will be a two-step process. The first step will determine if it is more likely than not that a tax position will be sustained upon examination and should therefore be recognized. The second step will measure a tax position that meets the more likely than not recognition threshold to determine the amount of benefit to recognize in the financial statements. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this Statement.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" method and the "iron curtain" method. The roll-over method focuses primarily on the impact of a misstatement on the income statement-including the reversing effect of prior year misstatements-but its use can lead to the accumulation of misstatements in the balance sheet. The iron-curtain method, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. We currently use the iron curtain method for quantifying identified financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification of errors under both the iron curtain and the roll-over methods.



SAB 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach"

as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Use of the "cumulative effect" transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose.

The Company will initially apply the provisions of SAB 108 using the cumulative effect transition method in connection with the preparation of our annual financial statements for the year ending December 31, 2006. The Company is currently assessing the impact of this statement.

CERTAIN KNOWN CONTRACTUAL OBLIGATIONS

| | | PAYMENTS DUE BY PERIOD | | | |
|---|---|---|---|---|---|
| CONTRACTUAL OBLIGATIONS | TOTAL | 1 YEAR OR LESS | 2-3 YEARS | 4-5 YEARS | AFTER 5 YEARS |
| Long term debt obligations | $ 36,873 | $ 9 | $ 18 | $ 36,846 | $ - |
| Interest Expense | 10,909 | 1 | 1 | 10,907 | - |
| Operating leases | 98 | 88 | 10 | - | - |
| | $ 47,880 | $ 98 | $ 29 | $ 47,753 | $ - |



ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In June 2006, we entered into a $36.4 million five year zero coupon convertible term loan. We analyzed all the provisions of the loan and related agreements for embedded derivatives under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and related Emerging Issues Task Force interpretations and SEC rules and concluded that certain imbedded derivatives were required to be bifurcated and separately valued as assets and liabilities on the Company's financial statements. The Company prepared valuations for each of the deemed derivatives using a Black-Scholes option pricing model and recorded a liability of approximately $12 million on the June 30 loan funding date, with an offsetting discount to the convertible term loan. On September 29, 2006 the terms of the loan were amended, and it was determined that bifurcation of the imbedded equity conversion option is no longer required as of that date. The derivative liability was adjusted to fair value on the amendment date, and the $2,919,000 increase in fair value was recorded as an "Other Expense" item in the Consolidated Statement of Operations. The $15.2 million fair value of the derivative liability was then transferred to the Additional Paid-in Capital component of Stockholder's Equity.

Other information about market risks for the nine months

ended September 30, 2006 does not differ materially from that discussed under Item 7A of Cadiz' Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 4. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

We have established disclosure controls and procedures to ensure that material information related to the Company, including its consolidated entities, is accumulated and communicated to senior management, including the Chairman and Chief Executive Officer (the "Principal Executive Officer") and Chief Financial Officer (the "Principal Financial Officer") and to our Board of Directors. Based on their evaluation as of September 30, 2006, our Principal Executive Officer and Principal Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and such information is accumulated and communicated to management, including the principal executive and principal financial officers as appropriate, to allow timely decisions regarding required disclosures.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act, there was no change identified in the Company's internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 7, 2003, we filed an administrative claim against The Metropolitan Water District of Southern California ("Metropolitan"), asserting the breach by Metropolitan of various obligations specified in our 1998 Principles of Agreement with Metropolitan and other related contracts. We believe that by failing to complete the environmental review process for the Cadiz Project, failing to accept the Right of Way grant offered by the Department of Interior and for taking other actions inconsistent with their obligations, Metropolitan violated the contracts between the parties, breached its fiduciary duties to us and interfered with our prospective economic advantages. The filing was made with the Executive Secretary of Metropolitan.

When settlement negotiations failed to produce a resolution, we filed a lawsuit against Metropolitan in Los Angeles Superior Court on November 17, 2005 seeking recovery of damages.

Metropolitan counsel responded with a demurrer, seeking to have certain claims disallowed. On October 18, 2006 the Court ruled in favor of Cadiz and overruled the demurrer to the claims for breach of fiduciary duty, promissory estoppel, breach of implied contract and specific performance. As a result, these claims will all go forward to trial, along with the breach of express contract claim, which was not addressed by the demurrer.

See "Legal Proceedings" included in the Company's latest Form 10-K for a complete discussion.

## ITEM 1A. RISK FACTORS

In June 2006, the Company entered into a new $36.4 million long-term debt facility (the "Loan") - see Part I, Item 2 above. As a consequence, our senior secured indebtedness has increased from approximately $25.9 million as of December 31, 2005 to approximately $36.4 million as of September 30, 2006. The Loan is convertible into shares of our common stock, and an election by lenders to convert all or a portion of the Loan will dilute the percentage of our common stock held by current stockholders. As before, if we default on our debt obligations, our lenders may sell off the assets that we have put up as collateral and this, in turn, would result in a cessation or sale of our operations.

In addition, pursuant to the Registration Rights Agreement which we entered into as a condition to the Loan, we have filed a Registration Statement with the SEC covering the resale of all shares issuable upon conversion of the Loan. This registration statement was declared effective on August 11, 2006. We are required to maintain the effectiveness of this Registration Statement for at least 180 days after the date it was declared effective. We must pay to the holders of the Loan an amount in cash equal to 0.5% of the initial principal amount of the Loan for each 30 day period (or portion thereof) during which this requirement is not satisfied.

There have been no other material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005.



## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During September, 2006 the Company issued 70,000 shares of the Company's common stock for $15.00 per share pursuant to the exercise by certain of the company's warrant holders of outstanding common stock purchase warrants. These warrants had been issued on November 30, 2004, when the Company completed a private placement of 400,000 Units at the price of $60.00 per Unit. Each Unit consisted of five (5) shares of the Company's common stock and one (1) common stock purchase warrant. Each warrant entitles the holder to purchase one (1) share of common stock at an exercise price of $15.00 per share. The warrants have a term of three years, expiring on November 30, 2007, and may be cancelled at the Company's option if the closing market price of the Company's common stock exceeds $18.75 for 10 consecutive trading days. 335,440 warrants remain outstanding on September 30, 2006.

The issuance of the common stock underlying the warrants as described above was not registered under the Securities Act of 1933, as amended (the "Securities Act"), but was exempt from the registration requirements of the Securities Act by virtue of Section 4(2) of the Securities Act as the transactions (including the issuance of the warrants) did not involve public offerings, the number of investors was limited, the investors were provided with information about us, and we placed restrictions on the resale of the securities.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable.

ITEM 5. OTHER INFORMATION

Not Applicable.

ITEM 6. EXHIBITS

The following exhibits are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

10.1 Amendment #1 to the $36,375,000 Credit Agreement among Cadiz Inc. and Cadiz Real Estate LLC, as Borrowers, the Several Lenders from time to time parties thereto, and Peloton Partners LLP, as Administrative Agent, dated as of September 29, 2006(1)

31.1 Certification of Keith Brackpool, Chairman and Chief Executive Officer of Cadiz Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of O'Donnell Iselin II, Chief Financial Officer and Secretary of Cadiz Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002



32.1 Certification of Keith Brackpool, Chairman and Chief Executive Officer of Cadiz Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of O'Donnell Iselin II, Chief Financial Officer and Secretary of Cadiz Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Previously filed as an Exhibit to our Current Report on Form 8-K dated September 29, 2006 as filed on October 4, 2006.

Page 31

SIGNATURE

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

CADIZ INC.

| | |
|---|---|
| By: /s/ Keith Brackpool | November 9, 2006 |
| Keith Brackpool<br>Chairman of the Board and<br>Chief Executive Officer<br>(Principal Executive Officer) | Date |
| By: /s/ O'Donnell Iselin II | November 9, 2006 |
| O'Donnell Iselin II,<br>Chief Financial Officer and<br>Secretary (Principal<br>Financial Officer) | Date |

Page 32

" width="71%">

| | | | |
|---|---|---|---|
| Current Liabilities | | | |
| Accounts payable, accrued expenses and other payables | | 4,747,839 | 5,577,204 |
| Current liabilities from discontinued operations | | 3,655 | 3,655 |
| 12% convertible promissory note, net | 10 | - | - |
| Total Current Liabilities | | 4,751,494 | 5,580,859 |
| 3% Convertible Promissory Notes Due 2011, Net | 10 | 32,299,939 | 30,848,024 |
| TOTAL LIABILITIES | | 37,051,433 | 36,428,883 |
| COMMITMENTS AND CONTINGENCIES | 11 | - | - |
| DEFICIT | | | |
| NCN Stockholders' Deficit | | | |

| | | | |
|---|---|---|---|
| Preferred stock, $0.001 par value, 5,000,000 shares authorized<br>None issued and outstanding | 12 | - | - |
| Common stock, $0.001 par value, 800,000,000 shares authorized<br>Issued and outstanding: 71,641,608 as of March 31, 2009 and December 31, 2008 | 12 | 71,642 | 71,642 |
| Additional paid-in capital | 12 | 60,138,474 | 59,578,612 |
| Accumulated deficit | 12 | (88,479,634) | (84,653,932) |
| Accumulated other comprehensive income | 12 | 1,647,140 | 1,647,461 |
| Total NCN Stockholders' Deficit | | (26,622,378) | (23,356,217) |
| Noncontrolling interests | 12 | (21,588) | - |
| TOTAL DEFICIT | 12 | (26,643,966) | (23,356,217) |
| TOTAL LIABILITIES AND DEFICIT | | $10,407,467 | $13,072,666 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

4

Table of Contents

NETWORK CN INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008 (RESTATED)
(Unaudited)

| | Note | For the three months ended March 31, 2009 | For the three months ended March 31, 2008 (Restated (1)) |
|---|---|---|---|
| REVENUES | | | |
| Advertising services | | $ 185,149 | $ 584,167 |
| | | | |
| COST OF REVENUES | | | |
| Cost of advertising services | | (452,259) | (3,961,340) |
| | | | |
| GROSS LOSS | | (267,110) | (3,377,173) |
| | | | |
| OPERATING EXPENSES | | | |
| Selling and marketing | | (165,986) | (640,318) |
| General and administrative | | (1,467,671) | (2,776,267) |
| Total Operating Expenses | | (1,633,657) | (3,416,585) |
| | | | |
| LOSS FROM OPERATIONS | | (1,900,767) | (6,793,758) |
| | | | |
| OTHER INCOME | | | |
| Interest income | | 3,721 | 9,259 |
| Other income | | 1,923 | 4 |
| Total Other Income | | 5,644 | 9,263 |
| | | | |
| INTEREST EXPENSE | | | |
| Amortization of deferred charges and debt discount | 10 | (1,577,346) | (1,348,284) |
| Interest expense | | (375,000) | (346,625) |
| Total Interest Expense | | (1,952,346) | (1,694,909) |
| | | | |
| NET LOSS BEFORE INCOME TAXES | | (3,847,469) | (8,479,404) |
| Income taxes | | - | - |
| NET LOSS FROM CONTINUING OPERATIONS | | (3,847,469) | (8,479,404) |
| | | | |
| DISCONTINUED OPERATIONS | | | |
| Net income from discontinued operations, net of income taxes | 15 | - | 34,554 |
| NET INCOME FROM DISCONTINUED OPERATIONS | | - | 34,554 |
| | | | |
| NET LOSS | | (3,847,469) | (8,444,850) |
| | | | |
| LESS: NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS, NET OF INCOME TAXES | | 21,767 | 73,336 |
| | | | |
| NET LOSS ATTRIBUTABLE TO NCN COMMON STOCKHOLDERS | | $ (3,825,702) | $ (8,371,514) |

| | | | | | |
|---|---|---|---|---|---|
| OTHER COMPREHENSIVE (LOSS) INCOME | | | | | |
| Total other comprehensive (loss) income | | | (142) | | 613,250 |
| Less: foreign currency translation gain attributable to noncontrolling interests | | | (179) | | (3,932) |
| Foreign currency translation (loss) gain attributable to NCN common stockholders | | | (321) | | 609,318 |
| | | | | | |
| COMPREHENSIVE LOSS ATTRIBUTABLE TO NCN COMMON STOCKHOLDERS | | $ | (3,826,023) | $ | (7,762,196) |
| | | | | | |
| NET INCOME (LOSS) PER COMMON SHARE – BASIC AND DILUTED | | | | | |
| Loss per common share from continuing operations attributable to NCN common stockholders | 14 | | (0.05) | | (0.12) |
| Income per common share from discontinued operations attributable to NCN common stockholders | 14 | | - | | - |
| Net loss per common share – basic and diluted | 14 | $ | (0.05) | $ | (0.12) |
| | | | | | |
| WEIGHTED AVERAGE SHARES OUTSTANDING – BASIC AND DILUTED | 14 | | 71,641,608 | | 71,418,201 |
| | | | | | |
| AMOUNTS ATTRIBUTABLE TO NCN COMMON STOCKHOLDERS | | | | | |
| Loss from continuing operations, net of tax | 14 | | (3,825,702) | | (8,389,710) |
| Discontinued operations, net of tax | 14 | | - | | 18,196 |
| NET LOSS ATTRIBUTABLE TO NCN COMMON STOCKHOLDERS | 14 | $ | (3,825,702) | $ | (8,371,514) |

(1) See Note 4 – Restatement and Reclassification

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents

NETWORK CN INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008 (RESTATED)
(Unaudited)

| | For the three months ended March 31, 2009 | For the three months ended March 31, 2008 (Restated (1)) |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss from continuing operations | $ (3,825,702) | $ (8,389,710) |
| Net income from discontinued operations | - | 18,196 |
| Net loss attributable to NCN common stockholders | (3,825,702) | (8,371,514) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization: | | |
| Equipment and intangible assets | 145,079 | 441,958 |
| Deferred charges and debt discount | 1,577,346 | 1,348,284 |
| Stock-based compensation for service | 559,861 | 774,743 |
| Loss on disposal of equipment | 8,400 | - |
| Write-back of allowance for doubtful debt | (231,985) | - |
| Noncontrolling interests | (21,767) | (73,336) |
| Changes in operating assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable | 258,213 | (129,564) |
| Prepayments for advertising operating rights | (90,663) | (235,690) |
| Prepaid expenses and other current assets | 292,104 | (3,781,917) |
| Accounts payable, accrued expenses and other payables | (829,365) | 953,253 |
| Net cash used in operating activities | (2,158,479) | (9,073,783) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of equipment | (52,488) | (2,684,884) |
| Proceeds from sales of equipment | 45,530 | - |
| Net cash used in acquisition of subsidiaries, net | - | (2,571,749) |
| Net cash used in investing activities | (6,958) | (5,256,633) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of 3% convertible promissory note, net of costs | - | 33,900,000 |
| Repayment of 12% convertible promissory note | - | (5,000,000) |
| Net cash provided by financing activities | - | 28,900,000 |
| | | |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 7,233 | 581,470 |
| | | |
| NET (DECREASE) INCREASE IN CASH | (2,158,204) | 15,151,054 |
| | | |
| CASH, BEGINNING OF PERIOD | 7,717,131 | 2,233,528 |
| | | |
| CASH, END OF PERIOD | $ 5,558,927 | $ 17,384,582 |
| | | |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |

| | | | | |
|---|---|---|---|---|
| Income taxes | | - | | - |
| Interest paid for convertible promissory notes | | - | | 346,625 |
| Interest paid for capital lease arrangement | | - | | - |
| Non-cash activities: | | | | |
| Issuance of common stock for acquisition of subsidiaries | $ | - | $ | 3,738,000 |

(1) See Note 4 – Restatement and Reclassification

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES:

In January 2008, the Company acquired 100% equity interest of Cityhorizon Limited ("Cityhorizon BVI"), a British Virgin Islands company. The Company issued 1,500,000 shares of restricted common stock of par value of $0.001 each, totaling $3,738,000 as part of the consideration.

The accompanying notes are an integral part of the condensed consolidated financial statements.

6

Table of Contents

NETWORK CN INC.
NOTES TO CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1. INTERIM FINANCIAL STATEMENT

The accompanying unaudited condensed consolidated financial statements of Network CN Inc., its subsidiaries and variable interest entities (collectively "NCN" or the "Company") have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and the rules and regulations of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of our financial position and results of operations.

The condensed consolidated financial statements for the three months ended March 31, 2009 and 2008 were not audited. It is management's opinion, however, that all material adjustments (consisting of normal recurring adjustments) have been made which are necessary for a fair financial statements presentation. The results for the interim period are not necessarily indicative of the results to be expected for the full fiscal year. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, previously filed with the Securities and Exchange Commission on March 27, 2009.

NOTE 2. ORGANIZATION AND PRINCIPAL ACTIVITIES

NCN is principally engaged in the provision of out-of-home advertising in China. Since late 2006, the Company has been operating an advertising network of roadside LED digital video panels, mega-size LED digital video billboards and light boxes in major Chinese cities.

Network CN Inc., originally incorporated on September 10, 1993 under the name EC Capital Limited, is a Delaware company with headquarters in the Hong Kong Special Administrative Region, the PRC. The Company was operated by different management teams in the past, under different operating names, pursuing a variety of business ventures. Between 2004 and 2006, the Company operated under the name Teda Travel Group Inc., which was primarily engaged in the provision of management services to hotels and resorts in China. On August 1, 2006, the Company changed its name to "Network CN Inc." in order to better reflect its new vision to build a nationwide information and entertainment network in China through its business in Travel Network and Media Network. In 2008, the Company disposed of its entire travel network in order to focus on Media Network. Accordingly, such travel business has been classified as discontinued operations for all periods presented (see Note 15 – Discontinued Operations for details).

Details of the Company's principal subsidiaries and variable interest entities as of March 31, 2009 are described in Note 5 – Subsidiaries and Variable Interest Entities.

Going Concern

The Company has experienced continuous recurring net losses in recent years. The net losses of the Company for the three months ended March 31, 2009 and 2008 were $3.8 million and $8.4 million respectively. Additionally, the Company has net cash used in operating activities of $2.2 million and $9.1 million for the three months ended March

31, 2009 and 2008 respectively. As of March 31, 2009, the Company recorded a stockholders' deficit of $26.6 million. These factors raise substantial doubt about its ability to continue as a going concern. The Company's plans regarding those concerns are addressed in the following paragraph. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Table of Contents

In response to current financial conditions, the Company has undergone drastic cost-cutting exercise including reduction of the Company's workforce, rentals, as well as selling and marketing expenses and other general and administrative expenses. Certain commercially non-viable concession right contracts were terminated and management has successfully negotiated with certain authority parties of concession rights to reduce advertising operating right fees. In addition, the Company has explored various means of obtaining additional financing. As of April 2, 2009, the Company entered into a new financing arrangement with the holders of its convertible notes and warrants and certain other investors, pursuant to which $45 million of 3% convertible promissory notes was converted into common stock and the remaining $5 million of the notes was exchanged for $5 million of 1% convertible promissory notes (see Note 17 – Subsequent Events for details). Accordingly, management believes that there are sufficient financial resources to meet the cash requirements for the next 12 months and the condensed consolidated financial statements have been prepared on a going concern basis.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) Basis of Presentation and Preparation

These condensed consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America.

These condensed consolidated financial statements were prepared on a going concern basis. The Company has determined that the going concern basis of preparation is appropriate based on its estimates and judgments of future performance of the Company, future events and projected cash flows. At each balance sheet date, the Company evaluates its estimates and judgments as part of its going concern assessment. Based on its assessment, the Company believes there are sufficient financial and cash resources to finance the Company as a going concern in the next twelve months. Accordingly, management has prepared the condensed consolidated financial statements on a going concern basis.

(B) Principles of Consolidation

The condensed consolidated financial statements include the financial statements of Network CN Inc., its subsidiaries and variable interest entities. Variable interest entities are those entities in which the Company, through contractual arrangements, bears the risks of, and enjoys the rewards normally associated with ownership of the entities, and therefore the Company is the primary beneficiary of these entities. In accordance with the Financial Accounting Standards Board ("FASB") Interpretation No. 46R "Consolidation of Variable Interest Entities" ("FIN 46R"), the primary beneficiary is required to consolidate the variable interest entities for financial reporting purposes. All significant intercompany transactions and balances have been eliminated upon consolidation.

(C) Use of Estimates

In preparing condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Differences from those estimates are reported in the period they become known and are disclosed to the extent they are material to the condensed consolidated financial statements taken as a whole.

(D) Cash and Cash Equivalents

Cash includes cash on hand, cash accounts, and interest bearing savings accounts placed with banks and financial institutions. For the purposes of the cash flow statements, the Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents. As of March 31, 2009 and 2008, the Company had no cash equivalents.

Table of Contents

(E) Allowance for Doubtful Debts

Allowance for doubtful debts is made against receivable to the extent they are considered to be doubtful. Receivables in the condensed consolidated balance sheet are stated net of such allowance. The Company records its allowance for doubtful debts based upon its assessment of various factors. The Company considers historical experience, the age of the receivable balances, the credit quality of its customers, current economic conditions, and other factors that may affect customers' ability to pay to determine the level of allowance required.

(F) Prepayments for Advertising Operating Rights, Net

Prepayments for advertising operating rights are measured at cost less accumulated amortization and impairment losses. Cost includes prepaid expenses directly attributable to the acquisition of advertising operating rights. Such prepaid expenses are in general charged to the condensed consolidated statements of operations on a straight-line basis over the operating period. All the costs expected to be amortized after 12 months of the balance sheet date are classified as non-current assets.

An impairment loss is recognized when the carrying amount of the prepayments for advertising operating rights exceeds the sum of the undiscounted cash flows expected to be generated from the advertising operating right's use and eventual disposition. An impairment loss is measured as the amount by which the carrying amount exceeds the fair value of the asset calculated using a discounted cash flow analysis.

(G) Equipment, Net

Equipment is stated at cost less accumulated depreciation and impairment losses. Depreciation is provided using the straight-line method over the estimated useful life as follows:

| | |
|---|---|
| Media display equipment | 5 - 7 years |
| Office equipment | 3 - 5 years |
| Furniture and fixtures | 3 - 5 years |
| Leasehold improvements | Over the unexpired lease terms |

Construction in progress is carried at cost less impairment losses, if any. It relates to construction of media display equipment. No provision for depreciation is made on construction in progress until the relevant assets are completed and put into use.

When equipment is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is reflected in the condensed consolidated statements of operations. Repairs and maintenance costs on equipment are expensed as incurred.

(H) Intangible Assets, Net

Intangible assets are stated at cost less accumulated amortization and impairment losses. Intangible assets that have indefinite useful lives are not amortized. Other intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives of 16 months to 20 years. The amortization methods and estimated useful lives of intangible assets are reviewed regularly.

(I) Impairment of Long-Lived Assets

Long-lived assets, including intangible assets with definite lives, are reviewed for impairment whenever events or changes in circumstance indicate that the carrying amount of the assets may not be recoverable. An intangible asset that is not subject to amortization is reviewed for impairment annually or more frequently whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset and intangible asset exceeds the sum of the undiscounted cash flows expected to be generated from the asset's use and eventual disposition. An impairment loss is measured as the amount by which the carrying amount exceeds the fair value of the asset calculated using a discounted cash flow analysis.

Table of Contents

(J) Deferred Charges, Net

Deferred charges are fees and expenses directly related to the issuance of convertible promissory notes, including placement agents' fees. Deferred charges are capitalized and amortized over the life of the convertible promissory notes using the effective yield method. Amortization of deferred charges is included in interest expense on the condensed consolidated statements of operations while the unamortized balance is included in deferred charges on the condensed consolidated balance sheets.

(K) Convertible Promissory Notes and Warrants

During 2007 and 2008, the Company issued a 12% convertible promissory note and warrants and 3% convertible promissory notes and warrants. As of March 31, 2009 and December 31, 2008, the warrants and embedded conversion feature were classified as equity under Emerging Issues Task Force ("EITF") Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" and met the other criteria in paragraph 11(a) of Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities". Such classification will be reassessed at each balance sheet date. The Company allocated the proceeds of the convertible promissory notes between convertible promissory notes and the financial instruments related to warrants associated with convertible promissory notes based on their relative fair values at the commitment date. The fair value of the financial instruments related to warrants associated with convertible promissory notes was determined utilizing the Black-Scholes option pricing model and the respective allocated proceeds to the warrants is recorded in additional paid-in capital. The embedded beneficial conversion feature associated with convertible promissory notes was recognized and measured by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital in accordance with EITF Issue No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio" and EITF Issue No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments".

The portion of debt discount resulting from the allocation of proceeds to the financial instruments related to warrants associated with convertible promissory notes is being amortized to interest expense over the life of the convertible promissory notes, using the effective yield method. For the portion of debt discount resulting from the allocation of proceeds to the beneficial conversion feature, it is amortized to interest expense over the term of the notes from the respective dates of issuance using the effective yield method.

(L) Early Redemption of Convertible Promissory Notes

Should early redemption of convertible promissory notes occur, the unamortized portion of the associated deferred charges and debt discount would be fully written off and any early redemption premium will be recognized as expense upon its occurrence. All related charges, if material, would be aggregated and included in a separate line "charges on early redemption of convertible promissory notes". Such an expense would be included in ordinary activities on the condensed consolidated statements of operations as required by SFAS No. 145 "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections".

Pursuant to the provisions of agreements in connection with the 3% convertible promissory notes, in the event of a default, or if the Company's actual earnings per share ("EPS") in any fiscal year is less than 80% of the respective EPS target, certain investors may require the Company to redeem the 3% Convertible Promissory Notes at 100% of the principal amount, plus any accrued and unpaid interest, plus an amount representing a 20% internal rate of return on the then outstanding principal amount. The Company accounts for such potential liability of 20% internal rate of return on the then outstanding principal amount in accordance with SFAS No. 5 "Accounting for Contingencies".

(M) Revenue Recognition

For advertising services, the Company recognizes revenue in the period when advertisements are either aired or published. Revenues from advertising barter transactions are recognized in the period during which the advertisements are either aired or published. Expenses from barter transactions are recognized in the period as incurred. Barter transactions are accounted in accordance with EITF Issue No. 99-17 “Accounting for Advertising Barter Transactions”, which are recorded at the fair value of the advertising provided based on the Company’s own historical practice of receiving cash for similar advertising from buyers unrelated to the counterparty in the barter transactions. The amounts included in advertising services revenue and general and administrative for barter transactions were $nil for the three months ended March 31, 2009 and 2008.

Table of Contents

For hotel management services, the Company recognizes revenue in the period when the services are rendered and collection is reasonably assured.

For tour services, the Company recognizes services-based revenue when the services have been performed. Guangdong Tianma International Travel Service Co., Ltd. (“Tianma”) offers independent leisure travelers bundled packaged-tour products which include both air-ticketing and hotel reservations. Tianma’s packaged-tour products cover a variety of domestic and international destinations.

Tianma organizes inbound and outbound tour and travel packages which can incorporate, among other things, air and land transportation, hotels, restaurants and tickets to tourist destinations and other excursions. Tianma books all elements of such packages with third-party service providers such as airlines, car rental companies and hotels, or through other tour package providers and then resells such packages to its clients. A typical sale of tour services is as follows:

1. Tianma, in consultation with sub-agents, organizes a tour or travel package, including making reservations for blocks of tickets, rooms, etc. with third-party service providers. Tianma may be required to make deposits, pay all or part of the ultimate fees charged by such service providers or make legally binding commitments to pay such fees. For air-tickets, Tianma normally books a block of air tickets with airlines in advance and pays the full amount of the tickets to reserve seats before any tours are formed. The air tickets are usually valid for a certain period of time. If the pre-packaged tours do not materialize and are eventually not formed, Tianma will resell the air tickets to other travel agents or customers. For hotels, meals and transportation, Tianma usually pays an upfront deposit of 50-60% of the total cost. The remaining balance is then settled after completion of the tours.

2. Tianma, through its sub-agents, advertises tour and travel packages at prices set by Tianma and sub-agents.

3. Customers approach Tianma or its appointed sub-agents to book an advertised packaged tour.

4. The customers pay a deposit to Tianma directly or through its appointed sub-agents.

5. When the minimum required number of customers (which number is different for each tour based on the elements and costs of the tour) for a particular tour is reached, Tianma will contact the customers for tour confirmation and request full payment. All payments received by the appointed sub-agents are paid to Tianma prior to the commencement of the tours.

6. Tianma will then make or finalize corresponding bookings with outside service providers such as airlines, bus operators, hotels, restaurants, etc. and pay any unpaid fees or deposits to such providers.

Tianma is the principal in such transactions and the primary obligor to the third-party providers regardless of whether it has received full payment from its customers. In addition, Tianma is also liable to the customers for any claims relating to the tours such as accidents or tour services. Tianma has adequate insurance coverage for accidental loss arising during the tours. The Company utilizes a network of sub-agents who operate strictly in Tianma’s name and can only advertise and promote the business of Tianma with the prior approval of Tianma.

(N) Stock-based Compensation

In December 2004, the FASB issued SFAS No. 123R “Share-Based Payment”, a revision to SFAS No. 123 “Accounting for Stock-Based Compensation”, and superseding APB Opinion No. 25 “Accounting for Stock Issued to Employees” and its related implementation guidance. Effective January 1, 2006, the Company adopted SFAS No. 123R, using a modified prospective application transition method, which establishes accounting for stock-based awards in exchange

for employee services. Under this application, the Company is required to record stock-based compensation expense for all awards granted after the date of adoption and unvested awards that were outstanding as of the date of adoption. SFAS No. 123R requires that stock-based compensation cost is measured at grant date, based on the fair value of the award, and recognized in expense over the requisite services period.

Table of Contents

Common stock, stock options and warrants issued to other than employees or directors in exchange for services are recorded on the basis of their fair value, as required by SFAS No. 123R, which is measured as of the date required by EITF Issue 96-18 "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services". In accordance with EITF 96-18, the non-employee stock options or warrants are measured at their fair value by using the Black-Scholes option pricing model as of the earlier of the date at which a commitment for performance to earn the equity instruments is reached ("performance commitment date") or the date at which performance is complete ("performance completion date"). The stock-based compensation expenses are recognized on a straight-line basis over the shorter of the period over which services are to be received or the vesting period. Accounting for non-employee stock options or warrants which involve only performance conditions when no performance commitment date or performance completion date has occurred as of reporting date requires measurement at the equity instruments then-current fair value. Any subsequent changes in the market value of the underlying common stock are reflected in the expense recorded in the subsequent period in which that change occurs.

(O) Income Taxes

The Company accounts for income taxes under SFAS No. 109 "Accounting for Income Taxes". Under SFAS No. 109, deferred tax assets and liabilities are provided for the future tax effects attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and for the expected future tax benefits from items including tax loss carry forwards.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or reversed. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(P) Comprehensive Income (Loss)

The Company follows SFAS No. 130 "Reporting Comprehensive Income" for the reporting and display of its comprehensive income (loss) and related components in the financial statements and thereby reports a measure of all changes in equity of an enterprise that results from transactions and economic events other than transactions with the shareholders. Items of comprehensive income (loss) are reported in both the consolidated statements of operations and comprehensive loss and the consolidated statement of stockholders' equity.

(Q) Earnings (Loss) Per Common Share

Basic earnings (loss) per common share are computed in accordance with SFAS No. 128 "Earnings Per Share" by dividing the net income (loss) attributable to holders of common stock by the weighted average number of shares of common stock outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares including the dilutive effect of common share equivalents then outstanding.

The diluted net loss per share is the same as the basic net loss per share for the three months ended March 31, 2009 and 2008 as all potential ordinary shares including stock options and warrants are anti-dilutive and are therefore excluded from the computation of diluted net loss per share.

(R) Operating Leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases are charged to the condensed consolidated

statements of operations on a straight-line basis over the lease period.

Table of Contents

(S) Foreign Currency Translation

The assets and liabilities of the Company's subsidiaries and variable interest entities denominated in currencies other than U.S. dollars are translated into U.S. dollars using the applicable exchange rates at the balance sheet date. For condensed consolidated statements of operations' items, amounts denominated in currencies other than U.S. dollars were translated into U.S. dollars using the average exchange rate during the period. Equity accounts were translated at their historical exchange rates. Net gains and losses resulting from translation of foreign currency financial statements are included in the statements of stockholders' equity as accumulated other comprehensive income (loss). Foreign currency transaction gains and losses are reflected in the condensed consolidated statements of operations.

(T) Fair Value of Financial Instruments

SFAS No. 157 "Fair Value Measurements" defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS 157 establishes three levels of inputs that may be used to measure fair value:

Level 1 - Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 - Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 - Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The carrying value of the Company's financial instruments, which consist of cash, accounts receivable, prepayments for advertising operating rights, prepaid expenses and other current assets, accounts payable, accrued expenses and other payables, approximates fair value due to the short-term maturities.

The carrying value of the Company's financial instruments related to warrants associated with convertible promissory notes is stated at a value being equal to the allocated proceeds of convertible promissory notes based on the relative fair value of notes and warrants. In the measurement of the fair value of these instruments, the Black-Scholes option pricing model is utilized, which is consistent with the Company's historical valuation techniques. These derived fair value estimates are significantly affected by the assumptions used. The allocated value of the financial instruments related to warrants associated with convertible promissory notes is recorded as an equity, which does not require to mark-to-market as of each subsequent reporting period.

(U) Concentration of Credit Risk

The Company places its cash with various financial institutions. The Company believes that no significant credit risk exists as these cash investments are made with high-credit-quality financial institutions.

All the revenue of the Company and a significant portion of the Company’s assets are generated and located in China. The Company’s business activities and accounts receivable are mainly from advertising services. Deposits are usually collected from customers in advance and the Company performs ongoing credit evaluation of its customers. The Company believes that no significant credit risk exists as credit loss.



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Table of Contents

(V) Segmental Reporting

SFAS No. 131 “Disclosures about Segments of an Enterprise and Related Information” establishes standards for reporting information about operating segments on a basis consistent with the Company’s internal organization structure as well as information about geographical areas, business segments and major customers in financial statements. The Company’s operating segments are organized internally primarily by the type of services rendered. In September 2008, the Company disposed of its entire travel business and focus on developing its media business in the PRC. Accordingly, it is management’s view that the services rendered by the Company are of one operating segment: Media Network.

(W) Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements”. Effective January 1, 2008, the Company adopted the measurement and disclosure other than those requirements related to nonfinancial assets and liabilities in accordance with guidance from FASB Staff Position 157-2 “Effective Date of FASB Statement No. 157”, which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal year 2009. In April 2009, the FASB issued Staff Position No. FAS 157-4 “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP FAS No. 157-4”). FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS No. 157 “Fair Value Measurements”, which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP FAS No. 157-4 will be applied prospectively and will be effective for interim and annual reporting periods ending after June 15, 2009. The Company believes the adoption of SFAS No. 157 for nonfinancial assets and liabilities will not have a significant effect on its consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (Revised) “Business Combinations” (“SFAS No. 141(R)”), replacing SFAS No. 141 “Business Combinations” (“SFAS No. 141”), and SFAS No. 160 “Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51”. SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141, broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent consideration be recognized at the acquisition date and re-measured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. SFAS No. 160 improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require; the ownership interests in subsidiaries held by parties other than the parent and the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value, entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 affects those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 141(R) and SFAS No. 160 are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. In April 2009, the FASB issued Staff Position No. FAS 141(R)-1

"Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies" ("FSP FAS No. 141(R)-1"). FSP FAS No. 141(R)-1 applies to all assets acquired and all liabilities assumed in a business combination that arise from contingencies. FSP FAS No. 141(R)-1 states that the acquirer will recognize such an asset or liability if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If it cannot be determined during the measurement period, then the asset or liability should be recognized at the acquisition date if the following criteria, consistent with SFAS No. 5 "Accounting for Contingencies", are met: (1) information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date, and (2) the amount of the asset or liability can be reasonably estimated. FSP FAS No. 141(R)-1 will be effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS No. 141(R) and FSP FAS No. 141(R)-1 did not have a material impact on our financial statements. Beginning January 1, 2009, the Company has applied the provisions of SFAS No. 160 to its accounting for noncontrolling interests and its financial statement disclosures. The disclosure provisions of such standard have been applied to all periods presented in the accompanying condensed consolidated financial statements.



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Table of Contents

In March 2008, the FASB issued SFAS No. 161 "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No. 161"). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS No. 161 applies to all derivative instruments within the scope of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133") as well as related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS No. 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. SFAS No. 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of SFAS No. 161 did not have a material impact on our financial statements.

In May 2008, the FASB issued SFAS No. 162 "The Hierarchy of Generally Accepted Accounting Principles". SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the accounting principles to be used. Any effect of applying the provisions of this statement will be reported as a change in accounting principle in accordance with SFAS No. 154 "Accounting Changes and Error Corrections". SFAS No. 162 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS No. 162 did not have a material impact on our financial statements.

In May 2008, the FASB issued SFAS No. 163 "Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60". The scope of this Statement is limited to financial guarantee insurance (and reinsurance) contracts, as described in this Statement, issued by enterprises included within the scope of Statement 60. Accordingly, this Statement does not apply to financial guarantee contracts issued by enterprises excluded from the scope of Statement 60 or to some insurance contracts that seem similar to financial guarantee insurance contracts issued by insurance enterprises (such as mortgage guaranty insurance or credit insurance on trade receivables). This Statement also does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities". This Statement will not have any impact on the Company's consolidated financial statements.

In May 2008, the FASB issued Staff Position No. APB 14-1 "Accounting for Convertible Debt Instruments that May be Settled in Cash Upon Conversion". APB 14-1 requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer's nonconvertible debt borrowing rate. The resulting debt discount is amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Retrospective application to all periods presented is required except for instruments that were not outstanding during any of the periods that will be presented in the annual financial statements for the period of adoption but were outstanding during an earlier period. The adoption of APB 14-1 did not have a material impact on our financial statements.

Table of Contents

In June 2008, the FASB issued EITF Issue No. 07-5 "Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock" ("EITF No. 07-5"). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS No. 133 "Accounting for Derivatives and Hedging Activities" ("SFAS No. 133") specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF No. 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS No. 133 paragraph 11(a) scope exception. The adoption of EITF No. 07-5 did not have a material impact on our financial statements.

In June 2008, the FASB issued EITF Issue No. 08-4 "Transition Guidance for Conforming Changes to Issue No. 98-5" ("EITF No. 08-4"). The objective of EITF No. 08-4 is to provide transition guidance for conforming changes made to EITF No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios", that result from EITF No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments", and SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Issue is effective for financial statements issued for fiscal years ending after December 15, 2008. Early application is permitted. The adoption of EITF No. 08-04 did not have a material impact on our financial statements.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"). FSP FAS 132(R)-1 requires more detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it will not have an impact on the financial position and results of operations.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS No. 107-1 and APB Opinion No. 28-1"). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 will be effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it will not have an impact on the financial position and results of operations.

NOTE 4. RESTATEMENT AND RECLASSIFICATION

(a) Restatement of Financial Results

On October 10, 2008, the Company filed a Current Report on Form 8-K to announce that the Company's Board of Directors, based upon the consideration of issues addressed in the SEC review and the recommendation of the Audit Committee, determined that the Company should restate its previously issued consolidated financial statements for the year ended December 31, 2007 and unaudited condensed consolidated financial statements for the interim periods

ended March 31, 2008 and June 30, 2008.

The restatement adjustments corrected the accounting errors arising from its misapplication of accounting policies to the discount associated with the beneficial conversion feature attributed to the issuance of the 3% convertible promissory notes in 2007. The Company initially amortized the discount according to EITF Issue No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio", which stated that discount resulting from allocation of proceeds to the beneficial conversion feature should be recognized as interest expense over the minimum period from the date of issuance to the date of earliest conversion. As the notes are convertible at the date of issuance, the Company fully amortized such discount through interest expense at the date of issuance accordingly. However, according to Issue 6 of EITF Issue No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments", EITF Issues No. 98-5 should be modified to require the discount related to the beneficial conversion feature to be accreted from the date of issuance to the stated redemption date regardless of when the earliest conversion date occurs using the effective interest method. The restatement adjustments were to reflect the retrospective application of the Issue 6 of EITF Issue No. 00-27.

Table of Contents

The restatement affected our previously reported non-cash interest expense, net loss, long-term debt and stockholders' equity but had no effects on our cash flow. There was no change to each subtotal (operating, investing and financing activities) in the Company's condensed consolidated statements of cash flows as a result of the restatement. Certain balances related to line items within certain cash flows were corrected as part of the restatement. The restatement in the condensed consolidated financial statements as of March 31, 2008 and for the three months ended March 31, 2008 is as follows:

| For the three months ended March 31, 2008 | As Previously Reported | Restatement Adjustments | As Restated |
|---|---|---|---|
| Interest Expense | | | |
| Amortization of deferred charges and debt discount | $ 11,790,530 | $ (10,442,246) | $ 1,348,284 |
| Net loss attributable to NCN common stockholders | (18,813,760) | 10,442,246 | (8,371,514) |
| Comprehensive loss | (18,204,442) | 10,442,246 | (7,762,196) |
| Net loss per common share – basic and diluted | $ (0.26) | $ 0.14 | $ (0.12) |

| As of March 31, 2008 | As Previously Reported | Restatement Adjustments | As Restated |
|---|---|---|---|
| Liabilities | | | |
| 3% convertible promissory notes due 2011, net | $ 42,045,203 | $ (15,102,206) | $ 26,942,997 |
| Total liabilities | 48,026,189 | (15,102,206) | 32,923,983 |
| Stockholders' Equity | | | |
| Accumulated deficit | (48,642,819) | 15,102,206 | (33,540,613) |
| Total stockholder's equity | $ 9,127,580 | $ 15,102,206 | $ 24,229,786 |

(b) Reclassification

To better present the results of the Company, the "by function of expense" method for the presentation of the condensed consolidated statements of operations and comprehensive loss has been adopted. Comparative amounts for prior periods have been reclassified in order to achieve a consistent presentation.

In addition, the Company completed the disposal of travel network during the year ended December 31, 2008. As a result of the disposal, the condensed consolidated financial statements of the Company reflect travel network operation as discontinued operations for all presented periods. Accordingly, revenues and costs and expenses of travel network have been excluded from the respective accounts in the condensed consolidated statements of operations. The net operating results of the discontinued operations have been reported, net of applicable income taxes, as "Net income from Discontinued Operations, Net of Income Taxes". For details, please refer to Note 15 – Discontinued Operations.

The above reclassification does not have an effect on net loss and net loss per share.

NOTE 5. SUBSIDIARIES AND VARIABLE INTEREST ENTITIES

Details of the Company's principal consolidated subsidiaries and variable interest entities as of March 31, 2009 were as follows:

| Name | Place of Incorporation | Ownership interest attributable to the Company | Principal activities |
|---|---|---|---|
| NCN Group Limited | BVI | 100% | Investment holding |

| | | | |
|---|---|---|---|
| NCN Media Services Limited | BVI | 100% | Investment holding |
| Crown Winner International Limited | Hong Kong | 100% | Investment holding |
| Cityhorizon Limited | Hong Kong | 100% | Investment holding |

17

Table of Contents

| | | | |
|---|---|---|---|
| NCN Group Management Limited | Hong Kong | 100% | Provision of administrative and management services |
| NCN Huamin Management Consultancy (Beijing) Company Limited | PRC | 100% | Provision of administrative and management services |
| Shanghai Quo Advertising Company Limited | PRC | 100% | Provision of advertising services |
| Xuancaiyi (Beijing) Advertising Company Limited | PRC | 51% | Provision of advertising services |
| Teda (Beijing) Hotels Management Limited | PRC | 100% | Dormant; undergoing liquidation process |
| NCN Travel Services Limited | BVI | 100% | Dormant |
| Linkrich Enterprise Advertising and Investment Limited | Hong Kong | 100% | Dormant |
| Cityhorizon Limited | BVI | 100% | Investment holding |
| Huizhong Lianhe Media Technology Co., Ltd | PRC | 100% | Provision of high-tech services |
| Beijing Huizhong Bona Media Advertising Co., Ltd. | PRC | 100% | Provision of advertising services |
| Huizhi Botong Media Advertising Beijing Co., Ltd | PRC | 100% | Provision of advertising services |
| Crown Eagle Investment Limited | Hong Kong | 100% | Dormant |
| Profit Wave Investment Limited | Hong Kong | 100% | Dormant |
| Qingdao Zhongan Boyang Advertising Co., Ltd. | PRC | 60% | Provision of advertising services |

NOTE 6. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net as of March 31, 2009 and December 31, 2008 were as follows:

| | As of March 31, 2009 (Unaudited) | As of December 31, 2008 (Audited) |
|---|---|---|
| Accounts receivable | $ 383,828 | $ 817,643 |
| Less: allowance for doubtful debts | (302,451) | (600,241) |
| Total | $ 81,377 | $ 217,402 |

For the three months ended March 31, 2009 and 2008, the Company recorded a write-back of allowance for doubtful debts for accounts receivable of $122,188 and $nil respectively. Such write-back of allowance for doubtful debts was included in general and administrative expenses in the condensed consolidated statements of operations. The Company also recorded a write-off of certain allowance for doubtful debts for accounts receivable of $175,593 and $nil for the three months ended March 31, 2009 and 2008 respectively.

NOTE 7. PREPAYMENTS FOR ADVERTISING OPERATING RIGHTS, NET

Prepayments for advertising operating rights, net as of March 31, 2009 and December 31, 2008 were as follows:

| As of | As of |
|---|---|

| | March 31, 2009 (Unaudited) | December 31, 2008 (Audited) |
|---|---|---|
| Gross carrying amount | $ 4,456,869 | $ 24,606,150 |
| Less: accumulated amortization | (1,666,331) | (16,275,735) |
| Less: provision for impairment | (2,289,096) | (7,912,303) |
| Prepayments for advertising operating rights, net | $ 501,442 | $ 418,112 |

Total amortization expense of prepayments for advertising operating rights of the Company for the three months ended March 31, 2009 and 2008 were $229,292 and $3,496,248 respectively. The amortization expense of prepayments for advertising operating rights was included as cost of advertising services in the condensed consolidated statements of operations.

Table of Contents

NOTE 8. PREPAID EXPENSES AND OTHER CURRENT ASSETS, NET

Prepaid expenses and other current assets, net as of March 31, 2009 and December 31, 2008 were as follows:

| | As of March 31, 2009 (Unaudited) | As of December 31, 2008 (Audited) |
|---|---|---|
| Rental deposits | $ 84,789 | $ 93,294 |
| Deposits paid for soliciting potential media projects | - | 3,109,609 |
| Payments from customers withheld by a third party | 1,402,503 | 1,402,751 |
| Other receivables | 57,267 | 2,937,228 |
| Prepaid expenses | 314,340 | 222,679 |
| Sub-total | 1,858,899 | 7,765,561 |
| Less: allowance for doubtful debts | (1,411,074) | (7,135,429) |
| Total | $ 447,825 | $ 630,132 |

For the three months ended March 31, 2009 and 2008, the Company recorded a write-back of allowance for doubtful debts for prepaid expenses and other current assets of $109,797 and $nil respectively. Such write-back of allowance for doubtful debts was included in general and administrative expenses in the condensed consolidated statements of operations. The Company also recorded a write-off of certain allowance for doubtful debts for prepaid expenses and other current assets of $5,613,760 and $nil for the three months ended March 31, 2009 and 2008 respectively.

NOTE 9. INTANGIBLE ASSETS, NET

Intangible assets, net as of March 31, 2009 and December 31, 2008 were as follows:

| | As of March 31, 2009 (Unaudited) | As of December 31, 2008 (Audited) |
|---|---|---|
| Amortized intangible rights | | $ |
| Gross carrying amount | $ 6,551,031 | 7,137,097 |
| Less: accumulated amortization | (752,155) | (1,312,790) |
| Less: provision for impairment loss | (5,375,000) | (5,375,000) |
| Amortized intangible rights, net | 423,876 | 449,307 |
| | | |
| Amortized acquired application systems | | |
| Gross carrying amount | 1,973,865 | 1,973,865 |
| Less: accumulated amortization | (197,388) | (197,388) |
| Less: provision for impairment loss | (1,776,477) | (1,776,477) |
| Amortized acquired application systems, net | - | - |
| | | |
| Intangible assets, net | $ 423,876 | $ 449,307 |

Total amortization expense of intangible assets of the Company for the three months ended March 31, 2009 and 2008 were $25,431and $259,665 respectively.

NOTE 10. CONVERTIBLE PROMISSORY NOTES AND WARRANTS

(A) 12% Convertible Promissory Note and Warrants

On November 12, 2007, the Company entered into a 12% Note and Warrant Purchase Agreement with Wei An Developments Limited ("Wei An") with respect to the purchase by Wei An a convertible promissory note in the principal account of $5,000,000 at interest rate of 12% per annum (the "12% Convertible Promissory Note"). The 12% Convertible Promissory Note is convertible into the Company's common stock at the conversion price of $2.40 per share. Pursuant to the agreement, the Company is subject to a commitment fee of 2% of the principal amount of the 12% Convertible Promissory Note. The term of the 12% Convertible Promissory Note is six months and the Company has the option to extend the 12% Convertible Promissory Note by an additional six-month period at an interest rate of 14% per annum and be subject to an additional commitment fee of 2% of the principal amount of the note. However, the Company has the right to prepay all or any portion of the amounts due under the note at any time without penalty or premium. In addition, pursuant to the Warrant Purchase Agreement, the Company issued warrants to purchase up to 250,000 shares of the Company's common stock at the exercise price of $2.30 per share, which are exercisable for a period of two years.

Table of Contents

As of March 31, 2009, none of the warrants associated with 12% Convertible Promissory Note was exercised.

On February 13, 2008, the Company fully redeemed 12% Convertible Promissory Note due May 2008 at a redemption price equal to 100% of the principal amount of $5,000,000 plus accrued and unpaid interest. No penalty or premium was charged for such early redemption. The Company recognized the unamortized portion of the associated deferred charges and debt discount of $48,261 and $149,885 respectively, as expenses included in amortization of deferred charges and debt discount on the condensed consolidated statements of operations during the three months ended March 31, 2008.

(B) 3% Convertible Promissory Notes and Warrants

On November 19, 2007, the Company and Quo Advertising entered into a 3% Note and Warrant Purchase Agreement (the “Purchase Agreement”) with affiliated investment funds of Och-Ziff Capital Management Group (the “Investors”), pursuant to which the Company agreed to issue 3% Senior Secured Convertible Notes due June 30, 2011 in the aggregate principal amount of up to $50,000,000 (the “3% Convertible Promissory Notes”) and warrants to acquire an aggregate amount of 34,285,715 shares of common stock of the Company (the “Warrants”).

The 3% Convertible Promissory Notes and Warrants were issued in three tranches:

1) On November 19, 2007, Convertible Notes in the aggregate principal amount of $6,000,000, Warrants exercisable for 2,400,000 shares at $2.50 per share and Warrants exercisable for 1,714,285 shares at $3.50 per share were issued;

2) On November 28, 2007, Convertible Notes in the aggregate principal amount of $9,000,000, Warrants exercisable for 3,600,000 shares at $2.50 per share and Warrants exercisable for 2,571,430 shares at $3.50 per share were issued; and

3) On January 31, 2008 (the “Third Closing”), Convertible Notes in the aggregate principal amount of $35,000,000, Warrants exercisable for 14,000,000 shares at $2.50 per share and Warrants exercisable for 10,000,000 shares at $3.50 per share were issued.

The 3% Convertible Promissory Notes bore interest at 3% per annum payable semi-annually in arrears and were convertible into shares of common stock at an initial conversion price of $1.65 per share, subject to customary anti-dilution adjustments. In addition, the conversion price was subject to adjusted downward on an annual basis if the Company should fail to meet certain annual EPS targets described in the Purchase Agreement. The EPS targets for fiscal 2008, 2009 and 2010 are $0.081, $0.453, and $0.699 respectively. In the event of a default, or if the Company’s actual EPS as defined in the Purchase Agreement for any fiscal year is less than 80% of the respective EPS target, certain Investors may require the Company to redeem the 3% Convertible Promissory Notes at 100% of the principal amount, plus any accrued and unpaid interest, plus an amount representing a 20% internal rate of return on the then outstanding principal amount. The Warrants were to expire on June 30, 2011 and granted the holders the right to acquire shares of common stock at $2.50 and $3.50 per share, subject to customary anti-dilution adjustments. The exercise price of the Warrants will also be adjusted downward whenever the conversion price of the 3% Convertible Promissory Notes is adjusted downward. In connection with the issuance of the 3% Senior Secured Convertible Notes, the Company also entered into registration rights agreement with the Investors, pursuant to which, as amended, the Company agreed to file at their request, a registration statement registering for resale any shares issued to the Investor upon conversion of the 3% Convertible Promissory Notes or exercise of the Warrants.

Table of Contents

On January 31, 2008, the Company issued $35,000,000 in 3% Convertible Promissory Notes and amended and restated $15,000,000 in 3% Convertible Promissory Notes issued in late 2007. Concurrent with the Third Closing, the Company loaned substantially all the proceeds from 3% Convertible Promissory Notes to its directly wholly owned subsidiary, NCN Group Limited (the "NCN Group"), and such loan was evidenced by an intercompany note issued by NCN Group in favor of the Company (the "NCN Group Note"). At the same time, the Company entered into a Security Agreement, pursuant to which the Company granted to the collateral agent for the benefit of the convertible note holders a first-priority security interest in certain of its assets, including the NCN Group Note and 66% of the shares of the NCN Group. In addition, the NCN Group and certain of the Company's indirectly wholly owned subsidiaries each granted the Company a security interest in certain of the assets of such subsidiaries to, among other things, secure the NCN Group Note and certain related obligations.

As of December 31, 2008, the Company failed to meet EPS target for fiscal 2008. The Investors agreed the conversion price of the 3% Convertible Promissory Notes remained unchanged at $1.65 and have not proposed any adjustment to the conversion price as of December 31, 2008 and March 31, 2009. None of the conversion options and warrants associated with the above convertible promissory notes has been exercised.

On April 2, 2009, the Company entered into a new financing arrangement with the holders of the 3% Convertible Promissory Notes and warrants and certain other investors, pursuant to which, $45 million of original notes was converted into common stock and the remaining $5 million of the notes was exchanged for $5 million of 1% convertible promissory notes. In addition, the original holders agreed to cancel the warrants and terminate the security agreement and the investor rights agreement among them and the Company. For details, please refer to Note 17 – Subsequent Events.

The following table details the accounting treatment of the convertible promissory notes:

| | 12% Convertible Promissory Note | 3% Convertible Promissory Notes (first and second tranches) | 3% Convertible Promissory Notes (third tranche) | Total |
|---|---|---|---|---|
| Proceeds of convertible promissory notes | $ 5,000,000 | $ 15,000,000 | $ 35,000,000 | $ 55,000,000 |
| Allocation of proceeds: | | | | |
| Allocated relative fair value of warrants | (333,670) | (2,490,000) | (5,810,000) | (8,633,670) |
| Allocated intrinsic value of beneficial conversion feature | - | (4,727,272) | (11,030,303) | (15,757,575) |
| Total net proceeds of the convertible promissory notes | 4,666,330 | 7,782,728 | 18,159,697 | 30,608,755 |
| Repayment of convertible promissory note | (5,000,000) | - | - | (5,000,000) |
| Amortization of debt discount | 333,670 | 2,034,549 | 4,322,965 | 6,691,184 |
| Net carrying value of convertible promissory notes as of March 31, 2009 | $ - | $ 9,817,277 | $ 22,482,662 | $ 32,299,939 |

Warrants and Beneficial Conversion Features

The fair values of the financial instruments associated with warrants of both 12% convertible promissory note and 3% convertible promissory notes were determined utilizing Black-Scholes option pricing model, which is consistent with the Company's historical valuation methods. The following assumptions and estimates were used in the Black-Scholes option pricing model: (1) 12% convertible promissory note: volatility of 182%; an average risk-free interest rate of 3.52%; dividend yield of 0%; and an expected life of 2 years, (2) 3% convertible promissory notes: volatility of 47%;

an average risk-free interest rate of 3.30%; dividend yield of 0%; and an expected life of 3.5 years.

Table of Contents

Both the warrants and embedded conversion features issued in connection with 12% convertible promissory note and 3% convertible promissory notes meet the criteria of EITF 00-19 “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock” for equity classification and also met the other criteria in paragraph 11(a) of SFAS 133 “Accounting for Derivative Instruments and Hedging Activities”. Accordingly, the conversion features do not require derivative accounting. The intrinsic value of beneficial conversion feature is calculated according to EITF Issue No. 98-5 “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio” and EITF Issue No. 00-27 “Application of Issue No. 98-5 to Certain Convertible Instruments”. For 3% convertible promissory note, as the effective conversion price after allocating a portion of the proceeds to the warrants was less than the Company’s market price of common stock at commitment date, it was considered to have a beneficial conversion feature while for the 12% convertible promissory note, no beneficial conversion feature existed. The value of beneficial conversion feature is recorded as a reduction in the carrying value of the convertible promissory notes against additional paid-in capital. As the 3% convertible promissory notes has stated redemption date, the respective debt discount being equal to the value of beneficial conversion feature of $15,757,575 is amortized over the term of the notes from the respective date of issuance using the effective yield method.

Amortization of Deferred Charges and Debt Discount

The amortization of deferred charges and debt discount for the three months ended March 31, 2009 was as follows:

| | Warrants | Conversion Features | Deferred Charges | Total |
|---|---|---|---|---|
| 12% convertible promissory note | $ - | $ - | $ - | $ - |
| 3% convertible promissory notes | 500,919 | 950,996 | 125,431 | 1,577,346 |
| Total | $ 500,919 | $ 950,996 | $ 125,431 | $ 1,577,346 |

The amortization of deferred charges and debt discount for the three months ended March 31, 2008 was as follows:

| | Warrants | Conversion Features | Deferred Charges | Total |
|---|---|---|---|---|
| 12% convertible promissory note | $ 259,204 | $ - | $ 80,700 | $ 339,904 |
| 3% convertible promissory notes | 309,747 | 588,057 | 110,576 | 1,008,380 |
| Total | $ 568,951 | $ 588,057 | $ 191,276 | $ 1,348,284 |

NOTE 11. COMMITMENTS AND CONTINGENCIES

(a) Commitments

1. Rental Lease Commitment

The Company’s existing rental leases do not contain significant restrictive provisions. The following is a schedule by year of future minimum lease obligations under non-cancelable rental operating leases as of March 31, 2009:

| | |
|---|---|
| Nine months ending December 31, 2009 | $ 210,823 |
| Fiscal years ending December 31, | |
| 2009 | 210,823 |
| 2010 | 180,277 |
| 2011 | - |
| 2012 | - |

| | | |
|---|---|---|
| Total | $ | 391,100 |

22

Table of Contents

2. Annual Advertising Operating Rights Fee Commitment

Since November 2006, the Company, through its subsidiaries NCN Media Services Limited, Quo Advertising, Xuancaiyi, Bona and Botong has acquired advertising rights from third parties to operate different types of advertising panels for certain periods.

The following table sets forth the estimated future annual commitment of the Company with respect to the advertising operating rights of 1,242 roadside advertising panels and 5 mega-size advertising panels that the Company held as of March 31, 2009:

| | |
|---|---|
| Nine months ending December 31, 2009 | $ 1,295,102 |
| Fiscal years ending December 31, | |
| 2009 | 1,295,102 |
| 2010 | 1,036,127 |
| 2011 | 768,896 |
| 2012 | 485,398 |
| 2013 | 210,293 |
| Thereafter | 80,624 |
| Total | $ 3,876,440 |

3. Capital commitments

As of March 31, 2009, the Company had commitments for capital expenditures in connection with construction of roadside advertising panels and mega-size advertising panels of approximately $18,000.

(b) Contingencies

The Company accounts for loss contingencies in accordance with SFAS No. 5 “Accounting for Loss Contingencies” and other related guidelines. Set forth below is a description of certain loss contingencies as of March 31, 2009 and management’s opinion as to the likelihood of loss in respect of loss contingency.

On March 20, 2008, the Company’s wholly-owned subsidiary, NCN Huamin Management Consultancy (Beijing) Company Limited (“NCN Huamin”), entered into a rental agreement with Beijing Chengtian Zhihong TV & Film Production Co., Ltd. (“Chengtian”), pursuant to which, a certain office premises located in Beijing was leased from Chengtian to NCN Huamin for a term of three years, commencing April 1, 2008. On December 30, 2008, NCN Huamin issued a notice to Chengtian to terminate the rental agreement effective on December 31, 2008, as Chengtian had breached several provisions as stated in the rental agreement and refused to take any remedial actions. On January 14, 2009, NCN Huamin received a notice from Beijing Arbitration Commission that Chengtian, as plaintiff, had initiated a lawsuit against NCN Huamin seeking an aggregate of approximately $505,000 for unpaid rental-related expense plus accrued interest as well as compensation for unilateral termination of the rental contract. On February 25, 2009, NCN Huamin counter-claimed for breach of rental contract against Chengtian and asserted to claim an aggregate of approximately $155,000 from Chengtian for overpayment of rental expenses and compensation for Chengtian’s breach of contract.

At present, the outcome of this lawsuit cannot be reasonably predicted. The Company does not believe that the outcome of this pending litigation will have a material impact on the Company’s financial statements, or results of operations.

NOTE 12. STOCKHOLDERS’ DEFICIT

(A) Stock, Options and Warrants Issued for Services

1. In August 2006, the Company issued a warrant to purchase up to 100,000 shares of restricted common stock to a consultant at an exercise price $0.70 per share. One-fourth of the shares underlying the warrant became exercisable every 45 days beginning from the date of issuance. The warrant remains exercisable until August 25, 2016. The fair market value of the warrant was estimated on the grant date using the Black-Scholes option pricing model as required by SFAS 123R with the following assumptions and estimates: expected dividend 0%, volatility 192%, a risk-free rate of 4.5% and an expected life of one (1) year. The value of the warrant recognized $nil for the three months ended March 31, 2009 and 2008.

Table of Contents

2. In July 2007, NCN Group Management Limited entered into Executive Employment Agreements (the "Agreements") with Godfrey Hui, Chief Executive Officer, Daniel So, former Managing Director, Daley Mok, Chief Financial Officer, Benedict Fung, former President, and Stanley Chu, former General Manager. Pursuant to the Agreements, each executive was granted shares of the Company's common stock subject to annual vesting over five years in the following amounts: Mr. Hui, 2,000,000 shares; Mr. So, 2,000,000 shares; Dr. Mok 1,500,000 shares; Mr. Fung 1,200,000 shares and Mr. Chu, 1,000,000 shares. However, since Mr. So, Mr. Fung and Mr. Chu resigned from their respective positions in January 2009, they are no longer entitled to those shares that will be vested on December 31, 2009, 2010 and 2011 in the following amounts: Mr. So 1,500,000 shares; Mr. Fung 970,000 shares and Mr. Chu 790,000 shares. In connection with these stock grants and in accordance with SFAS 123R, the Company recognized non-cash stock-based compensation of $453,250 and $699,300 included in general and administrative expenses on the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 respectively. Out of the total shares granted under the Agreements, on January 2, 2008, an aggregate of 660,000 S-8 shares with par value of $0.001 each were vested and issued to the concerned executives.

3. In September, 2007, the Company entered into a service agreement with independent directors Peter Mak, Ronglie Xu, Joachim Burger (who resigned as a director of the Company on September 30, 2008), Gerd Jakob and Edward Lu. Pursuant to the service agreements, each independent director was granted shares of the Company's common stock subject to a vesting period of ten months in the following amounts: Peter Mak: 15,000 shares; Ronglie Xu: 15,000 shares; Joachim Burger: 15,000 shares, Gerd Jakob: 10,000 shares and Edward Lu: 10,000 shares. In connection with these stock grants and in accordance with SFAS 123R, the Company recognized $nil and $43,485 of non-cash stock-based compensation included in general and administrative expenses on the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 respectively. On July 21, 2008, an aggregate of 65,000 S-8 shares of common stock of par value of $0.001 each were vested and issued to the independent directors.

4. In November 2007, the Company issued a warrant to purchase up to 300,000 shares of restricted common stock to a placement agent for provision of agency services in connection with the issuance of 3% convertible promissory notes at an exercise price $3.0 per share which are exercisable for a period of two years. The fair value of the warrant was estimated on the grant date using the Black-Scholes option pricing model as required by SFAS 123R with the following weighted average assumptions: expected dividend 0%, volatility 182%, a risk-free rate of 4.05 % and an expected life of two (2) year. The value of the warrant recognized for the three months ended March 31, 2009 and 2008 were $31,959 and $31,958 respectively. As of March 31, 2009, none of the associated warrants was exercised.

5. In December 2007, the Company committed to grant 235,000 S-8 shares of common stock to certain employees of the Company for their services rendered during the year ended December 31, 2007. In connection with these stock grants and in accordance with SFAS 123R, the Company recognized non-cash stock-based compensation of $nil in general and administrative expenses on the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008. Such 235,000 S-8 shares of par value of $0.001 each were issued on January 2, 2008. In addition, the Company committed to grant another 30,000 S-8 shares of common stock to an employee pursuant to his employment contract for service rendered. The Company recognized the non-cash stock-based compensation of $nil for the three months ended March 31, 2009 and 2008 for such 30,000 S-8 shares granted. In October 2008, such 30,000 S-8 shares of common stock of par value of $0.001 each were vested and issued to the employee.

6. In June 2008, the Board of Directors resolved to grant 110,000 shares of common stock to the board of directors, Peter Mak, Ronglie Xu, Joachim Burger, Gerd Jakob, Edward Lu, Godfrey Hui, Daniel So, Daley Mok and Stanley Chu, as part of their directors' fee for their service rendered during the period from July 1, 2008 to June 30, 2009. Each director was granted shares of the Company's common stock subject to a vesting period of twelve months in the following amounts: Peter Mak: 15,000 shares; Ronglie Xu: 15,000 shares; Joachim Burger: 15,000 shares; Gerd Jakob: 10,000 shares; Edward Lu: 10,000 shares; Godfrey Hui: 15,000 shares; Daniel So: 10,000 shares; Daley Mok:

10,000 shares and Stanley Chu: 10,000 shares. In connection with these stock grants and in accordance with SFAS 123R, the Company recognized $47,499 and $nil of non-cash stock-based compensation included in general and administrative expenses on the condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 respectively.

Table of Contents

7. In July 2008, the Company committed to grant 170,000 S-8 shares of common stock to certain employees of the Company for their services rendered. One of the employees resigned in January 2009 and his entitlement to 70,000 shares was canceled. In accordance with SFAS 123R, the Company reversed all previous recognized non-cash stock based compensation associated with such 70,000 shares. Accordingly, in connection with these stock grants, the Company recorded a net credit balance of non-cash stock based compensation of $4,258 and $nil for the three months ended March 31, 2009 and 2008 respectively.

8. In August 2008, the Company committed to grant 100,000 S-8 shares of common stock to a consultant for services rendered. The value of stock grant recognized for the three months ended March 31, 2009 and 2008 were $31,411 and $nil respectively.

(B) Stock Issued for Acquisition

In January 2008, in connection with the acquisition of Cityhorizon BVI, the Company issued 1,500,000 shares of restricted common stock of par value of $0.001 each, totaling $3,738,000, as part of the consideration.

(C) Conversion Option and Stock Warrants Issued in Notes Activities

On November 12, 2007, pursuant to the 12% Note and Warrant Purchase Agreement of $5,000,000, the Company issued warrants to purchase up to 250,000 shares of the Company’s common stock at the exercise price of $2.30 per share, which are exercisable for a period of two years to Wei An. The allocated proceeds to the warrants of $333,670 based on the relative fair value of 12% Convertible Promissory Notes and warrants were recorded as reduction in the carrying value of the note against additional-paid in capital. As the effective conversion price is higher than the Company’s market price of common stock at commitment date, no beneficial conversion existed. Please refer to Note 10 – Convertible Promissory Notes and Warrants for details.

On November 19, 2007, pursuant to the 3% Note and Warrant purchase Agreement, the Company issued warrants to purchase up to 2,400,000 shares of the Company’s common stock at the exercise price of $2.5 per share and 1,714,285 shares of the Company’s common stock at the exercise price of $3.5 per share associated with the convertible notes of $6,000,000 in the first closing. On November 28, 2007, the Company also issued warrants to purchase up to 3,600,000 shares of the Company’s common stock at the exercise price of $2.5 per share and 2,571,430 shares of the Company’s common stock at the exercise price of $3.5 per share. The allocated proceeds to these warrants were $2,490,000 in aggregate which were recorded as reduction in the carrying value of the notes against additional paid-in capital. As the effective conversion price after allocating a portion of the proceeds to the warrants was less than the Company’s market price of common stock at commitment date, it was considered to have a beneficial conversion feature with value of $4,727,272 recorded as a reduction in the carrying value of the notes against additional paid-in capital. Please refer to Note 10 – Convertible Promissory Notes and Warrants for details.

On January 31, 2008, the Company issued $35,000,000 in 3% Convertible Promissory Notes and amended and restated $15,000,000 in 3% Convertible Promissory Notes issued in late 2007. In addition, the Company issued additional warrants to purchase 14,000,000 shares of the Company’s common stock at $2.50 per share and warrants to purchase 10,000,000 shares of the Company’s common stock at $3.50 per share. The allocated proceeds to these warrants were $5,810,000 in aggregate which were recorded as reduction in the carrying value of the notes against additional paid-in capital. As the effective conversion price after allocating a portion of the proceeds to the warrants was less than the Company’s market price of common stock at commitment date, it was considered to have a beneficial conversion feature with value of $11,030,303 recorded as a reduction in the carrying value of the notes against additional paid-in capital. Please refer to Note 10 – Convertible Promissory Notes and Warrants for details.

(D) Changes in Deficit

The following table summarizes the changes in deficit for the three months ended March 31, 2009:

Table of Contents

| | Noncontrolling Interests | NCN Common Stockholders | Total |
|---|---|---|---|
| Total deficit as of December 31, 2008 | $ - | $ (23,356,217) | $ (23,356,217) |
| Net loss | (21,767) | (3,825,702) | (3,847,469) |
| Other comprehensive income (loss) | 179 | (321) | (142) |
| Preferred stock | - | - | - |
| Common stock | - | - | - |
| Additional paid-in capital | - | 559,862 | 559,862 |
| Total deficit as of March 31, 2009 | $ (21,588) | $ (26,622,378) | $ (26,643,966) |

NOTE 13. RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2009 and 2008, the Company did not enter into any material transactions or series of transactions that would be considered material in which any officer, director or beneficial owner of 5% or more of any class of the Company's capital stock, or any immediate family member of any of the preceding persons, had a direct or indirect material interest.

NOTE 14. NET INCOME (LOSS) PER COMMON SHARE

Net loss per share information for the three months ended March 31, 2009 and 2008 was as follows:

| | For the three months ended March 31, 2009 (Unaudited) | For the three months ended March 31, 2008 (Unaudited) |
|---|---|---|
| Numerator: | | |
| Net loss from continuing operations attributable to NCN common stockholders | $ (3,825,702) | $ (8,389,710) |
| Net income from discontinued operations attributable to NCN common stockholders | - | 18,196 |
| Net loss attributable to NCN common stockholders | (3,825,702) | (8,371,514) |
| Denominator: | | |
| Weighted average number of shares outstanding, basic | 71,641,608 | 71,418,201 |
| Effect of dilutive securities | - | - |
| Options and warrants | - | - |
| Weighted average number of shares outstanding, diluted | 71,641,608 | 71,418,201 |
| | | |
| Net income (loss) per common share – basic and diluted | | |
| Continuing operations | (0.05) | (0.12) |
| Discontinued operations | - | - |
| Net loss per common share – basic and diluted | $ (0.05) | $ (0.12) |

The diluted net loss per common share is the same as the basic net loss per common share for the three months ended March 31, 2009 and 2008 as the ordinary shares to be issued under stock options and warrants outstanding are anti-dilutive and are therefore excluded from the computation of diluted net loss per common share. The securities that could potentially dilute basic net income (loss) per common share in the future that were not included in the computation of diluted net income (loss) per common share because of anti-dilutive effect as of March 31, 2009 and 2008 were summarized as follows:

Table of Contents

| | For the three months ended March 31, 2009 (Unaudited) | For the three months ended March 31, 2008 (Unaudited) |
|---|---|---|
| Potential common equivalent shares: | | |
| Stock warrants for services (1) | - | 64,869 |
| Conversion feature associated with convertible promissory notes to common stock | - | 10,466,200 |
| Common stock to be granted to directors executives and employees for services (including non-vested shares) | 3,975,000 | 7,105,000 |
| Common stock to be granted to consultants for services (including non-vested shares) | 100,000 | - |
| Total | 4,075,000 | 17,636,069 |

Remarks:

(1) As of March 31, 2009, the number of potential common equivalent shares associated with warrants issued for services was nil, which was related to a warrant to purchase 100,000 common stock issued by the Company to a consultant in 2006 for service rendered at an exercise price of $0.70, which expired in August 2016.

NOTE 15. DISCONTINUED OPERATIONS

In September 2008, the Company disposed of its entire travel network which was classified as one of the Company's business segments in order to focus on its media business. Accordingly, the Company entered into stock purchase agreements to dispose of its entire travel network which included the sale of NCN Management Services Group (including Tianma) and NCN Landmark Group.

The Company treated the sale of entire travel network as discontinued operations. Accordingly, revenues, costs and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. The net operating results of the discontinued operations have been reported, net of applicable income taxes, as "Net Income from Discontinued Operations, Net of Income Taxes".

Summary operating results for the discontinued operations for travel network were as follows:

| | For the three months ended March 31, 2009 (Unaudited) | For the three months ended March 31, 2008 (Unaudited) |
|---|---|---|
| Revenues | $ - | $ 8,458,482 |
| Cost of revenues | - | (8,301,823) |
| Gross profit | - | 156,659 |
| Operating expenses | - | (141,225) |
| Other income | - | 17,734 |
| Interest income | - | 1,386 |
| Income from discontinued operations, net of income taxes | $ - | $ 34,554 |

NOTE 16. BUSINESS SEGMENTS FROM CONTINUING OPERATIONS

In September 2008, the Company disposed of its entire travel business. Accordingly, the Company now operates in one single business segment: Media Network, providing out-of home advertising services.

NOTE 17. SUBSEQUENT EVENTS

On April 2, 2009, the Company entered into a new financing arrangement with the holders of the 3% Convertible Promissory Notes and Warrants and certain other investors.

27

Table of Contents

Pursuant to a note exchange and option agreement, dated April 2, 2009, between the Company and Keywin Holdings Limited ( "Keywin"), Keywin exchanged the 3% Convertible Promissory Notes in the principal amount of $45,000,000, and all accrued and unpaid interest thereon, for 307,035,463 shares of the Company's common stock and an option to purchase an aggregate of 122,814,185 shares of the Company's common stock, for an aggregate purchase price of $2,000,000, exercisable for a three-month period commencing on April 2, 2009.

Pursuant to a note exchange agreement, dated April 2, 2009, among the Company and the Investors, the parties agreed to cancel the 3% Convertible Promissory Notes in the principal amount of $5,000,000 held by the Investors (including all accrued and unpaid interest thereon), and all of the Warrants, in exchange for the Company's issuance of new 1% Unsecured Senior Convertible Promissory Notes due 2012 in the principal amount of $5,000,000 (the "New Notes"). The New Notes bear interest at 1% per annum, payable semi-annually in arrears, mature on April 1, 2012, and are convertible at any time into shares of our common stock at an initial conversion price of $0.02326 per share, subject to customary anti-dilution adjustments. In addition, in the event of a default, the holders will have the right to redeem the New Notes at 110% of the principal amount, plus any accrued and unpaid interest. The parties also agreed to terminate the security agreement and release all security interests arising out of the Purchase Agreement and the 3% Convertible Promissory Notes.

In connection with the issuance of the New Notes, the Company agreed to provide Keywin and the Investors certain registration rights in respect of the Company's common stock issued to Keywin, issuable upon conversion of the option issued to Keywin and issuable upon conversion of the New Notes, pursuant to a Registration Rights Agreement, dated April 2, 2009, among the Company, the Investors and Keywin.

On April 2, 2009, the Company also entered into a Letter Agreement and Termination of Investor Rights Agreement with the Investors and Keywin (the "Letter Agreement"), pursuant to which the parties agreed to terminate the Investor Rights Agreement, dated November 19, 2007, entered into between the Company and the Investors in connection with the Purchase Agreement.

Pursuant to the Letter Agreement, the Company also agreed to provide certain co-sale rights to the Investors. In the event that Keywin, its affiliates and/or any of the officers or directors of the Company (collectively, the "Controlling Stockholders") propose to transfer, sell, assign or otherwise dispose of, directly or indirectly, any of its or their securities in the Company (the "Selling Controlling Stockholder") in a transaction which, together with previous transfers or sales, would constitute a Change in Control (as defined in the Letter Agreement), then each of the Investors (and their assigns) will have the right to sell, at their sole election, together with such Selling Controlling Stockholder, up to their entire interest in the Company (including either the New Notes or the securities issuable upon conversion of the New Notes), except that any such co-sale must be on the same terms and conditions agreed to by the Selling Controlling Stockholder.

Pursuant to the Letter Agreement, the parties also agreed to certain limitations on conversion of the New Notes. The Investors agreed that they would not convert, and the Company agreed that it would not issue any shares of its common stock upon any attempted conversion or exercise of, any portion of the New Notes, if after giving effect to such conversion, the Investors (together with their affiliates) collectively would have acquired, through the conversion of the New Notes or otherwise, beneficial ownership of a number of shares of the Company's common stock in excess of 9.99% of the aggregate number of shares of common stock outstanding immediately after giving effect to such conversion or exercise.

On April 6, 2009, in connection with the above new financing arrangement, an aggregate of 307,035,463 shares of the Company's common stock with par value of $0.001 each were issued to Keywin accordingly.

Table of Contents

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

Cautionary Statements

The following management's discussion and analysis of financial condition and results of operations is based upon and should be read in conjunction with the Company's condensed consolidated financial statements and the notes thereto included in "Part I – Financial Information, Item 1. Financial Statement". All amounts are expressed in U.S. dollars.

Overview

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

Our net advertising revenues were $185,149 and $584,167 for the three months ended March 31, 2009 and 2008 respectively. Our net loss was $3,847,469 and $8,444,850 for the three months ended March 31, 2009 and 2008. Our results of operations were negatively affected by a variety of factors, which led to less than expected revenues and cash inflows during the first quarter of 2009, including the following:

- The rising costs to acquire advertising rights due to competition among bidders for those rights;
- Delays in obtaining government approvals for panel installation due to the government's focus on fighting snow storms in different provinces in the early months of 2008;
- Slower than expected consumer acceptance of the digital form of advertising media;
- Strong competition from other media companies; and
- Slowing demand due to the worldwide financial crisis and deteriorating economic conditions in China, leading many customers to cut their advertising budget. The impact of the reduction in the pace of our advertising spending is expected to be more significant on our new digital form of media than traditional advertising platforms.

To address these unfavorable market conditions, in the latter half of 2008, we undertook drastic cost-cutting measures including reduction of our workforce, rentals, as well as reductions to our selling and marketing expenses and other general and administrative expenses. In addition, the commercial viability of each of our concession right contracts was re-assessed. Some commercially non-viable concession right contracts were terminated as a result of this re-assessment and management has also successfully negotiated some reductions in advertising operating right fees under existing contracts. The outcome of these cost reduction measures has been reflected in our financial results. We will continue to strictly control our operating costs for the foreseeable future. We will also continue to allocate more resources to those commercially viable projects as well as explore new prominent advertising related projects.

For more information relating to our business, please see the section entitled “Business” in our Annual Report on Form 10-K for the fiscal year ending December 31, 2008 as filed with the United States Securities and Exchange Commission on March 27, 2009.

Table of Contents

Recent Developments

Restructuring of Convertible Debt

On November 19, 2007, we entered into a Note and Warrant Purchase Agreement, as amended, or the Purchase Agreement, with our subsidiary Quo Advertising and affiliated investment funds of Och-Ziff Capital Management Group, or the Investors, pursuant to which we agreed to issue in three tranches, 3% Senior Secured Convertible Notes, due June 30, 2011, in the aggregate principal amount of up to $50,000,000, or the "Notes", and warrants to acquire an aggregate amount of 34,285,715 shares of our Common Stock, or the Warrants. On November 19, 2007, we issued Notes in the aggregate principal amount of $6,000,000, Warrants to purchase shares of our common stock at $2.50 per share and Warrants to purchase shares of our common stock at $3.50 per share. On November 28, 2007, we issued Notes in the aggregate principal amount of $9,000,000, Warrants to purchase shares of our common stock at $2.50 per share and Warrants to purchase shares of our common stock at $3.50 per share.

On January 31, 2008, we amended and restated the previously issued Notes and issued to the Investors 3% Senior Secured Convertible Notes in the aggregate principal amount of $50,000,000, or the Amended and Restated Notes, Warrants to purchase shares of our common stock at $2.50 per share and Warrants to purchase shares of our common stock at $3.50 per share, or the Third Closing. In connection with the Third Closing, the parties entered into the First Amendment to the Purchase Agreement, dated as of January 31, 2008, to, among other things, establish additional funding channels between the Company and its subsidiaries in China and provide for certain other modifications in connections with the Third Closing. Concurrently with the Third Closing, we loaned substantially all the proceeds from the Amended and Restated Notes to our wholly-owned direct subsidiary, NCN Group, and such loan was evidenced by an intercompany note issued by NCN Group in favor of the Company, or the NCN Group Note. In connection with the Amended and Restated Notes, we entered into a Security Agreement, dated as of January 31, 2008, or the Security Agreement, pursuant to which we granted to the collateral agent for the benefit of the Investors, a first-priority security interest in certain of our assets, including the NCN Group Note and 66% of the equity interest of NCN Group. In addition, NCN Group and certain of our indirect wholly owned subsidiaries each granted the Company a security interest in certain of the assets of such subsidiaries to, among other things, secure the NCN Group Note and certain related obligations.

On April 2, 2009, we entered into a new financing arrangement with the Investors and certain other investors, memorialized in the following documents.

Note Exchange Agreement

On April 2, 2009, we entered into a Note Exchange Agreement with certain of the Investors, or the Note Exchange Agreement, pursuant to which the parties agreed to cancel Amended and Restated Notes in the principal amount of $5 million held by such Investors (including accrued and unpaid interest thereon), and all the Warrants, in exchange for our issuance of new 1% Unsecured Senior Convertible Notes due 2012 in the principal amount of $5 million, or the New Notes. The New Notes bear interest at 1% per annum, payable semi-annually in arrears, and mature on April 2, 2012. They are convertible at any time into shares of our common stock at an initial conversion price of $0.02326 per share, subject to customary anti-dilution adjustments. In addition, in the event of a default, the holders of the New Notes, or the Note Holders, will have the right to redeem the New Notes at 110% of the principal amount, plus any accrued and unpaid interest. The parties also agreed to terminate the Security Agreement and release all security interests arising out of the Purchase Agreement and the Amended and Restated Notes.

Notes Exchange and Option Agreement

On April 2, 2009, we also entered into a Note Exchange and Option Agreement, or the Note Exchange and Option Agreement, with Keywin Holdings Limited, a transferee of the Investors, Keywin, pursuant to which we agreed to exchange the remaining Amended and Restated Notes in the principal amount of $45 million (including all accrued and unpaid interest thereon) for (i) 307,035,463 shares of our common stock, or the Keywin Shares, and (ii) an option to purchase an aggregate of 122,814,185 shares of our common stock for an aggregate purchase price of $2,000,000, exercisable for a three-month period commencing on April 2, 2009, or the Keywin Option.

Table of Contents

Registration Rights Agreement

In connection with the Note Exchange Agreement and the Note Exchange and Option Agreement, we agreed to provide Keywin and the Note Holders, pursuant to a Registration Rights Agreement, dated April 2, 2009, or the Registration Rights Agreement, among the Company, the Note Holders and Keywin, demand and piggy-back registration rights in respect of the Keywin Shares, shares of our common stock issuable upon exercise of the Keywin Option and shares of our common stock issuable upon conversion of the New Notes.

Letter Agreement and Termination of Investor Rights Agreement

On April 2, 2009, we also entered into a Letter Agreement and Termination of Investor Rights Agreement with the Investors and Keywin, or the Letter Agreement, pursuant to which the parties agreed to terminate the Investor Rights Agreement, dated November 19, 2007, entered into between us and the Investors in connection with the Purchase Agreement.

Pursuant to the Letter Agreement, we also agreed to provide certain co-sale rights to the Investors. In the event that Keywin, its affiliates and/or any of the officers or directors of the Company (collectively, referred to as the Controlling Stockholders) propose to transfer, sell, assign or otherwise dispose of, directly or indirectly, any of its or their securities in the Company in a transaction which, together with previous transfers or sales, would constitute a Change in Control (as defined in the Letter Agreement), then each of the Investors (and their assigns) will have the right to sell, at their sole election, together with such selling Controlling Stockholder, up to their entire interest in the Company (including either the New Notes or the securities issuable upon conversion of the New Notes), except that any such co-sale must be on the same terms and conditions agreed to by the selling Controlling Stockholder.

Pursuant to the Letter Agreement, the parties also agreed to certain limitations on conversion of the New Notes. The Investors agreed that they would not convert, and we agreed that we would not issue any shares of our common stock upon any attempted conversion or exercise of, any portion of the New Notes, if after giving effect to such conversion, the Investors (together with their affiliates) collectively would have acquired, through the conversion of the New Notes or otherwise, beneficial ownership of a number of shares of our common stock in excess of 9.99% of the aggregate number of shares of common stock outstanding immediately after giving effect to such conversion or exercise.

On April 6, 2009, in connection with the above new financing arrangement, an aggregate of 307,035,463 shares of the Company’s common stock with par value of $0.001 each were issued to Keywin accordingly.

Restatements of Consolidated Financial Statements

On October 10, 2008, we filed a Current Report on Form 8-K to announce that our Board of Directors, based upon the consideration of issues addressed in the SEC review and the recommendation of our Audit Committee, determined that we should restate our previously issued condensed consolidated financial statements for quarterly periods ended March 31, 2008 and June 30, 2008 and consolidated financial statements for the year ended December 31, 2007.

The restatement adjustments corrected the accounting errors arising from our misapplication of accounting policies to the discount associated with the beneficial conversion feature attributed to the issuance of the 3% convertible promissory notes in 2007 and 2008. We initially amortized the discount according to EITF Issue No. 98-5, “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio”, which stated that discount resulting from allocation of proceeds to the beneficial conversion feature should be recognized as interest expense over the minimum period from the date of issuance to the date of earliest conversion. As the notes are convertible at the date of issuance, we fully amortized such discount through interest

expense at the date of issuance accordingly. However, according to Issue 6 of EITF Issue No. 00-27 “Application of Issue No. 98-5 to Certain Convertible Instruments”, EITF Issues No. 98-5 should be modified to require the discount related to the beneficial conversion feature to be accreted from the date of issuance to the stated redemption date regardless of when the earliest conversion date occurs using the effective interest method. The restatement adjustments were to reflect the retrospective application of the Issue 6 of EITF Issue No. 00-27.

The aggregate net effect of the restatement was to (1) increase stockholders’ equity by approximately $15.1 million as of March 31, 2008; (2) decrease both non-cash interest expense and net loss for the three months ended March 31, 2008 by approximately $10.4 million. Accordingly, the net loss per common share (basic and diluted) for the three months ended March 31, 2008 decreased from $0.26 to $0.12.

Results of Operations

Comparison of Three Months Ended March 31, 2009 and March 31, 2008

Revenues – In the three months ended March 31, 2009, our revenues were derived from sale of advertising services. Revenues from advertising services for the three months ended March 31, 2009 were $185,149 as compared to $584,167 for the corresponding prior year period, a decrease of 68%. The decrease was mainly attributed to the decrease in the advertising sales orders as a result of the worldwide financial crisis and deteriorating economic conditions in China.

Cost of Advertising Services – Cost of advertising services for the three months ended March 31, 2009 was $452,259, a decrease of 89% compared to $3,961,340 for the corresponding prior year period. This significant decrease was mainly attributable to the decrease in amortization of advertising operating rights fees. The decrease in the amortization of advertising operating rights fees resulted from the termination of commercially non-viable concession right contracts in late 2008 and early 2009 as well as the renegotiation of certain concession advertising operating right fees to a lower price.

Selling and Marketing Expenses – Selling and marketing expenses for the three months ended March 31, 2009 decreased by 74% to $165,986, compared to $640,318 for the same period last year, primarily due to a decrease in advertising services provided by the Company.

General and Administrative Expenses – General and administrative expenses for the three months ended March 31, 2009 decreased by 47% to $1,467,671, compared to $2,776,267 for the corresponding prior year period. The decrease in general and administrative expenses was mainly due to drastic cost cutting measures, including reduction of the Company's workforce, rental, and other general and administrative expenses, since the latter half of 2008. The write-back of allowance for doubtful debts of $231,985 included in general and administrative expenses also led to the decrease in general and administrative expenses.

Interest Expense – Interest expense for the three months ended March 31, 2009 increased to $1,952,346, or by 15%, compared to $1,694,909 for the same period last year. The increase was primarily due to the issuance of $35,000,000 in 3% Convertible Promissory Notes on January 31, 2008, which resulted in only two months' interest expense during the three-month period ended March 31, 2008, as compared to three months of interest expense during the 2009 period.

Income Taxes – The Company derives all of its income in the PRC and is subject to income tax in the PRC. No income tax was recorded during the three months ended March 31, 2009 and 2008 as the Company and all of its subsidiaries and variable interest entities operated at a taxable loss during the respective periods.

Net loss from Continuing Operations – The Company incurred a net loss from continuing operations of $3,847,469 for the three months ended March 31, 2009, a decrease of 55% compared to a net loss of $8,479,404 for the corresponding prior year period. The decrease in net loss was driven by several factors, including the decrease in the cost of advertising services, decrease in selling and marketing expenses and decrease in workforce, rental and other general and administrative expenses as a result of our cost cutting measures, all as more particularly described above.

Discontinued Operations

In 2008, our Board of Directors determined that it was in the best interests of the Company to focus on developing its media business and to explore ways of divesting its travel business. In September 2008, we sold our entire non-media business division, which included the sale of NCN Management Services Group (including Tianma) and NCN

Landmark Group.

We treated the sales of entire travel network as discontinued operations. Accordingly, revenues, costs and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. Summary operating results for the discontinued operations for travel network as follows:

Table of Contents

| | Three Months Ended March 31, 2009 (Unaudited) | March 31, 2008 (Unaudited) |
|---|---|---|
| Revenues | $ - | $ 8,458,482 |
| Cost of revenues | - | (8,301,823) |
| Gross profit | - | 156,659 |
| Operating expenses | - | (141,225) |
| Other income | - | 17,734 |
| Interest income | - | 1,386 |
| Net Income from discontinued operations, net of income taxes | - | 34,554 |
| Less: net income attributable to noncontrolling interests | - | (16,358) |
| Income from discontinued operations, net of income taxes and noncontrolling interests | $ - | $ 18,196 |

Liquidity and Capital Resources

As of March 31, 2009, we had cash of $5,558,927, compared to $7,717,131 as of December 31, 2008, a decrease of $2,158,204. The decrease was mainly attributable to the cash utilized by operating activities.

Operating Activities

Net cash utilized by operating activities for the three months ended March 31, 2009 was $2,158,479, as compared with $9,073,783 for the corresponding prior year period. The decrease in net cash used in operating activities was mainly attributable to the decrease in net loss as a result of our drastic cost-cutting measures and the decrease in the payments for prepaid expenses and other current assets.

Investing Activities

Net cash used in investing activities for the three months ended March 31, 2009 was $6,958, compared with $5,256,633 for the corresponding prior year period. The decrease was mainly attributable to less equipment being purchased and no acquisitions being completed during the three months ended March 31, 2009. For the three months ended March 31, 2008, the investing activities consisted primarily of the purchase of equipment related to our media business and costs associated with the acquisition of Cityhorizon BVI.

Financing Activities

Net cash provided by financing activities was $nil for the three months ended March 31, 2009, compared with $28,900,000 for the same period last year. For the three months ended March 31, 2008, the financing activities consisted of the issuance of $35,000,000 in 3% Convertible Promissory Notes, offset by $5,000,000 paid to redeem the outstanding 12% convertible promissory note due May 2008.

Capital Expenditures

During the three months ended March 31, 2009, we acquired assets of $52,488, which were financed through proceeds from the issuance of convertible promissory notes.

Capital Commitments

Rental Lease Commitment

The Company’s existing rental leases do not contain significant restrictive provisions. The following is a schedule by year of future minimum lease obligations under non-cancelable rental operating leases as of March 31, 2009:

33

| | |
|---|---|
| Nine months ending December 31, 2009 | $ 210,823 |
| Fiscal years ending December 31, | |
| 2009 | 210,823 |
| 2010 | 180,277 |
| 2011 | - |
| 2012 | - |
| Total | $ 391,100 |

Annual Advertising Operating Rights Fee Commitment

Since November 2006, the Company, through its subsidiaries NCN Media Services Limited, Quo Advertising, Xuancaiyi, Bona and Botong, has acquired advertising rights from third parties to operate different types of advertising panels for certain periods.

The following table sets forth the estimated future annual commitment of the Company with respect to the advertising operating rights of 1,242 roadside advertising panels and 5 mega-size advertising panels that the Company held as of March 31, 2009:

| | |
|---|---|
| Nine months ending December 31, 2009 | $ 1,295,102 |
| Fiscal years ending December 31, | |
| 2009 | 1,295,102 |
| 2010 | 1,036,127 |
| 2011 | 768,896 |
| 2012 | 485,398 |
| 2013 | 210,293 |
| Thereafter | 80,624 |
| Total | $ 3,876,440 |

Due to the unexpected unfavorable market conditions described above, cash inflows from advertising revenues were less than we expected. We will have to raise additional funds in order to further expand our media network, though we should be able to satisfy our requirements during the next 12 months if we scale down our operations. Because we presently have only limited revenue from operations, we intend to continue to rely primarily on financing through the issuance of our equity and debt securities to satisfy future capital requirements to enable us to finance ongoing operations. There can be no assurance that we will be able to enter into such agreements. Current global financial conditions and unfavorable conditions in our existing notes described above make securing a financing difficult to achieve. Failure to raise additional funds would have a material adverse effect on our financial condition. Furthermore, the issuance of equity or debt securities which are or may become convertible into equity securities in connection with such financing could result in substantial additional dilution to the stockholders.

To address our cash constraints, our management will continue to strictly control our operating costs. We will also continue to allocate resources to commercially viable projects as well as explore new prominent advertising related projects.

Advertising Operating Rights Fees

Advertising operating rights fees are the major cost of our advertising revenue. To maintain the advertising operating rights, we are required to pay advertising operating rights fees in accordance with payment terms set forth in contracts we entered into with various parties. These parties generally require us to prepay advertising operating rights fees for a period of time. The details of our advertising operating rights fees as of March 31, 2009 and 2008 were as follows:

| | Three Months Ended | |
| --- | --- | --- |
| | March 31, 2009 (Unaudited) | March 31, 2008 (Unaudited) |
| Payment for prepayments for advertising operating rights | $ 312,622 | $ 7,377,894 |
| Settlement of accrued advertising operating rights | 700,000 | - |
| Total payment | $ 1,012,622 | $ 7,377,894 |
| | | |
| Amortization of prepayments for advertising operating rights | $ 229,292 | $ 3,496,248 |
| Accrued advertising operating rights fee recognized | 83,568 | 104,401 |
| Total advertising operating rights fee recognized | $ 312,860 | $ 3,600,649 |

Table of Contents

| | As of March 31, 2009 | As of December 31, 2008 |
|---|---|---|
| Prepayments for advertising operating rights, net | $ 501,442 | $ 418,112 |
| Accrued advertising operating rights fees | $ 116,568 | $ 733,000 |

For future advertising operating rights commitment under non-cancellable advertising operating right contracts, please refer to the table under the following Section – "Contractual Obligations and Commercial Commitments".

We financed the above payments through the issuance of convertible promissory notes in the principal amount of $50 million. As we currently generate limited revenue from our media operation, in addition to the proceeds from the issuance of convertible promissory notes, we intend to continue to raise funds through the issuance of equity and debt securities to satisfy future payment requirements. There can be no assurance that we will be able to enter into such agreements.

In the event that advertising operating rights fees cannot be paid in accordance with the payment terms set forth in our contracts, we may not be able to continue to operate our advertising panels and our ability to generate revenue will be adversely affected. As such, failure to raise additional funds would have significant negative impact on our financial condition.

Contractual Obligations and Commercial Commitments

The following table presents certain payments due under contractual obligations with minimum firm commitments as of March 31, 2009:

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Long-term Debt Obligations | 50,000,000 | - | 50,000,000 | - | - |
| Operating Lease Obligations | 391,100 | 210,823 | 180,277 | - | - |
| Annual Advertising Operating Rights Fee Obligations | 3,876,440 | 1,295,102 | 1,805,023 | 695,691 | 80,624 |
| Purchase Obligations | 18,000 | 18,000 | - | - | - |

Long-term Debt Obligations. We issued an aggregate of $50,000,000 in 3% Convertible Promissory Notes in late 2007 and early 2008 to our investors. Such 3% Convertible Promissory Notes mature on June 30, 2011. For details, please refer to the notes to financial statements.

Operating Lease Obligations. We have entered into various non-cancelable operating lease agreements for our offices and staff quarter. Such operating leases do not contain significant restrictive provisions.

Annual Advertising Operating Rights Fee Obligations. Since November 2006, the Company, through its subsidiaries, NCN Media Services Limited, Quo Advertising, Xuancaiyi, Bona and Botong, has acquired rights from third parties to operate roadside advertising panels and mega-size advertising panels whose lease terms expiring between 2009 and 2024.

Purchase Obligations. We are obligated to make payments under non-cancellable contractual arrangements with our vendors, principally for constructing our advertising panels.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires our management to make assumptions, estimates and judgments that affect the amounts reported, including the notes thereto, and related disclosures of commitments and contingencies, if any. We have identified certain accounting policies that are significant to the preparation of our financial statements. These accounting policies are important for an understanding of our financial condition and results of operation. Critical accounting policies are those that are most important to the portrayal of our financial conditions and results of operations and require management's difficult, subjective, or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Certain accounting estimates are particularly sensitive because of their significance to financial statements and because of the possibility that future events affecting the estimate may differ significantly from management's current judgments. There have been no material changes to the critical accounting policies previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Table of Contents

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements”. Effective January 1, 2008, the Company adopted the measurement and disclosure other than those requirements related to nonfinancial assets and liabilities in accordance with guidance from FASB Staff Position 157-2 “Effective Date of FASB Statement No. 157”, which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal year 2009. In April 2009, the FASB issued Staff Position No. FAS 157-4 “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP FAS No. 157-4”). FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS No. 157 “Fair Value Measurements”, which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP FAS No. 157-4 will be applied prospectively and will be effective for interim and annual reporting periods ending after June 15, 2009. The Company believes the adoption of SFAS No. 157 for nonfinancial assets and liabilities will not have a significant effect on its consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (Revised) “Business Combinations” (“SFAS No. 141(R)”), replacing SFAS No. 141 “Business Combinations” (“SFAS No. 141”), and SFAS No. 160 “Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51”. SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141, broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent consideration be recognized at the acquisition date and re-measured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. SFAS No. 160 improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require; the ownership interests in subsidiaries held by parties other than the parent and the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value, entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 affects those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 141(R) and SFAS No. 160 are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. In April 2009, the FASB issued Staff Position No. FAS 141(R)-1 “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies” (“FSP FAS No. 141(R)-1”). FSP FAS No. 141(R)-1 applies to all assets acquired and all liabilities assumed in a business combination that arise from contingencies. FSP FAS No. 141(R)-1 states that the acquirer will recognize such an asset or liability if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If it cannot be determined during the measurement period, then the asset or liability should be recognized at the acquisition date if the following criteria, consistent with SFAS No. 5 “Accounting for Contingencies”, are met: (1) information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date, and (2) the amount of the asset or liability can be reasonably estimated. FSP FAS No. 141(R)-1 will be effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period

beginning on or after December 15, 2008. The adoption of SFAS No. 141(R) and FSP FAS No. 141(R)-1 did not have a material impact on our financial statements. Beginning January 1, 2009, the Company has applied the provisions of SFAS No. 160 to its accounting for noncontrolling interests and its financial statement disclosures. The disclosure provisions of such standard have been applied to all periods presented in the accompanying condensed consolidated financial statements.

Table of Contents

In March 2008, the FASB issued SFAS No. 161 "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No. 161"). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS No. 161 applies to all derivative instruments within the scope of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133") as well as related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS No. 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. SFAS No. 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of SFAS No. 161 did not have a material impact on our financial statements.

In May 2008, the FASB issued SFAS No. 162 "The Hierarchy of Generally Accepted Accounting Principles". SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the accounting principles to be used. Any effect of applying the provisions of this statement will be reported as a change in accounting principle in accordance with SFAS No. 154 "Accounting Changes and Error Corrections". SFAS No. 162 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS No. 162 did not have a material impact on our financial statements.

In May 2008, the FASB issued SFAS No. 163 "Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60". The scope of this Statement is limited to financial guarantee insurance (and reinsurance) contracts, as described in this Statement, issued by enterprises included within the scope of Statement 60. Accordingly, this Statement does not apply to financial guarantee contracts issued by enterprises excluded from the scope of Statement 60 or to some insurance contracts that seem similar to financial guarantee insurance contracts issued by insurance enterprises (such as mortgage guaranty insurance or credit insurance on trade receivables). This Statement also does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities". This Statement will not have any impact on the Company's consolidated financial statements.

In May 2008, the FASB issued Staff Position No. APB 14-1 "Accounting for Convertible Debt Instruments that May be Settled in Cash Upon Conversion". APB 14-1 requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer's nonconvertible debt borrowing rate. The resulting debt discount is amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Retrospective application to all periods presented is required except for instruments that were not outstanding during any of the periods that will be presented in the annual financial statements for the period of adoption but were outstanding during an earlier period. The adoption of APB 14-1 did not have a material impact on our financial statements.

In June 2008, the FASB issued EITF Issue No. 07-5 "Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock" ("EITF No. 07-5"). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS No. 133 "Accounting for Derivatives and Hedging Activities" ("SFAS No. 133") specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF No. 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS No. 133 paragraph 11(a) scope exception. The adoption of EITF No. 07-5 did not have a material impact on our financial statements.

37

In June 2008, the FASB issued EITF Issue No. 08-4 “Transition Guidance for Conforming Changes to Issue No. 98-5” (“EITF No. 08-4”). The objective of EITF No. 08-4 is to provide transition guidance for conforming changes made to EITF No. 98-5 “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios”, that result from EITF No. 00-27 “Application of Issue No. 98-5 to Certain Convertible Instruments”, and SFAS No. 150 “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”. This Issue is effective for financial statements issued for fiscal years ending after December 15, 2008. Early application is permitted. The adoption of EITF No. 08-04 did not have a material impact on our financial statements.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 “Employers’ Disclosures about Postretirement Benefit Plan Assets” (“FSP FAS 132(R)-1”). FSP FAS 132(R)-1 requires more detailed disclosures about employers’ plan assets in a defined benefit pension or other postretirement plan, including employers’ investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it will not have an impact on the financial position and results of operations.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 “Interim Disclosures about Fair Value of Financial Instruments” (“FSP FAS No. 107-1 and APB Opinion No. 28-1”). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 will be effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it will not have an impact on the financial position and results of operations.

Off Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The follow discussion about our market risk disclosures involves forward-looking statements. Actual results could differ from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates and inflation rates. We do not use derivative financial instruments for speculative or trading purposes.

Interest Rate Risk

We have no significant interest-bearing assets and our convertible promissory notes are fixed rate securities. Our exposure to market risk for changes in interest rates relates primarily to the interest income generated by our cash deposits in banks. We have not been exposed, nor do we anticipate being exposed, to material risks due to changes in

interest rates. However, our future interest income may be different from our expectations due to changes in interest rates.

Foreign Currency Exchange Risk

While our reporting currency is the U.S. dollar, our consolidated revenues and consolidated costs and expenses are substantially denominated in RMB. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be affected by fluctuations in the exchange rate between U.S. dollars and RMB. If the RMB depreciates against the U.S. dollar, the value of our RMB revenues, earnings and assets as expressed in our U.S. dollar financial statements will decline. If the RMB appreciates against U.S. dollars, any new RMB-denominated investments or expenditures will be more costly to us. Assets and liabilities are translated at exchange rates at the balance sheet dates and revenue and expenses are translated at the average exchange rates and stockholders' equity is translated at historical exchange rates. Any resulting translation adjustments are not included in determining net income but are included in determining other comprehensive income, a component of stockholders' equity. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk.

38

Table of Contents

The value of the RMB against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions. Since July 2005, the RMB has not been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Inflation Risk

Inflationary factors such as increases in the costs to acquire advertising rights and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of revenues if the selling prices of our services do not increase with these increased costs.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) that are designed to ensure that information that would be required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including to our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, our management, including Mr. Godfrey Hui, our Chief Executive Officer and Mr. Daley Mok, our Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2009. Based on that evaluation, Mr. Hui and Mr. Mok concluded that as of March 31, 2009, and as of the date that the evaluation of the effectiveness of our disclosure controls and procedures was completed, our disclosure controls and procedures were effective to satisfy the objectives for which they are intended.

Changes in Internal Control Over Financial Reporting

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

During the fiscal quarter ended March 31, 2009, there were no changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On March 20, 2008, our wholly-owned subsidiary, NCN Huamin, entered into a rental agreement with Beijing Chengtian Zhihong TV & Film Production Co., Ltd., or Chengtian, pursuant to which a certain office premises located in Beijing was leased from Chengtian to NCN Huamin for a term of three years, commencing April 1, 2008. On December 30, 2008, NCN Huamin issued a notice to Chengtian to terminate the rental agreement effective on December 31, 2008 due to the fact that Chengtian had breached several provisions of the rental agreement and refused to take any remedial actions. On January 14, 2009, NCN Huamin received a notice from Beijing Arbitration Commission that Chengtian, as plaintiff, had initiated a lawsuit against NCN Huamin seeking an aggregate of approximately $505,000 for unpaid rental-related expenses, plus accrued interest, as well as compensation for unilateral termination of the rental contract. On February 25, 2009, NCN Huamin counter-claimed for breach of rental contract against Chengtian, seeking an aggregate of approximately $155,000 from Chengtian for overpayment of rental expenses and compensation for Chengtian's breach of contract. At present, the outcome of this lawsuit cannot be reasonably predicted. We do not believe that the outcome of this pending litigation will have a material impact on our consolidated financial statements, or our results of operations.

Table of Contents

Other than as described above, there are no material legal proceedings to which we are a party, or to which any of our property is subject, that we expect to have a material adverse effect on our financial condition.

ITEM 1A. RISK FACTORS.

There are no material changes from the risk factors previously disclosed in Part I, Item 1A. “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 27, 2009.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted during the first quarter of 2009 to a vote of security holders, through the solicitation of proxies or otherwise.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

The following exhibits are filed as part of this report or incorporated by reference:

| Exhibit No. | Description |
|---|---|
| 31.1 | Certifications of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certifications of Principal Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certifications of Principal Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | |

Certifications of Principal Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

| Date: May 6, 2009 | NETWORK CN INC. | |
|---|---|---|
| | By: | /s/ Godfrey Hui<br>Godfrey Hui, Chief Executive Officer<br>(Principal Executive Officer) |
| | By: | /s/ Daley Mok<br>Daley Mok, Chief Financial Officer<br>(Principal Financial Officer and Principal Accounting Officer) |