

China Digital TV Holding Co., Ltd.  
Form 20-F  
June 18, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

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**FORM 20-F**

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**  
OR
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**—For the fiscal year ended December 31, 2007**  
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**—For the transition period from \_\_\_\_\_ to \_\_\_\_\_**  
OR
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-33692

**CHINA DIGITAL TV HOLDING CO., LTD.**  
(Exact Name of Registrant as Specified in Its Charter)

**N/A**  
(Translation of Registrant's Name Into English)

**Cayman Islands**  
(Jurisdiction of Incorporation or Organization)

**Jingmeng High-Tech Building B, 4th Floor  
No. 5 Shangdi East Road  
Haidian District, Beijing 100085  
People's Republic of China**  
(Address of Principal Executive Offices)

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

| Title of Each Class  | Name of Each Exchange On Which Registered |
|--|---|
| Ordinary shares, par value US\$0.0005 per share*                 | New York Stock Exchange                   |
| American depositary shares, each representing one ordinary share |   |

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

None  
(Title of Class)

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

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

None  
(Title of Class)

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

As of December 31, 2007, 57,296,932 ordinary shares, par value US\$0.0005 per share, were issued and outstanding.

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

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

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

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

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## INTRODUCTION

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

- “ADSs” refers to our American depositary shares, each of which represents one ordinary share;
- “ADRs” refers to American depositary receipts, which, if issued, evidence our ADSs;
- “CA systems” refers to conditional access systems provided to the PRC’s digital television market, which consist of (i) smart cards that are inserted into set-top boxes at the subscriber’s end, or terminal end, (ii) software installed at the digital television network operator’s transmission point, or head end, and (iii) software for set-top boxes, enabling digital television network operators to control the distribution of contents and value-added services to their subscribers and block unauthorized access to their networks;
- “China” or the “PRC” refers to the People’s Republic of China, excluding, for the purposes of this annual report, Hong Kong, Macau and Taiwan;
- “RMB” or “Renminbi” refers to the legal currency of China;
- “U.S. dollars” or “\$” refers to the legal currency of the United States;
- “US GAAP” refers to generally accepted accounting principles in the United States; and
- all references to the number of the ordinary shares and the number of the Series A convertible redeemable shares, or Series A preferred shares, of our wholly owned subsidiary, China Digital TV Technology Co., Ltd., or CDTV BVI, take into account a 40-for-1 share split executed by CDTV BVI in May 2007.

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

## FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to our business, operating results and financial condition as well as our current expectations, assumptions, estimates and projections about our industry. All statements other than statements of historical fact in this annual report are forward-looking statements. These forward-looking statements can be identified by words or phrases such as the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “may,” “is/are likely to,” “should,” “will” and similar expressions. These forward-looking statements include, without limitation, statements relating to:

- our goals and strategies;
- the future growth of the PRC’s digital television broadcasting market, and factors driving that growth;
- changes in technology standards in the digital television broadcasting industry and our ability to adapt to these changes;

our expectations regarding demand for our products and services;

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- our ability to expand our production, our sales and distribution network and other aspects of our operations;
  - expected changes in our revenues and certain cost and expense items;
- our ability to effectively protect our intellectual property rights and not infringe on the intellectual property rights of others;
  - our belief regarding the competitiveness of our products and services;
  - competition in the CA systems market;
- government policies and regulations relating to the digital television broadcasting industry, the CA systems industry and other areas relevant to our business activities;
  - any significant changes to the PRC government's digitalization program;
  - general economic and business conditions in the PRC;
  - our future business development and economic performance; and
  - our use of proceeds.

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

- general economic and business conditions in the PRC and elsewhere;
- governmental, statutory, regulatory or administrative initiatives affecting us;
- trends in the PRC's digital television broadcasting industry, including progress of digitalization in the PRC and the growth of digital television network operators;
  - future profitability of our operations;
  - exchange rate fluctuations between the Renminbi and other currencies; and
  - the availability of qualified management and technical personnel.

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

## PART I

### Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

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

Not Applicable.

**Item 3. Key Information****A. Selected Financial Data****Our Selected Consolidated Financial Data**

The following selected consolidated financial data should be read in conjunction with our audited historical consolidated financial statements, the notes thereto and “Item 5. Operating and Financial Review and Prospects.” The selected consolidated statement of operations data for the years ended December 31, 2005, 2006 and 2007, and the selected consolidated balance sheet data as of December 31, 2006 and 2007 set forth below are derived from our audited consolidated financial statements included elsewhere in this annual report. The selected consolidated statement of operations data for the year ended December 31, 2004 and the selected historical consolidated balance sheet data as of December 31, 2004 and 2005 set forth below are derived from our audited consolidated financial statements which are not included in this annual report.

Selected consolidated financial information as of December 31, 2003 and for the year ended December 31, 2003 has been omitted because such information could not be provided without unreasonable effort or expense.

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

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

|  | <b>Years ended December 31,</b>  |             |             |             |
|--|--|-------------|-------------|-------------|
|  | <b>2004<sup>(a)</sup></b>  | <b>2005</b> | <b>2006</b> | <b>2007</b> |
|  | <b>(in thousands of U.S. dollars, except share and per share data)</b> |             |             |             |
| <b>Consolidated Statements of Operations Data:</b>         |  |             |             |             |
| Revenues   |  |             |             |             |
| Products   | \$ 1,388   | \$ 9,291    | \$ 26,443   | \$ 49,741   |
| Services   | 2,300  | 3,855       | 4,182       | 6,011       |
|  | 3,688  | 13,146      | 30,625      | 55,752      |
| Business tax   | (61)   | (60)        | (225)       | (299)       |
| Net revenues   | 3,627  | 13,086      | 30,370      | 55,453      |
| Cost of revenues   |  |             |             |             |
| Products   | 458  | 1,936       | 4,726       | 8,100       |
| Services   | 1,339  | 1,967       | 1,859       | 2,135       |
|  | 1,797  | 3,903       | 6,585       | 10,235      |
| Gross profit   | 1,830  | 9,183       | 23,785      | 45,218      |
| Total operating expenses                                   | 3,019  | 3,830       | 5,297       | 12,107      |
| (Loss)/ income from operations                             | (1,189)  | 5,353       | 18,488      | 33,111      |
| Interest income  | 12   | 117         | 279         | 2,790       |
| Impairment of long-term investment                         | (358)  | —           | —           | —           |
| Other income   | —  | —           | —           | 263         |
| Recognition of the change in the fair value of the warrant | (472)  | (18)        | (5,406)     | —           |

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|   |         |       |        |         |
|---|---------|-------|--------|---------|
| (Loss)/ income before income taxes      | (2,007) | 5,452 | 13,361 | 36,164  |
| Income tax                              | 21      | 66    | 59     | (2,342) |
| (Loss)/ income before minority interest | (1,986) | 5,518 | 13,420 | 33,822  |

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## Years ended December 31,

2004<sup>(a)</sup>                      2005                      2006                      2007  
(in thousands of U.S. dollars, except share and per share data)

|   |             |          |          |           |
|---|-------------|----------|----------|-----------|
| Minority interest   | 1,319       | 975      | 430      | —         |
| Net (loss)/ income  | (3,305)     | 4,543    | 12,990   | 33,816    |
| Deemed dividend to preferred shareholder at issuance          | (7,427)     | —        | —        | —         |
| Cash dividend to preferred shareholder                        | —           | —        | (5,731)  | —         |
| Net (loss)/ income attributable to holders of ordinary shares | \$ (10,732) | \$ 4,543 | \$ 7,259 | \$ 33,816 |

**Earnings per share data:**

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Net (loss)/ income per share—basic ordinary shares   | \$ (0.36)  | \$ 0.11    | \$ 0.24    | \$ 0.74    |
| Net income per share—basic participating preferred shares                                      | 1.32       | 0.11       | 0.54       | 0.66       |
| Net (loss)/ income per ordinary share—diluted  | \$ (0.36)  | \$ 0.11    | \$ 0.21    | \$ 0.68    |
| Weighted average shares used in calculating basic net (loss)/ income per share—ordinary shares | 30,000,000 | 30,000,000 | 30,488,889 | 39,170,004 |
| Weighted average shares used in calculating basic net income per share—preferred shares        | 5,638,889  | 10,000,000 | 10,519,120 | 7,389,394  |
| Weighted average shares used in calculating basic net (loss)/ income per share                 | 30,000,000 | 30,000,000 | 34,225,321 | 42,773,590 |

**Consolidated Balance Sheet Data:**

|  |          |           |           |            |
|--|----------|-----------|-----------|------------|
| Cash and cash equivalents  | \$ 5,278 | \$ 8,272  | \$ 21,137 | \$ 228,958 |
| Total assets   | 9,545    | 16,217    | 33,505    | 263,735    |
| Total liabilities  | 5,585    | 6,362     | 21,564    | 11,884     |
| Minority interest  | 1,969    | 2,944     | 4,000     | 4,000      |
| Series A convertible redeemable preferred shares   | 12,000   | 12,000    | 16,078    | —          |
| Total shareholders' (deficiency)/ equity   | (10,009) | (5,089)   | (8,137)   | 247,851    |
| Total liabilities, minority interest, Series A convertible redeemable preferred shares and shareholders equity | \$ 9,545 | \$ 16,217 | \$ 33,505 | \$ 263,735 |

(a) The consolidated statements of operations data for the year ended December 31, 2004 also include the results of operations of the smart card and CA systems business of N-T Information Engineering through June 7, 2004, on which date such business was transferred to N-S Digital TV, our variable interest entity.

**Exchange Rate Information**

We present our historical consolidated financial statements in U.S. dollars. In addition, solely for the convenience of the reader, certain pricing information is presented in U.S. dollars and certain contractual amounts that are in Renminbi include a U.S. dollar equivalent. Except as otherwise specified, this pricing information and these contractual amounts are translated at \$1.00 to RMB7.2946, the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York on December 31, 2007. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all. The PRC government imposes controls over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade.

On June 16, 2008, the noon buying rate in The City of New York for cable transfers of Renminbi as certified for customs purposes by the Federal Reserve Bank of New York was RMB6.8911 to \$1.00. The following table sets forth additional information concerning exchange rates between Renminbi and U.S. dollars for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this annual report or will use in the preparation of our periodic reports or any other information to be provided to you.

| Period                 | Period End | RMB per \$1.00 Noon Buying Rate |        |        |
|------------------------|------------|---------------------------------|--------|--------|
|                        |            | Average <sup>(1)</sup>          | Low    | High   |
| 2003                   | 8.2769     | 8.2770                          | 8.2272 | 8.2800 |
| 2004                   | 8.2765     | 8.2768                          | 8.2764 | 8.2774 |
| 2005                   | 8.0702     | 8.1940                          | 8.0702 | 8.2765 |
| 2006                   | 7.8041     | 7.9723                          | 7.8041 | 8.0702 |
| 2007                   | 7.2946     | 7.6072                          | 7.2946 | 7.8127 |
| December               | 7.2946     | 7.3680                          | 7.2946 | 7.4120 |
| 2008                   |            |                                 |        |        |
| January                | 7.1818     | 7.2405                          | 7.1818 | 7.2946 |
| February               | 7.1115     | 7.1644                          | 7.1100 | 7.1973 |
| March                  | 7.0120     | 7.0722                          | 7.0105 | 7.1110 |
| April                  | 6.9870     | 6.9997                          | 6.9840 | 7.0185 |
| May                    | 6.9400     | 6.9725                          | 6.9377 | 7.0000 |
| June (through June 16) | 6.8911     | 6.9235                          | 6.8911 | 6.9633 |

Source: Federal Reserve Bank of New York

(1) Annual averages are calculated using month-end rates. Monthly averages are calculated using the average of the daily rates during the relevant period.

## B. Capitalization and Indebtedness

Not Applicable.

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

Not Applicable.

## D. Risk Factors

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

### Risks Relating to Our Business and Industry

*The PRC television broadcasting industry may not digitalize as quickly as we expect, as a result of which our revenues would be materially adversely affected.*

Our future success depends upon the pace at which PRC television network operators switch from analog to digital transmission. Analysys International, a Beijing-based market research firm, projected that the number of digital cable television subscribers in the PRC will grow from 12.5 million as of December 31, 2006 to 111.2 million as of December 31, 2010. However, various factors may cause PRC television network operators to convert from analog to digital transmission at a slower pace. The PRC government, which has strongly encouraged television network operators to digitalize their networks and has set a target of 2015 for all, except for up to six, analog channels to be switched off, may relax or cancel the 2015 target. PRC television viewers may fail to subscribe to digital television services in sufficient numbers to support wide-scale digitalization. PRC television network operators may decide that the commercial benefits of digitalization are outweighed by the costs or other commercial or policy considerations. If

any of these or other factors were to cause the pace of digitalization to proceed significantly more slowly than we anticipate, our sales of CA systems, in particular smart cards, would suffer significantly, and our revenues would be materially adversely affected.

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***Changes in the regulatory environment of, and government policies towards, the PRC television network industry could materially adversely affect our revenues.***

Strong PRC government support has been a significant driver of the PRC television broadcasting industry's transition from analog to digital transmission. Although the PRC government has set a target of 2015 for all television networks to switch to digital transmissions, terminating all analog transmissions except for up to six channels that will continue in service for the benefit of those unable to afford digital television, there is no assurance that the government will not change or adjust its digitalization policies at any time, including canceling or relaxing the target for digitalization. If the digitalization process in the PRC were to be slowed down or otherwise adversely affected by any government action or inaction, we might not be able to develop new customers or attract new business from existing customers, and our revenues would be materially adversely affected.

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

In addition, many of our customers are directly or indirectly owned by the central PRC government or provincial or local governments. As a result, their business strategies and capital expenditure budgets are significantly influenced by government policies at various levels. Any change in the business strategies of our customers that leads to a reduction in the funds available to purchase our CA systems could have a material adverse effect on our business, operating results and financial condition. Furthermore, any changes in regulation that might result in the consolidation of the PRC cable television network industry could, among other things, substantially increase the bargaining power of the consolidated network operators over us and require us to reduce the prices of our CA systems and other products and services, which could, in turn, materially adversely affect our net income.

***If significant numbers of television viewers in the PRC are unwilling to pay for digital television or value-added services, we may not be able to sustain our current revenue level.***

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

However, television network operators may be unsuccessful in promoting digital television or value-added services. Television viewers in the PRC are accustomed to receiving television for free or for a very low price. Even viewers who are accustomed to paying for cable television subscriptions have historically paid very low rates and may not be willing to pay significantly higher rates for digital television services, or additional fees for value-added services. If cable television operators are unable to develop unique and compelling content to differentiate themselves from terrestrial broadcasters or offer value-added services that meet viewers' needs at an affordable price, they may find it difficult to persuade viewers to accept the pay-television model or pay more for digital cable television or value-added services than viewers have historically paid for analog cable television. In that event, our customers' digital subscriber numbers may not grow and we may be unable to sustain our current revenue level.





***If significant numbers of television network operators who have already installed our CA system head-end software fail to purchase commercial quantities of our smart cards, we may not be able to sustain our current revenue level.***

Television network operators who purchase and install our CA systems head-end software generally purchase our smart cards in batches over a period of months as they roll out digital services to their subscribers in stages. Most of our revenues are derived from the sale of smart cards to customers who are engaged in such service roll-outs. However, certain television network operators have installed our CA systems head-end software and subsequently failed to purchase commercial quantities of our smart cards. Factors that may cause a television network operator to suspend or halt its digitalization using our products include, but are not limited to, changes in such television network operator's management priorities or financial condition, and a decision by such television network operator to carry out digitalization using the CA systems of a competitor. If significant numbers of television network operators who have already installed our CA systems head-end software fail to purchase commercial quantities of our smart cards, we may not be able to sustain our current revenue level.

***We derive substantially all of our revenues from customers who are installing new CA systems, who may not require system upgrades or new applications for some time if at all. If we are unable to continue attracting new customers to install our CA systems or persuade existing customers to purchase our system upgrades or value-added applications, our profitability and prospects may be materially adversely affected.***

CA systems vendors in more mature digital television markets, such as the United States and Europe, derive revenues not only from the purchase of new CA systems by television network operators who are switching from analog to digital transmissions but also from the purchase of new and replacement smart cards, system upgrades and new value-added services by existing customers. In the PRC, however, cable television network operators are still in the initial phase of purchasing CA systems and introducing digital content and services to their subscribers. To date, none of our customers has made a follow-on purchase for system upgrades or card replacements. As a result, the success of our business depends entirely on our ability to attract a continuing stream of customers who are switching from analog to digital transmission. If we are unable to continue attracting sufficient numbers of such customers, or to begin developing a significant source of recurring revenues, our profitability and prospects may be materially adversely affected.

***We have a limited operating history, which may make it difficult for you to evaluate our business and prospects, and our rapid growth to date may not be sustainable.***

Since our incorporation in March 2004, we have enjoyed rapid growth in revenues. Our net revenues increased, 82.6%, 132.1% and 260.7% in 2007, 2006 and 2005, respectively, compared to the prior year. Such revenue growth rates may not be representative of future growth or be sustainable. As our operating history is limited, the revenue and income potential of our business and markets are unproven. Our historical operating results may not provide a meaningful basis for evaluating our business, financial performance and prospects. In addition, we face numerous risks, uncertainties, expenses and difficulties frequently encountered by companies at an early stage of development. Some of these risks and uncertainties relate to our ability to:

- develop new customers or new business from existing customers;
- expand the technical sophistication of the products we offer;
- respond effectively to competitive pressures; and
- attract and retain qualified management and employees.

We cannot predict whether we will meet internal or external expectations of our future performance. If we are not successful in addressing these risks and uncertainties, our business, operating results and financial condition may be materially adversely affected.

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

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

***A significant portion of our revenues in any single period depends on a limited number of customers. If one customer defers or cancels its orders or chooses our competitors' products or services, our revenues in such period could decline significantly.***

We currently derive, and we expect to continue to derive, a significant portion of our revenues from a limited number of customers, although the particular customers may vary from period to period. As digital cable television networks are in their infancy in the PRC, the largest shipments of smart cards are to operators who are launching new digital transmission systems and need to purchase in bulk for their new networks. For example, three customers each contributed more than 10% of our total revenues in 2005, representing an aggregate of 44.1% of our total revenues during 2005; two customers each contributed more than 10% of our total revenues in 2006, representing an aggregate of 27.5% of our total revenues during 2006; and one customer contributed more than 10% of our total revenues in 2007, representing 14.1% of our revenues in that period. If a customer significantly reduces the volume of its purchases from us, defers or cancels orders or terminates its relationship with us, our revenues could decline significantly and, as a result, our business, operating results and financial condition could be materially adversely affected.

***Our business may suffer if cable television network operators, who currently comprise our primary customer base, do not compete successfully with existing and emerging alternative platforms for delivering television programs, including terrestrial networks, Internet protocol television and satellite broadcasting networks.***

Our existing customers are mainly cable television network operators in the PRC, which compete with traditional terrestrial television networks for the same pool of viewers. As technologies develop, other means of delivering information and entertainment to television viewers are evolving. For example, some telecommunications companies in the PRC are seeking to compete with terrestrial broadcasters and cable television network operators by offering Internet protocol television, or IPTV, which allows telecommunications companies to stream television programs through telephone lines. While the PRC Ministry of Industry and Information (formerly known as the PRC Ministry of Information Industry), or the MII, so far has issued only five IPTV licenses, it may issue significantly more licenses in the future. In addition, the SARFT issued a broadcast license in 2006 to the PRC's first direct satellite broadcast company, which is expected to begin commercial operation this year. We may not be as successful in selling our CA systems to the operators of IPTV or satellite television networks as we have been in selling to cable television network operators. To the extent that the terrestrial television networks, telecommunications companies and satellite television network operators compete successfully with cable television network operators for viewers, the ability of our existing customer base to attract and retain subscribers may be adversely affected. As a result, demand for additional smart

cards will falter and we may not be able to sustain our current revenue level.

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

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

In addition to our CA systems, the secured transmission of digital television programming also relies on certain other software and hardware components, such as set-top boxes supplied by other vendors, used on our customers' digital television networks. A security breach of any of these other software and hardware components could also result in unauthorized access to the television networks of our customers. For example, in November 2007, it was discovered that an individual located in the city of Daqing in Heilongjiang Province had provided shared access to the local digital television network to more than one hundred other people without authorization by hacking into certain set-top boxes used on that network, which do not have advanced security features due to cost considerations. By using a "tracking" technology offered by our CA systems, which enables an operator to track down the compromised set-up boxes, the local television network operator identified the points of breach, took measures to block further unauthorized access and contained the impact of the breach. The local police department also investigated the breach and made an arrest. According to our contractual arrangement with this cable network operator, we believe we are not liable for such security breach of software or hardware components that are supplied by other vendors. However, our business, operating results and financial conditions could still be materially and adversely affected if the scale of such security breach reaches a level such that the affected television network operators may have difficulty in recruiting new subscribers or retaining existing subscribers and a significant reduction in demand for our smart cards results. Furthermore, as our CA systems are used on the affected networks, our reputation could also be harmed by being associated with such security breaches on our customers' networks.

***We generally do not have long-term contracts with suppliers of computer chips or the companies that manufacture our smart cards. If any of our computer chip suppliers or smart-card manufacturers is unable to fulfill our orders in time or at all, we may be unable to deliver smart cards to our customers on time or at all, which could have a material adverse effect on our business, operating results and financial condition.***

We generally do not have long-term contracts with our suppliers. We purchase substantially all of the computer chips that are used in our smart cards from two suppliers, STMicroelectronics, or STM, and ACG Identification Technologies Asia Pte. Ltd., or ACG, which is an agent for Infineon Technologies AG, or Infineon. In addition, we have arrangements with four smart-card manufacturers, China Electronics Smart Card Co., Ltd., or China Electronics, the China Sciences Group, Axalto Smart Card Technology Co., and Oberthur Card Systems, to embed the computer chips into plastic cards. We generally place purchase orders with our computer chip and smart card suppliers as needed to meet our customers' demand. Generally, our computer chip and smart card suppliers are not under any

contractual obligation to accept our purchase orders or fulfill them within our desired time frame. However, we currently maintain a one-year contract with each of China Electronics and the China Sciences Group, that requires China Electronics or the China Sciences Group, as the case may be, to fulfill our orders in accordance with an agreed schedule. Any significant delay or failure by any of our suppliers or manufacturers to fulfill our orders for computer chips or smart cards could force us to obtain computer chips or smart cards from alternative sources at higher cost, negatively affecting our operating margins, or could prevent us from delivering smart cards in the required quantities to our customers on time. Any such failure by us could have a material adverse effect on our reputation, retention of customers, business, operating results and financial condition, and may subject us to claims from our customers.

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

The market for digital television CA systems and software applications is intensely competitive. Several of the world's leading developers and producers of CA systems, including Conax AS, Irdeto Access BV, Kudelski SA and NDS Group, operate in the PRC market. We also compete with domestic CA systems vendors, including Communicate Technologies Inc., DVN Holdings Ltd. and Sumavision Technologies Co., Ltd. Some of our competitors have substantially greater financial, technical and other resources than we do, and may respond more quickly than us to technological or commercial changes in our industry. In addition, some competitors offer their CA systems at a lower price than we do. We may need to reduce our prices to compete with them, which may lead to reduced margins or loss of market share. See "Item 4. Information on the Company—B. Business Overview—Competition."

***We depend upon key personnel, including our senior executives and technical and engineering staff, and our business and growth prospects may be severely disrupted if we lose their services.***

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

***Our attempts to diversify our business and expand our revenues by cooperating with digital television network operators to provide value-added television services may not be successful and may prove costly.***

We are pursuing strategies to expand and diversify our revenues, including cooperating with digital television network operators to offer premium cable television services such as electronic program guides based advertising platforms, pay-per-view programming and video-on-demand. To this end, we established Beijing Novel-Super Media Investment Co., Ltd., or N-S Media Investment, as a wholly owned subsidiary of Super TV in December 2007 and are currently in the process of establishing a joint venture, Dongguan SuperTV Video Info Co. Ltd., or Dongguan SuperTV, between N-S Digital TV and a PRC citizen to provide value-added services to television viewers. See "Item 4. Information on the Company—A. History and Development of the Company." However, we have no prior experience cooperating with television network operators in providing value-added services, and may not be successful in doing so. In addition, our attempts to develop this new business model may be time-consuming and may distract our management from developing our existing lines of business, which could adversely affect our business, operating results and financial condition.

*We may face difficulties implementing our acquisition strategy, including identifying suitable opportunities and integrating acquired businesses and assets with our existing operations, which could have a material adverse effect on our business, operating results and financial condition.*

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

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

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

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

The PRC government introduced regulations in 1999 generally requiring a company that engages in the production and sale of encryption products to obtain two licenses, one for the production of encryption products and the other for the sale and distribution of encryption products, and the implementation rules for issuing such two licenses were promulgated in December 2005. Under these regulations and rules, a company generally is only allowed to produce and/or sell encryption products that use algorithms designated by the encryption authority and such products shall also be certified by the encryption authority. The encryption authority initially designated permitted algorithms for CA systems in April 2007 and a final and official designation remains pending. Like many other vendors of CA systems in the PRC, N-S Digital TV has been producing and selling CA systems using algorithms other than those initially designated by the encryption authority. We understand the encryption authority has allowed a transition period, of a duration yet to be determined at the sole discretion of the encryption authority, for vendors of CA systems to comply with this requirement to use the algorithms to be finally and officially designated by the government. See "Item 4. Information on the Company—B. Business Overview—Regulation—Regulation of Encryption Industry." N-S Digital TV has



engaged in the production and sale of encryption products since its establishment in May 2004, but it did not obtain the license for the production of encryption products until June 2006. It has commenced the process of applying for a license for the sale of encryption products, but its efforts may not be successful. If its efforts to obtain such license are unsuccessful, it may be required to discontinue selling encryption products. In addition, if N-S Digital TV fails to adopt the government-designated algorithms for its CA systems products at the end of the transition period, it may be required to discontinue the production and sale of its non-compliant CA systems. If N-S Digital TV fails to obtain a license for the sale of encryption products but continues such sales and if the relevant PRC government authorities deem such sales activities to be in violation of the applicable regulations, or if the relevant PRC government authorities deem N-S Digital TV's production of encryption products prior to June 2006 to be in violation of the applicable regulations, they may impose sanctions against N-S Digital TV. Such sanctions may include confiscation of income from non-compliant activities, fines of up to three times the amount of income from non-compliant activities and revocation of the licenses already issued. Imposition of such sanctions may result in material disruptions to our business operations, damage to our reputation and financial losses. As a result, our business, operating results and financial condition may be materially adversely affected.

***Enforcement of certain recent PRC regulatory requirements regarding the use of encryption products may prevent prospective customers from purchasing our CA systems and our business could be materially adversely affected as a result.***

In March 2007, the PRC encryption authority introduced regulations that require users to use only encryption products that are certified by the encryption authority and purchased from vendors who hold an encryption product sales license. We have commenced the process of applying for but not yet obtained an encryption product sales license. In addition, our CA systems have not been certified by the encryption authority because we have not adopted the government-designated algorithms for our CA systems. King & Wood, our PRC counsel, has advised us that because the encryption authority has allowed a transition period, of a duration yet to be determined at the sole discretion of the encryption authority, for us to adopt the algorithms to be finally and officially designated by the government, it is unlikely that the encryption authority will enforce the above-mentioned regulatory requirements with respect to the use or purchase of our CA systems during that transition period. However, if we have not obtained the required encryption products sales license or the certification for our CA systems upon the expiration of the transition period, enforcement of the above-mentioned regulatory requirements could prevent our prospective customers from purchasing our CA systems. In addition, even if we do obtain the required encryption product sales license and develop products incorporating algorithms certified by the PRC encryption authority, we cannot assure you that we will be able to successfully market such products. As a result, our business, operating results and financial condition may be materially adversely affected.

***We may incur development costs and may be required to pay certain fees in order to use the algorithms designated by the PRC encryption authority for CA systems.***

A company generally is only allowed to produce and/or sell encryption products that have adopted the algorithms designated by the PRC encryption authority. As the encryption authority did not initially designate any algorithms for CA systems until April 2007, we have been using algorithms in our CA systems other than those designated by the encryption authority. If we are required by the government authorities to instead use the algorithms designated by the encryption authority in our CA systems, we may incur costs to develop new products adopting such algorithms and may have to pay certain fees to the government for such usage. Development costs and the payment of such fees, the amount of which remains unclear, may have an adverse material effect on our profit margin if we cannot pass on such increased costs to our customers.

***We are in the process of registering as our trademarks the English and Chinese names “NOVEL SUPERTV”. If we fail to have such trademarks registered, our business operations could be adversely affected.***

We used to depend on N-T Information Engineering for the use of the English and Chinese names for “NOVEL-TONGFANG” and a graphic logo pursuant to a non-exclusive license agreement. N-T Information Engineering has registered these names and this logo as trademarks. Pursuant to our agreement with N-T Information Engineering, we may use these trademarks free of charge for as long as they remain registered. Prior to January 2008, we used these trademarks in all of the CA systems we sold in the PRC. The registrations for these trademarks expire at various dates in 2013. We also used “NOVEL-TONGFANG” as part of the name of our variable interest entity, N-S Digital TV.

In November 2007, we ceased using “NOVEL-TONGFANG” in N-S Digital TV’s name by changing its name from “Beijing Novel-Tongfang Digital TV Technology Co., Ltd.” to “Beijing Novel-Super Digital TV Technology Co., Ltd.” In January 2008, we ceased using the English and Chinese names for “NOVEL-TONGFANG” as trademarks for our products and we currently intend not to use such trademarks in the future. We started to use the English and Chinese names for “NOVEL SUPERTV” in combination with the graphic logo we licensed from N-T Information Engineering as the trademarks for our products. In the meanwhile, we are in the process of acquiring for free the licensed graphic logo from N-T Information Engineering and applying to register the trademarks of the English and Chinese names for

“NOVEL SUPERTV.” We cannot assure you that the registration of such trademarks containing the English and Chinese names of “NOVEL SUPERTV” will finally be approved by the PRC trademark registration authority. If we fail to have such trademarks registered, we may not be able to prevent any third parties, including our competitors, from using the same trademarks for their products or services. In addition, if a third party has already registered names similar to “NOVEL SUPERTV” as its trademarks, we may be prevented from using the English and Chinese names for “NOVEL SUPERTV” as our trademarks. In either case, our business operations could be adversely affected as a result.

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

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

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

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

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

Almost all of our business operations, including the encoding of our smart cards, which is an essential part of the smart card production process, all our research and development activities and our corporate headquarters are concentrated within a single facility that we lease in Beijing, PRC. As we do not maintain back-up facilities, we rely on this facility for the continued operation of our business. In addition, we currently do not maintain any business disruption or similar insurance coverage. A major earthquake, fire or other catastrophic event that results in the destruction of, or significant disruption to, the facility could severely affect our ability to complete sales or conduct other normal business operations. As a result, our business, operating results and financial condition could be materially adversely affected.

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

Our quarterly operating results have varied significantly in the past and are likely to continue to vary significantly in the future. Historically, we have generally experienced a slowdown or decrease in smart card orders in the first quarter of the year due to the Chinese Lunar New Year holiday and an annual trade fair for the digital television, broadband and related industries in the PRC during such quarter. In addition, our quarterly revenues are subject to fluctuation because they substantially depend upon the timing of orders. Our quarterly revenues have generally reflected a small number of relatively large orders for our CA systems, which generally have long sales and order cycles. Our cost of revenue and operating expenses may also fluctuate from quarter to quarter. As a result, you may not be able to rely on period-to-period comparisons of our operating results as an indication of our future performance. Our actual quarterly

results may differ from market expectations, which could adversely affect the price of our ADSs.

***Failure to manage our growth or develop appropriate internal organizational structures, internal control environment and risk monitoring and management systems in line with our rapid growth could negatively affect our business and prospects.***

Our business and operations have expanded rapidly since our formation in 2004. Significant management resources must be expended to develop and implement appropriate structures for internal organization and information flow, an effective internal control environment and risk monitoring and management systems in line with our rapid growth, as well as to hire and integrate qualified employees into our organization. In addition, the disclosure and other ongoing obligations associated with becoming a public company also increased the challenges to our finance and accounting team. It is possible that our existing internal control and risk monitoring and management systems could prove to be inadequate. If we fail to appropriately develop and implement structures for internal organization and information flow, an effective internal control environment and a risk monitoring and management system, we may not be able to identify unfavorable business trends, administrative oversights or other risks that could materially adversely affect our business, operating results and financial condition.

***In the course of preparing our consolidated financial statements for the year ended December 31, 2007, several significant deficiencies in our internal control over financial reporting were noted. We expect to incur extra costs in implementing measures to address such deficiencies. If we fail to maintain an effective system of internal control over financial reporting, our ability to accurately and timely report our financial results or prevent fraud may be adversely affected. As a result, investor confidence and the trading price of our ADSs may be adversely impacted.***

Upon the completion of our initial public offering, we have become a public company in the United States that is subject to the Sarbanes-Oxley Act of 2002. Section 404 of the Sarbanes-Oxley Act of 2002, or Section 404, requires that we include a report of management on our internal control over financial reporting in our annual report on Form 20-F beginning with our annual report for the fiscal year ending December 31, 2008. In addition, our independent registered public accounting firm must report on the effectiveness of our internal control over financial reporting. Our management may conclude that our internal control over financial reporting is not effective. Moreover, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may disagree. If such independent registered public accounting firm is not satisfied with our internal control or the level at which our control is documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us, then it may not be able to issue an un-qualified opinion. In addition, our reporting obligations as a public company may place a significant strain on our management, operational and financial resources and systems for the foreseeable future.

Prior to our initial public offering, we had been a private company with limited accounting personnel and other resources with which to address our internal controls and procedures. Our independent registered public accounting firm has not conducted an audit of our internal control over financial reporting; however, in connection with the audit of our consolidated financial statements for the year ended December 31, 2007, our independent registered public accounting firm identified several "significant deficiencies" in our internal control over financial reporting, as defined in the standards established by the Public Company Accounting Oversight Board (United States). The significant deficiencies identified related to (i) our inadequate accounting resources with a good understanding of US GAAP and SEC reporting requirements, (ii) our failure to develop a comprehensive accounting policies and procedures manual and (iii) our failure to establish detailed financial closing and reporting policies and procedures. We have been in the process of implementing a number of measures to address the deficiencies that have been identified. In the first quarter of 2008, we appointed an internal audit manager. Since April 2008, we also have hired a Financial Controller, together with a team of accounting personnel, to enhance our understanding of US GAAP and SEC reporting requirements. In October 2007, we engaged an international accounting firm to help us design our internal control process and prepare a US GAAP accounting policies and procedures manual. By April 2008, we had substantially completed the drafting of these documents. We are in the process of establishing closing and reporting procedures and

standards and will continue to enhance our efforts in this regard.

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During the course of documenting and testing our internal control procedures in order to satisfy the requirements of Section 404, we may identify other deficiencies in our internal control over financial reporting. We plan to remediate control deficiencies identified in time to meet the deadline imposed by the requirements of Section 404, but we may be unable to do so.

In addition, if we fail to maintain the adequacy of our internal control over financial reporting, as these standards are modified, supplemented or amended from time to time, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404. If we fail to achieve and maintain an effective internal control environment, we could suffer material misstatements in our financial statements and fail to meet our reporting obligations, which would likely cause investors to lose confidence in our reported financial information. This could harm our operating results and lead to a decline in the trading price of our ADSs. Additionally, ineffective internal control over financial reporting could expose us to increased risk of fraud or misuse of corporate assets and subject us to potential delisting from the stock exchange on which we list, regulatory investigations and civil or criminal sanctions.

***We may need additional capital and we may not be able to obtain it, which could adversely affect our liquidity and financial position.***

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

- our future financial condition, results of operations and cash flows;
- conditions of the U.S. and other capital markets in which we may seek to raise funds;
- investors' perception of, and demand for, securities of digital television components and related companies; and
- economic, political and other conditions in the PRC and elsewhere.

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

***We may become a passive foreign investment company, or PFIC, which could result in adverse United States federal income tax consequences to U.S. holders of our ADSs.***

Depending upon the value of our shares and ADSs and the nature of our assets and income over time, we could be classified as a PFIC by the United States Internal Revenue Service for U.S. federal income tax purposes. Based upon the past composition of our income and valuation of our assets, including goodwill, we believe we were not a PFIC for 2007. There can be no assurance that we will not be a PFIC for the taxable year 2008 or future taxable years, as PFIC status is tested each year and depends on our assets and income in such year. Our PFIC status for the current taxable year 2008 will not be determinable until the close of the taxable year ending December 31, 2008.

We will be classified as a PFIC in any taxable year if either: (1) the average percentage value of our gross assets during the taxable year that produce passive income or are held for the production of passive income is at least 50% of the value of our total gross assets or (2) 75% or more of our gross income for the taxable year is passive income. For example, we would be a PFIC for the taxable year 2008 if the sum of our average market capitalization, which is our



share price multiplied by the total number of our outstanding shares, and our liabilities over that taxable year is not more than twice the value of our cash, cash equivalents and other assets that can be readily converted into cash. In particular, we would likely become a PFIC if the value of our outstanding shares were to decrease significantly while we hold substantial cash and cash equivalents.

If we are classified as a PFIC in any taxable year in which you hold our ADSs or shares and you are a U.S. holder, you would generally be taxed at higher ordinary income rates, rather than lower capital gain rates, if you dispose of our ADSs or shares for a gain in a later year, even if we are not a PFIC in that year. In addition, a portion of the tax imposed on your gain would be increased by an interest charge. Moreover, if we were classified as a PFIC in any taxable year, you would not be able to benefit from any preferential tax rate with respect to any dividend distribution that you may receive from us in that year or in the following year. Finally, you would also be subject to special United States federal income tax reporting requirements. We cannot assure you that we will not be a PFIC for 2008 or any future taxable year. For more information on the United States federal income tax consequences to you that would result from our classification as a PFIC, see “Item 10. Additional Information—E. Taxation—United States Federal Income Taxation—Taxation of Capital Gains—PFIC Rules.”

### **Risks Relating to Our Corporate Structure**

***If the PRC government determines that N-S Digital TV is a vendor of non-PRC CA systems by virtue of the agreements that establish the structure for operating our business, we could face difficulty selling our CA systems in the PRC.***

SARFT policy requires any cable television network operator who uses a non-PRC CA system to install a parallel PRC CA system. Under this policy, vendors of non-PRC CA systems may sell only to cable network operators who have already installed a PRC CA system or who are willing to purchase a parallel PRC CA system. This may result in a competitive disadvantage for vendors of non-PRC CA systems relative to vendors of PRC CA systems. Such policy does not expressly indicate whether the CA systems produced by a foreign-invested company incorporated in the PRC, such as our subsidiary, Super TV, fall into the category of non-PRC CA systems. In light of this ambiguity, in order to avoid our CA systems being deemed non-PRC CA systems, we have established N-S Digital TV, which is wholly owned by PRC persons, to produce and sell our CA systems. We do not have any equity interest in N-S Digital TV and instead enjoy the economic benefits of, and have substantive control over, N-S Digital TV through contractual arrangements with N-S Digital TV and its shareholders. N-S Digital TV also holds the licenses and approvals that are essential to our business, and we derive a significant portion of our revenues from N-S Digital TV.

There are substantial uncertainties regarding the interpretation and application of the above-described PRC government policy and relevant PRC laws and regulations. Accordingly, the PRC government may determine that N-S Digital TV is a vendor of non-PRC CA systems by virtue of our contractual arrangements with N-S Digital TV and its shareholders. If N-S Digital TV is deemed to be a vendor of non-PRC CA systems by the PRC government, cable network operators may cancel their orders for our CA systems to avoid being required to install a parallel PRC CA system, and we may also lose potential customers who are not willing, or have no plan, to install a parallel PRC CA system for economic or other reasons. As a result, our business, financial condition and operating results could be materially adversely affected.

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

Our CA systems business uses encryption technology and thus is required by the relevant PRC laws and regulations to obtain a license to produce commercial encryption products. Although foreign-invested enterprises incorporated in the PRC, such as our subsidiary, Super TV, are not expressly prohibited from conducting a business that uses encryption technology, foreign-invested enterprises may have difficulty obtaining the necessary license due to the PRC encryption authority’s generally restrictive approach towards foreign participation in the PRC encryption industry. N-S Digital TV, which is wholly owned by PRC persons and through which we conduct our CA systems business, has obtained a license to produce commercial encryption products as required for our business.



Our contractual arrangements with N-S Digital TV and its shareholders provide us with the economic benefits of, and substantive control over, N-S Digital TV. If the PRC encryption authority determines that our control over, or relationship with, N-S Digital TV through those contractual arrangements is contrary to their generally restrictive approach towards foreign participation in the PRC encryption industry, we can not assure you that the PRC encryption authority will not reconsider N-S Digital TV's eligibility to hold the license to produce commercial encryption products. The PRC encryption authority may revoke, or refuse to renew, N-S Digital TV's license to produce commercial encryption products, or refuse to grant any other encryption-related license that may be required for our business in the future. If that were to happen, we might have to discontinue all or a substantial portion of our business pending the re-issuance, extension or issuance of the required license. In addition, we might have to restructure our operation in order to have such license re-issued, extended or issued. Such restructuring may result in a loss or reduction of our control over, or the economic benefits we enjoy from, N-S Digital TV under existing contractual arrangements. As a result, our business, financial condition or operating results could be materially adversely affected.

***Our contractual arrangements with our operating company, N-S Digital TV, and its shareholders may not be as effective in providing operational control as direct ownership and may be difficult to enforce.***

In order for our CA systems not to be deemed by the PRC government as non-PRC CA systems, which may result in a competitive disadvantage for us in the PRC market, we have established N-S Digital TV, which is wholly owned by PRC persons, to produce and sell our CA systems in the PRC. As a result, we generate a significant portion of our revenues through N-S Digital TV. We do not have any equity interest in N-S Digital TV and instead enjoy the economic benefits of, and have substantive control over, N-S Digital TV through contractual arrangements with N-S Digital TV and its shareholders. N-S Digital TV also holds the licenses and approvals that are essential to our business. For a description of such contractual arrangements, see "Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions." These arrangements may not be as effective in providing control over our operations as direct ownership would be. In particular, N-S Digital TV could fail to perform or make payments as required under these contractual arrangements, and we would have to rely on the PRC legal system to enforce these arrangements, which may not be effective. For example, we have entered into share pledge agreements with the shareholders of N-S Digital TV in September 2005 and August 2007, under which such shareholders pledge their equity interests in N-S Digital TV to us. However, the relevant government agency has refused to register such kinds of pledges due to the lack of relevant registration procedures. Under the Property Rights Law of the PRC promulgated on March 16, 2007, which became effective on October 1, 2007, or the Property Rights Law, a pledge of equity interests can only be valid after such pledge is registered at the relevant agency, though the Property Rights Law is silent on whether the registration requirement applies to a pledge agreement that was entered into prior to October 1, 2007, the date when the Property Rights Law became effective, such as our share pledge agreements with the shareholders of N-S Digital TV. Without the registration with the relevant government agency, a pledgor could disregard a prior pledge and re-pledge the same equity interests to third parties. We cannot assure you whether or when Super TV will be able to register the pledges with the relevant government agency, prior to which such pledges may be invalid under the Property Rights Law.

***The shareholders or directors of N-S Digital TV may have conflicts of interest with us, which may materially and adversely affect our business and financial condition.***

We do not have any equity interest in N-S Digital TV and instead enjoy the economic benefits of, and have substantive control over, N-S Digital TV through contractual arrangements with N-S Digital TV and its shareholders. Conflicts of interests may arise between us and the shareholders of N-S Digital TV. In addition, three directors of N-S Digital TV are also directors of our company, and conflicts may arise between the duties they owe to N-S Digital TV and the duties they owe to us. We cannot assure you that if any such conflicts arise, any or all of the shareholders or directors of N-S Digital TV, as the case may be, will act in the best interests of our company or that such conflicts will be resolved in our favor. We have no specific policies or procedures for resolving any such conflicts that may arise. In addition, these shareholders or directors may breach, or cause N-S Digital TV to breach or refuse to renew,

the existing contractual arrangements that allow us to effectively control N-S Digital TV and receive economic benefits from it. If we cannot satisfactorily resolve any conflicts of interest or disputes between us and the shareholders or directors of N-S Digital TV, we may have to rely on legal proceedings, which may involve substantial uncertainty and result in disruptions to our business operations.

***Contractual arrangements we have entered into between Super TV and N-S Digital TV may be subject to scrutiny by the PRC tax authorities and any finding that we or N-S Digital TV owe additional taxes could substantially reduce our consolidated net income and the value of your investment.***

Under PRC laws and regulations, arrangements and transactions among related parties may be subject to audit or challenge by the PRC tax authorities. We could face material adverse tax consequences if the PRC tax authorities determine that the contractual arrangements between Super TV, our wholly owned subsidiary in the PRC, and N-S Digital TV do not represent an arm's-length price and consequently adjust N-S Digital TV's income in the form of a transfer pricing adjustment. A transfer pricing adjustment could, among other things, result in a reduction of expense deductions recorded by N-S Digital TV, which could in turn increase its tax liabilities. In addition, the PRC tax authorities may impose late payment fees and other penalties.

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

As of May 31, 2008, our three largest shareholders beneficially owned a total of approximately 58.4% of our outstanding shares. Accordingly, they will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have the power to prevent or cause a change in control. In addition, without the consent of these shareholders, we could be prevented from entering into transactions that could be beneficial to us. These shareholders may cause us to take actions that are opposed by other shareholders as the interests of these shareholders may differ from the interests of our other shareholders, including those who purchased the ADSs in our initial public offering. See "Item 7. Major Shareholders and Related Party Transactions" for more information regarding the share ownership of our officers, directors and significant shareholders.

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

***Adverse changes in economic policies of the PRC government could have a material adverse effect on the overall economic growth of the PRC, which could reduce the demand for our products and materially adversely affect our business.***

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

The PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in the PRC is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over the PRC's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies.

While the PRC economy has experienced significant growth over the past decade, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our operating results and financial condition may

be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. The PRC government has implemented certain measures, including recent interest rate increases, to control the pace of economic growth. These measures may cause decreased economic activity in the PRC, including a slowing or decline in investment in cable television networks, which in turn could adversely affect our operating results and financial condition.

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

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

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

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

On September 21, 2006, the CSRC published on its official website procedures regarding its approval of overseas listings by special purpose vehicles. The CSRC approval procedures require the filing of an application and supporting documents with the CSRC.

We completed the initial listing and trading of our ADSs on the New York Stock Exchange on October 11, 2007. We did not seek CSRC approval in connection with our initial public offering. Our PRC counsel, King & Wood, advised us that, based on their understanding of the current PRC laws, regulations and rules and the procedures announced on September 21, 2006, because we completed our restructuring in 2004 in connection with an equity investment in our company by a private equity investor more than two years prior to the promulgation of the New M&A Rules, we were not and are not required by the New M&A Rules to apply to the CSRC for approval of our initial public offering, unless we are clearly required to do so by any rules promulgated in the future. See "Item 4. Information on the Company—B. Business Overview—Regulation—Regulation of Overseas Listings." However, the application of the New M&A Rules remains unclear. If the CSRC or another PRC regulatory agency subsequently determines that the CSRC's approval was required for our initial public offering, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our privileges in the PRC, or take other actions that could have a material adverse effect on our business, financial condition, results of operations, as well as the trading price of our ADSs.





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

The SAFE has promulgated regulations that require PRC residents and PRC corporate entities to register with and obtain approvals from relevant PRC government authorities in connection with their direct or indirect offshore investment activities. These regulations may apply to our shareholders who are PRC residents in connection with our prior and any future offshore acquisitions, including the employee participants in our stock incentive plans who are PRC citizens.

The SAFE regulations required registration by March 31, 2006 of direct or indirect investments previously made by PRC residents in offshore companies prior to the implementation of the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-Raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies on November 1, 2005. If a PRC shareholder with a direct or indirect stake in an offshore parent company fails to make the required SAFE registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion.

We cannot assure you that all of our shareholders who are PRC residents will comply with our request to make or obtain any registrations or approvals required under these regulations or other related legislation. If any existing shareholder transfers any of our shares or ADSs to another PRC resident, it is unclear whether such new shareholder is also required to make the SAFE registration. Furthermore, as these regulations are still relatively new and there is uncertainty concerning the reconciliation of the new regulation with other approval requirements, it is unclear how the regulation, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. The failure or inability of our PRC resident shareholders to obtain any required approvals or make any required registrations may subject us to fines and legal sanctions, and prevent us from being able to make distributions or pay dividends, as a result of which our business operations and our ability to distribute profits to you could be materially adversely affected.

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

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

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

beneficial to our businesses, pay dividends, or otherwise fund and conduct our business.

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***Restrictions on currency exchange may limit our ability to utilize our revenues effectively.***

Substantially all of our revenues were denominated in Renminbi in 2007. The Renminbi is currently convertible under the “current account,” which includes dividends, trade and service-related foreign exchange transactions, but not under the “capital account,” which includes foreign direct investment and loans. Currently, Super TV may purchase foreign exchange for settlement of “current account transactions,” including purchase of imported computer chips and payment of dividends to us, without the approval of the SAFE by complying with certain procedural requirements. However, the relevant PRC governmental authorities may limit or eliminate our ability to purchase foreign currencies in the future for current account transactions. Since a significant amount of our future revenues will be denominated in Renminbi, any existing and future restrictions on currency exchange may limit our ability to utilize revenues generated in Renminbi to purchase computer chips from suppliers outside of the PRC or fund our business activities outside of the PRC denominated in foreign currencies or pay dividends in foreign currencies to our shareholders, including holders of our ADSs. Foreign exchange transactions under the capital account are still subject to limitations and require approvals from, or registration with, the SAFE and other relevant PRC governmental authorities. This could affect the ability of Super TV to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us.

***PRC regulation of loans and investment by offshore holding companies to PRC entities may delay or prevent us from using the proceeds we received from our initial public offering, which could materially and adversely affect our liquidity and our ability to fund and expand our business.***

As an offshore holding company, we may make loans or additional capital contributions to Super TV, our wholly owned subsidiary in the PRC, in order to utilize the proceeds we received from our initial public offering. Any loans to Super TV are subject to PRC regulations and approvals. For example:

- loans by us to Super TV, a foreign-invested enterprise, cannot exceed statutory limits and must be registered with the SAFE or its local counterpart; and
- loans by us to N-S Digital TV, which is a domestic PRC entity, must be approved by the relevant government authorities and must also be registered with the SAFE or its local counterpart.

We may also decide to finance Super TV by means of capital contributions, and such contributions must be approved by the MOFCOM or its local counterpart. We are unlikely to finance N-S Digital TV by means of capital contributions due to regulatory issues discussed in “Item 4. Information on the Company—B. Business Overview—Regulation—Regulation of the Cable Television Industry.” We may not be able to obtain the relevant government registrations or approval on a timely basis, if at all, with respect to future loans or capital contributions by us to Super TV or to N-S Digital TV. If we fail to do so, our ability to use the proceeds of our initial public offering and to capitalize our PRC operations may be negatively affected, which could adversely and materially affect our liquidity and our ability to fund and expand our business.

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

As substantially all of our revenues are denominated in Renminbi and the net proceeds from our initial public offering are denominated in U.S. dollars, fluctuations in exchange rates between U.S. dollars and Renminbi will affect the relative purchasing power of these proceeds and our balance sheet and earnings per share in U.S. dollars. Appreciation or depreciation in the value of the Renminbi relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business, financial condition or results of operations. Since July 2005, the Renminbi is no longer pegged solely to the U.S. dollar. Instead, the Renminbi is reported to be pegged against a basket of currencies, determined by the People’s Bank of China, against which it can rise or fall by as much as 0.3% each day. This permitted floating range was raised to 0.5% in May 2007. The

Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the U.S. dollar. Fluctuations in the exchange rate will also affect the relative value of dividends, if any, payable on, our ordinary shares in U.S. dollars terms and the value of any U.S. dollar-denominated investments we make in the future. In addition, since substantially all of our revenues are denominated in Renminbi while approximately half of our cost of revenues is denominated in U.S. dollars, fluctuations in the exchange rate could also impact our results of operations and financial condition.

Very limited hedging transactions are available in the PRC to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency.

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

The PRC government has provided various incentives to Super TV and N-S Digital TV. These incentives include reduced enterprise income tax rates, value-added tax refunds and tax holidays. For example, as high-and-new technology enterprises incorporated and operated in the Beijing High-Tech Development Experimental Zone, which is a designated high and new technology development zone, each of Super TV and N-S Digital TV is entitled to a preferential income tax rate of 15% (against the standard income tax rate of 33% before January 1, 2008 and 25% from January 1, 2008). In addition, each of Super TV and N-S Digital TV is entitled to income tax exemption from 2004 to 2006 and a 50% reduction of income tax from 2007 to 2009. Furthermore, for certain software-related products that are qualified as “software products” by PRC tax authorities, we received tax refunds which effectively reduce the applicable value-added tax rate from 17% to 3%.

Super TV and N-S Digital TV must meet a number of financial and non-financial criteria in order to continue to qualify for the above tax incentives. Moreover, the government could determine at any time to eliminate or reduce the scale of such preferential tax policies. For example, under the newly enacted PRC Enterprise Income Tax Law, or the 2008 EIT Law, which took effect on January 1, 2008, the enterprise income tax rate applicable to N-S Digital TV and Super TV could be increased to 25%. See “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Taxes and Incentives—PRC.”

Any increase in Super TV’s or N-S Digital TV’s enterprise income tax rate or discontinuation or reduction of any of the preferential tax treatments or financial incentives currently enjoyed by Super TV or N-S Digital TV could adversely affect our business, operating results and financial condition.

***We may be treated as a resident enterprise for PRC tax purposes under the PRC Enterprise Income Tax Law and we may therefore be subject to PRC income tax for any dividends we receive from our subsidiaries, which may materially and adversely affect the amount of dividends we must pay to our shareholders and ADS holders.***

Pursuant to the 2008 EIT Law and Enterprise Income Tax Law Implementation Regulations, or the Implementing Rules, enacted by the State Council on December 6, 2007 and which became effective on January 1, 2008, enterprises established under the laws of foreign countries or regions whose “de facto management bodies” are located within the PRC territory are considered resident enterprises and will normally be subject to the enterprise income tax at the rate of 25% on its global income. According to the Implementation Rules, “de facto management body” refers to a managing body that exercises, in substance, overall management and control over the production and business, personnel, accounting and assets of an enterprise. Substantially all of our management is currently and expected to continue to be located in the PRC, and there exists the risk that CDTV Holding may be considered a resident enterprise and therefore be subject to the enterprise income tax at the rate of 25% on its global income, which will include any dividend income we receive from our subsidiaries. In addition, although the 2008 EIT Law provides that dividend income between qualified resident enterprises is exempted income, it is not clear what is considered a qualified resident enterprise under the 2008 EIT Law. If we are required under the 2008 EIT Law to pay income tax for our global income, including any dividends we receive from our subsidiaries, it will materially and adversely affect the amount of dividends we may pay to our shareholders and ADS holders.



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

Prior to January 1, 2008, dividends payable to non-PRC investors were exempted from withholding tax. The 2008 EIT Law and the Implementing Rules, both of which became effective on January 1, 2008, provide that an income tax rate of 10% (subject to the tax treaties between PRC and other jurisdictions) will generally be applicable to dividends payable to non-PRC investors which are derived from sources within the PRC, provided that dividends are not subject to the 10% tax if they are paid out of distributable profits accumulated before January 1, 2008. Similarly, any gain realized on the transfer of shares by such investors is also subject to 10% tax if such gains are regarded as income derived from sources within the PRC. We are a Cayman Islands holding company and substantially all of our income may come from dividends we receive from our subsidiaries, primarily those located in the PRC. If we declare dividends from such income and such dividends are paid out of distributable profits accumulated after January 1, 2008, it is unclear whether the dividends we pay with respect to our ADSs, or the gain our non-PRC shareholders or ADS holders may realize from the transfer of our ordinary shares or ADSs, would be treated as PRC-sourced income and be subject to PRC tax. If we are required under the 2008 EIT Law to withhold PRC income tax on our dividends payable to our non-PRC shareholders and ADS holders, or if non-PRC foreign shareholders and ADS holders are required to pay PRC income tax on the transfer of their ordinary shares or ADSs, the value of your investment may be materially reduced.

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

In May 2008, a major earthquake registering 8.0 on the Richter scale struck Sichuan Province and certain other parts of China, devastating much of the affected areas and causing tens of thousands of deaths and widespread injuries. In addition, in early 2008, parts of Mainland China, in particular its southern, central and eastern regions, experienced what was reportedly the most severe winter weather in the country in half a century, which resulted in significant and extensive damage to factories, power lines, homes, automobiles, crops and other properties, blackouts, transportation and communications disruptions and other losses in the affected areas. Moreover, certain countries and regions, including China, have encountered incidents of the H5N1 strain of bird flu, or avian flu, as well as severe acute respiratory syndrome, or SARS, over the past five years. We are unable to predict the effect, if any, that any future natural disasters and health and public security hazards may have on our business. Any future natural disasters and health and public security hazards may, among other things, significantly disrupt our ability to adequately staff our business, and may generally disrupt our operations. Furthermore, such natural disasters and health and public security hazards may severely restrict the level of economic activity in affected areas, which may in turn materially and adversely affect our business and prospects. As a result, any natural disasters or health hazards in China may have a material adverse effect on our financial condition and results of operations.

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

On June 29, 2007, the PRC National People's Congress enacted the Labor Contract Law, which became effective on January 1, 2008. The Labor Contract Law formalizes workers' rights concerning overtime hours, pensions, layoffs, employment contracts and the role of trade unions and provides for specific standards and procedure for the termination of an employment contract. In addition, the Labor Contract Law requires the payment of a statutory severance pay upon the termination of an employment contract in most cases, including in cases of the expiration of a fixed-term employment contract. As there has been little guidance as to how the Labor Contract Law will be interpreted and enforced by the relevant PRC authorities, there remains substantial uncertainty as to its potential impact on our business and results of operations. The implementation of the Labor Contract Law may increase our operating expenses, in particular our personnel expenses and labor service expenses. In the event that we decide to



significantly reduce the number of our employees or otherwise change our employment or labor practices, the Labor Contract Law may also limit our ability to effect these changes in a manner that we believe to be cost-effective or desirable, which could adversely affect our business and results of operations.

## **Risks Relating to the ADSs**

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

The trading price of our ADSs has been be volatile and subject to wide fluctuations. Since October 5, 2007, the closing prices of our ADSs on the New York Stock Exchange has ranged from \$14.64 to \$51.08 per ADS and the last reported sale price on June 16, 2008 was \$14.75. Our ADSs may continue to fluctuate in response to various factors beyond our control. The financial markets in general, and the market prices for many other PRC companies listed on stock exchanges in the United States in particular, have experienced extreme volatility. These broad market and industry factors may significantly affect the market price and volatility of our ADSs, regardless of our actual operating performance.

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

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

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

As of May 31, 2008, we had 57,374,049 ordinary shares outstanding (excluding 1,922,883 ordinary shares that were issued and held for our account in preparation for exercise of share options by option holders under our employee stock incentive plans), including 20,090,037 ordinary shares represented by 20,090,037 ADSs (excluding the 1,922,883 ADSs that were held for our account in preparation for exercise of share options by option holders under our employee stock incentive plans). All ADSs are freely transferable without restriction or additional registration under the Securities Act of 1933, as amended, or the Securities Act. The remaining ordinary shares outstanding have been available for sale, after the expiration of the 180-day lock-up period beginning from the date of our initial public offering prospectus, subject to volume and other restrictions that may be applicable under Rule 144 and Rule 701 under the Securities Act. In addition, we have filed a registration statement on Form S-8 to register the ordinary shares to be issued to the share option holders under our employee stock incentive plans. The ordinary shares to be received by such share option holders who are not affiliated with us may be resold freely to the public market. We cannot predict what effect, if any, market sales of securities held by our significant shareholders or any other shareholder or the availability of these securities for future sale will have on the market price of our ADSs.

***Your interest in our ADSs will be diluted as a result of our 2005 Stock Incentive Plan, 2008 Stock Incentive Plan or other stock option grants.***

We have reserved 4,444,440 ordinary shares for issuance pursuant to our Amended and Restated 2005 Stock Incentive Plan. We have reserved a total of 1,200,000 ordinary shares for issuance under the 2008 Stock Incentive Plan, subject to any adjustments as contemplated by the plan. As of December 31, 2007, options to purchase 3,877,429 ordinary shares had been granted and were outstanding under our Amended and Restated 2005 Stock Incentive Plan and 2008

Stock Incentive Plan. For a description of these plans, see “Item 6. Directors, Senior Management and Employees—B. Compensation of Directors and Senior Officers—Stock Options.” In addition, in 2005 we granted options to purchase 143,474 ordinary shares to Tech Power Enterprises, a company affiliated with SB Asia Infrastructure Fund L.P., or SAIF, a principal shareholder of our company, and in 2007 we granted options to purchase 40,000 ordinary shares to Mr. Louis T. Hsieh, who became an independent director of our company upon the completion of our initial public offering. Therefore, as of December 31, 2007, options to purchase 4,060,903 ordinary shares had been granted and were outstanding. The exercise of those options would result in a reduction in the percentage of ownership of the holders of ordinary shares and of ADSs, and therefore would result in a dilution in the earnings per ordinary share and per ADS. You may face difficulties in protecting your interests, and your ability to protect your rights through the United States federal courts may be limited, because we are incorporated under Cayman Islands law.

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

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

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

- to recognize or enforce against us judgments of courts of the United States based on the civil liability provisions of United States federal securities laws; and
- in original actions brought in the Cayman Islands, to impose liabilities against us based on the civil liability provisions of United States federal securities laws that are penal in nature.

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

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

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

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

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

result, you may not be able to exercise your right to vote and you may lack recourse if your ordinary shares are not voted as you requested.

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

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

- we have failed to timely provide the depositary with our notice of meeting and related voting materials;
- we have instructed the depositary that we do not wish a discretionary proxy to be given;
- we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;
- a matter to be voted on at the meeting would have a material adverse impact on shareholders; or
- voting at the meeting is made on a show of hands.

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

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

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

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

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



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

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

**Item 4. Information on the Company**

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

N-T Information Engineering was established by Tsinghua Enterprise Group, a company affiliated with Tsinghua University, and Hong Kong-based Tsinghua Novel Hi-Tech Investment Holding Ltd. in July 1998, and initially focused on developing, producing and selling digital data broadcasting equipment for cable television operators. In December 2002, N-T Information Engineering completed its acquisition of the CA systems-related assets of Tsinghua Tongfang. In March 2004, CDTV BVI was incorporated as a holding company in the British Virgin Islands, or BVI. Following the establishment of CDTV BVI, we restructured our operations, in connection with an investment by SAIF, by establishing Super TV, a wholly owned subsidiary of CDTV BVI, on May 31, 2004. On the same day, N-T Information Engineering and Ms. Li Yang, a PRC citizen then employed by SAIF, established N-S Digital TV. In June 2004, N-S Digital TV acquired from N-T Information Engineering its smart card and CA systems business and, in August 2006, N-S Digital TV acquired from N-T Information Engineering its set-top box design business. In April 2007, a new holding company, China Digital TV Holding Co., Ltd., or CDTV Holding, was established in the Cayman Islands. In May 2007, CDTV BVI executed a 40-for-1 share split of its ordinary shares and Series A preferred shares. Following this share split, the shareholders of CDTV BVI exchanged all of their shares of CDTV BVI for shares of CDTV Holding in proportion to their percentage interest in CDTV BVI, as a result of which CDTV BVI became a wholly owned subsidiary of CDTV Holding. In August 2007, with our consent, Ms. Li Yang transferred her entire equity interest in N-S Digital TV to Ms. Wei Gao, a PRC citizen employed by an affiliated company of SAIF. In order to benefit from the tax arrangement between the PRC and Hong Kong, in December 2007, CDTV BVI acquired Golden Benefit Technology Limited, or Golden Benefit, a company incorporated in Hong Kong, for a nominal consideration, and transferred its 100% equity interest in Super TV to Golden Benefit. Golden Benefit has conducted no operation since its incorporation. See “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Taxes and Incentives—PRC.” In December 2007, Super TV established a wholly owned subsidiary, N-S Media Investment, in the PRC to partner with China’s cable television operators and content providers to offer value-added services to television viewers. In February 2008, CDTV BVI established a wholly-owned subsidiary, China Super Media Holdings Limited, or CSM Holdings, in Hong Kong. In addition, in May 2008, N-S Digital TV entered into a joint venture agreement with a PRC citizen for the purposes of establishing Dongguan SuperTV to provide value-added services to television viewers.

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

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



***Our Investments and Acquisitions***

In August 2006, N-S Digital TV entered into an asset transfer agreement to purchase from N-T Information Engineering its set-top box design business for an initial purchase price of RMB29,440,000 (\$4,035,862), subject to certain post-closing downward adjustments. As an adjustment to the initial purchase price, N-T Information Engineering refunded RMB12,051,000 (\$1,652,044) to N-S Digital TV in April 2007. For details of the adjustment mechanism of the initial purchase price, see “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions—Super TV and N-S Digital TV Arrangements—Transfer of Assets and Equity Interests and Trademark License—Asset Transfer Agreement, dated August 5, 2006, between N-T Information Engineering and N-S Digital TV, as amended on April 6, 2007.”

In August 2006, N-S Digital TV entered into an equity transfer agreement to purchase from N-T Information Engineering its 51% equity interest in Foshan Nanhai Guokai Digital TV Technology Co., Ltd., or Guokai, for a cash consideration of RMB2,370,000 (\$324,898). The parties entered into a new agreement in March 2007 to reduce the consideration to RMB2,255,858 (\$309,250). Guokai is a company primarily engaged in the research, development and sale of digital TV-related systems, software and products. A Japanese multinational company holds the remaining 49% equity interest in Guokai. This transaction was completed on July 27, 2007.

In March 2007, N-S Digital TV and Jiangsu Qingda Technology Co. Ltd, or Jiangsu Qingda, one of our customers, entered into an agreement to set up a joint venture in Nanjing of Jiangsu Province mainly engaging in digital television technology development and services, Nanjing Qingda Yongxin Culture & Media Co. Ltd., or Qingda Yongxin. N-S Digital TV contributed cash of RMB0.8 million (\$0.1 million), representing 40% of equity interest in the joint venture. Jiangsu Qingda contributed cash of RMB1.2 million (\$0.2 million) representing 60% of equity interest in the joint venture. In three years after the establishment of Qingda Yongxin, N-S Digital TV has the option to purchase up to an additional 30% of the equity interest of Qingda Yongxin. The purchase price of the additional interest will be determined based on the valuation of the joint venture on the date of purchase, which will be the higher of ten times its net profits in the year prior to the purchase, and the net asset value of Qingda Yongxin on the last fiscal year end date prior to the purchase. As of December 31, 2007, Qingda Yongxin has not commenced operations.

In May 2008, N-S Digital TV and Xitao Lai, a PRC citizen, entered into an agreement to set up Dongguan SuperTV, a joint venture in Dongguan, Guangdong Province, mainly to provide value-added services to television viewers. N-S Digital TV and Xitao Lai will each contribute cash of RMB 5.0 million (\$0.7 million), representing 50% of equity interest in the joint venture. N-S Digital TV has an option to purchase an additional 10% equity interest in the joint venture from Xitao Lai, subject to certain conditions. In addition, N-S Digital TV is entitled to 70% of shareholders' voting rights and appointing three out of the five members of the board of directors of Dongguan SuperTV. We are currently in the process of incorporating Dongguan SuperTV.

### ***Capital Expenditures and Divestitures***

See "Item 5. Operating and Financial Review and Prospectus—B. Liquidity and Capital Resources—Capital Expenditures" for information concerning our principal capital expenditures for the previous three years and those currently in progress. We have not undertaken any significant divestitures.

## **B. Business Overview**

### **Overview**

We are the leading provider of CA systems to the PRC's rapidly growing digital television market. Our CA systems, which consist of smart cards, head-end software for television network operators and terminal-end software for set-top box manufacturers, enable digital television network operators in the PRC to control the distribution of content and value-added services to their subscribers and block unauthorized access to their networks. As of December 31, 2007, we had installed CA systems at 164 digital television network operators in 27 of the 32 provinces, autonomous regions and centrally administered municipalities in the PRC. We were the leading vendor of smart cards for CA systems in terms of smart cards shipped in the PRC in 2007, with a market share of approximately 48% in 2007, according to Analysis International. We derive a substantial majority of our revenues from sales of our smart cards, which accounted for 85.6% and 89.1% of our total revenues in 2006 and 2007, respectively. We expect that the sales of our smart cards will continue to constitute the majority of our revenues in the near future. In addition, we license our set-top box design to set-top box manufacturers and sell advanced digital television application software such as electronic program guides and subscriber management systems to digital television network operators. Following the establishment of N-S Media and Dongguan SuperTV, we expect to engage in the value-added television business by

offering premium value-added cable television services such as electronic program guides based advertising platforms, pay-per-view programming and video-on-demand through cooperation with digital television network operators.

PRC television network operators are in the early stages of switching from analog to digital transmissions, and the PRC government has set a target of 2015 for operators to complete their digital transition. We are a primary beneficiary of this transition because CA systems are an essential component of any pay-television platform. We sell our CA systems and digital television application software to PRC television network operators, including cable, satellite and terrestrial television network operators, and enterprises that maintain private cable television networks within their facilities.

Among the 49 cable television network operators selected by the SARFT to host digital television demonstration projects, 29 are our customers. Our top five customers in terms of revenues in 2007 were Jiangsu Qingda, Dongguan Broadcasting Network Media Development Stock Co., Ltd., Kunshan Municipal Digital Cable Technology Co., Ltd., Hefei CATV Broadband Co. Ltd. and Chengdu Municipal Xingwang Media Co., Ltd. China Central Television, the largest broadcaster in China, also uses our CA system as well as those from other vendors to encrypt its programs for distribution to local television operators, although it is not a major contributor to our revenue.

We were founded in 2004 by Dr. Zengxiang Lu and Mr. Jianhua Zhu, who had worked together from 2001 at N-T Information Engineering, one of the PRC's earliest CA systems vendors. We purchased N-T Information Engineering's CA systems business in 2004 and continued to build upon the strong reputation that business had achieved. Our net revenues increased from \$13.1 million in 2005 to \$30.4 million in 2006 and \$55.5 million in 2007. We sold 0.2 million, 1.5 million, 3.9 million and 7.3 million smart cards in 2004, 2005, 2006 and 2007, respectively. We grew our net income from \$4.5 million in 2005 to \$13.0 million in 2006 and 33.8 million 2007.

## **Our Products and Services**

Our core products and services include the following:

- end-to-end CA systems, including smart cards, head-end software and terminal-end software;
- other digital television application software for television network operators; and
- set-top box designs.

### ***CA Systems***

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

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

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

- **Parental control.** Parents can use the set-top box to set viewing controls by creating a password that must be entered to watch television or to watch certain programs, and can block access to the system at certain hours.
- **Location control.** Television network operators can authorize each smart card and set-top box to function only on the premises of the subscriber in whose name the smart card and set-top box are registered, preventing subscribers from providing their smart cards and set-top boxes to others.
- **E-wallets.** Information about pre-payment by subscribers for programs or services can be recorded on their smart cards. As subscribers order programs or services, the fees are deducted from the amounts recorded on their smart cards.
- **Messaging.** Network operators can communicate with their subscribers by transmitting electronic messages about bill status, rate changes and new programs and services to their subscribers' televisions. Network operators also can allow other vendors, such as water or electricity companies, to send billing or other service messages via this messaging platform.
- **Upgrades.** CA systems upgrades can be accomplished by transmitting software over the transmission network to the terminal end.

We guarantee the security of the encryption technologies of our CA systems. In the event of a security problem, we undertake to attempt to resolve the problem by taking steps such as resetting the encryption code or adding additional layers of encryption. If these or other system modifications do not resolve the problem, we undertake to replace our smart cards. Our warranty terms vary, but we generally agree to replace our smart cards for free during the first one to two years after sale in the event of a security breach, with the customer bearing some portion or all of the cost thereafter. To date, we have not encountered any material problems with the security of our CA systems.

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

Our customers generally wait until after they have purchased, installed and tested our head-end CA systems software before placing purchase orders for smart cards. We may offer discounts for large smart card orders. We sold 1.5 million, 3.9 million and 7.3 million cards in 2005, 2006 and 2007, respectively.

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

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

Our head-end software also includes simulcrypton software that allows network operators to install parallel CA systems from multiple vendors and transmit their programs to some subscribers using one CA system's security codes

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

As of December 31, 2007, our CA systems had been installed at 164 digital television network operators.

We generally install, customize, test and commission our CA systems over a period of months and train our customer's staff to operate it. Our prices vary according to the size and complexity of each customer's network, as well as market conditions. Generally, 90% of the contract price is payable upon issuance of a preliminary acceptance or, if there is only a single acceptance, upon its issuance, and the remaining 10% is payable upon issuance of a final acceptance or within one year of such issuance.

**Terminal-End Software.** We license our CA systems terminal-end software to whichever set-top box manufacturer has been chosen by our customer to produce set-top boxes compatible with our CA systems. More than 115 set-top box manufacturers in the PRC have installed our technology in their set-top boxes.

Once our customer has selected one or more set-top box manufacturers, the selected manufacturers enter into contracts with us to license our terminal-end software for use in their manufacturing processes so that their set-top boxes can be used on the planned network. The manufacturers agree to pay us a one-time license fee, including fees for testing and certifying their set-top boxes, and royalties for each box they manufacture using our software. In 2006, we began entering into agreements with certain television network operators who purchase our CA systems pursuant to which the operators agree to pay us royalties for each set-top box deployed on their networks that uses our CA systems terminal-end software.

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

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

- maintains and updates a database of subscriber information;
- processes subscriber orders for new services;
- maintains billing, payment and authorization records and sends e-mail bills and receipts to subscribers; and
- processes subscriber requests to repair or replace defective or lost set-top boxes or smart cards.

As of December 31, 2007, our SMS software had been installed by 54 television network operators. Our prices vary according to the size and complexity of each customer's network, as well as market conditions.

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

As of December 31, 2007, our electronic program guide had been installed by 93 television network operators. We generally sell our electronic program guide together with our CA systems, but it is also compatible with the CA systems of other vendors. When we sell our electronic program guides packaged with our CA systems, we provide the same maintenance terms as for the CA systems. Our prices vary according to the size and complexity of each customer's network, as well as market conditions.





### ***Set-top Box Design***

We produce a design, or operating system, for set-top boxes and license it to set-top box manufacturers. Our sophisticated design enables set-top box manufacturers to incorporate high-end features into their set-top boxes. We also provide our customers with computer chips for the set-top boxes that have been made to our specifications by third-party fabricators. The set-top box manufacturers generally sign a purchase order specifying the number of set-top boxes that they intend to manufacture using our design, and pay us a license fee and royalties based on such number. Our set-top box design does not include CA system terminal-end software. Manufacturers who use our set-top box design may separately purchase our or other vendors' CA system terminal-end software. We are developing additional applications for our set-top box designs to support new value-added services and to allow the set-top boxes to operate as personal video recorders.

### **Technical Support and Services**

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

As of December 31, 2007, we had a total of 58 technicians and engineers located in Beijing and six other cities on call around the clock to respond to customer requests for information and assistance. Our three regional service centers are strategically located in eastern (Hangzhou), central (Changsha) and southern (Nanhai) China, and we have smaller centers serving customers in the cities of Dalian in the northeast, Chengdu in the southwest and Hefei in the east. Each service center maintains a 24-hour telephone hotline. Upon receiving a call for assistance, our technical support employees first attempt to identify and resolve the problem over the telephone or by accessing the software remotely, and then arrange a site visit if necessary. In addition, each customer is assigned a project manager who oversees the initial software installation and remains primarily responsible for ensuring that after-sale requests for assistance are handled promptly.

### **Sales and Marketing**

As of December 31, 2007, we had 67 full-time direct sales personnel. We maintain regular contact with our customer base through contacts at industry forums and sales visits, and use these opportunities to educate them about digital television systems. We actively monitor which operators are moving towards digitalization, and when we learn that a particular operator is planning to launch a digital network, we target that operator for more frequent contact by our sales and technical personnel. We compensate our sales personnel by means of base salaries and performance bonuses.

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

We currently have one distributor, Jiangsu Qingda, a Nanjing-based company, which acts as our exclusive distributor for CA systems and smart cards in Jiangsu Province in eastern China. Jiangsu Qingda also provides after-sales technical support and maintenance services for our customers in Jiangsu Province. We entered into a new, 13-year distribution contract with Jiangsu Qingda effective January 1, 2007. We account for revenues contributed by Jiangsu Qingda in the same way as revenues from our customers who are television network operators. Jiangsu Qingda was our largest contributor to revenues in 2006 and 2007.

### **Customers**

Our primary customers are cable television network operators. We sell our products and services to networks of all sizes. Our top five customers during the year ended December 31, 2007 were Jiangsu Qingda, Dongguan Broadcasting Network Media Development Stock Co., Ltd., Kunshan Municipal Digital Cable Technology Co., Ltd., Hefei CATV Broadband Co., Ltd. and Chengdu Municipal Xinwang Media Co., Ltd., which contributed 14.1%, 8.0%, 3.9%, 3.0% and 2.9%, respectively, of our total revenues for such period. China Central Television, the largest broadcaster in China, also uses our CA system as well as those from other vendors to encrypt its programs for distribution to local television operators, although it is not a major contributor to our revenue.

We also have sold our CA systems to:

- satellite and terrestrial television network operators, including the China Central Satellite Television Transmission Center;
- large enterprises that maintain private cable television networks within their facilities, including the Beijing Capital International Airport; and
- the operators of wireless television networks for taxi fleets, including the Shanxi Dazhong Mobile Television Co., Ltd.

We currently derive, and we expect to continue to derive, a significant portion of our revenues each period from a limited number of large customers, although the particular customers may vary from period to period. As digital cable television systems are in their infancy in the PRC, the largest shipments of smart cards are to operators who are launching new digital transmission systems and need to purchase in bulk for their new networks. For example, each of Hangzhou Digital Television Co., Ltd., Dalian Tiantu Cable Network Stock Co., Ltd. and Taiyuan Cable Television Network Co., Ltd. contributed more than 10% of our total revenues in 2005, representing 20.0%, 12.6% and 11.5%, respectively, of our total revenues during 2005, and each of Jiangsu Qingda, our distributor, and Dalian Tiantu Cable Network Stock Co., Ltd., contributed more than 10% of our total revenues in 2006, representing 14.5% and 13.0%, respectively, of our total revenues during 2006. Jiangsu Qingda was our only customer that contributed more than 10% of our total revenues during 2007, representing 14.1% of our revenues in that period. We may face certain risks from this concentration of revenues. See “Item 3. Key Information—D. Risk Factors—Risks Relating to Our Business and Industry—A significant portion of our revenues in any single period depends on a limited number of customers. If one customer defers or cancels its orders or chooses our competitors’ products or services, our revenues in such period could decline significantly.”

Because most cable television network operators in the PRC are state-owned, they are required to follow a public bidding process for major purchases. As a result, the majority of our CA systems sales are made pursuant to a formal bid process. In such cases, the network operator generally submits its CA systems requirements to a state-owned bidding company, which posts a request for bids at its Internet site and specifies the necessary financial and technical qualifications of bidders. We closely monitor new requests for bids. We also cultivate good relations with potential customers before they reach the stage of requesting bids, so that we can better understand their needs and tailor our bid proposals accordingly. We are generally required to accompany our bid with a cash deposit, which generally is from \$6,500 to \$13,000 and which is refundable in full if we fail to win the sales contract. If we succeed in winning the contract, some network operators require that we leave our deposit in their account until we have installed and tested our software and the network operator has signed a certificate of acceptance. The time from when a request for bid is posted until a winner is selected is usually one to two months.

Our customers also include set-top box manufacturers, to whom we license terminal-end software for our CA systems and set-top box designs. More than 115 set-top box manufacturers in the PRC have installed our terminal-end software in their set-top boxes, including Changhong Electric Co., Huawei Technologies, Panasonic AVC Networks, Samsung Electronics, TCL Technology, Intel Corporation, LG, and OKI. In addition, 18 set-top box manufacturers have licensed our set-top box designs, including Motorola and Hisense.

## **Suppliers**

Before 2006, we bought most of our computer chips for our smart cards from STM. In order to maintain a secure supply of computer chips, beginning in 2006 we have purchased a significant portion of our computer chips from ACG, which acts as an agent for Infineon. We are currently holding talks with two other vendors about purchasing computer chips from them.

STM and Infineon produce chips that use our card operating system at their facilities in France and Germany, respectively, and deliver them to Beijing by air freight. We do not have long-term contracts with any of our computer chip suppliers, but place orders according to our customers' demands. We pay based upon the prevailing market price at the time of order. The vendors warranty their chips for a period of one year from delivery.

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

We have arrangements with four smart-card manufacturers, China Electronics, the China Sciences Group, Axalto Smart Card Technology Co. and Oberthur Card Systems, to embed the computer chips into plastic cards. We currently maintain a one-year contract with each of China Electronics and the China Sciences Group that guarantees us a volume-based price discount and requires China Electronics or the China Sciences Group, as the case may be, to fulfill our orders in accordance with an agreed schedule. We do not have any long-term contract with Axalto Smart Card Technology Co. or Oberthur Card Systems. Our contracts with China Electronics and the China Sciences Group require them to meet the ISO-7816 standard for card readability. In addition, we believe that there are numerous alternative smart-card manufacturers from whom we would be able to obtain smart cards if either or both of our current suppliers were unable to meet our needs.

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

### **Competition**

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

- customer service and technical support;
- brand name, track record and market recognition;
- encryption management and other technologies, including our smart cards;
- the number of set-top box manufacturers with whom we cooperate; and
- price.

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

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



According to Analysys International, we were the leader in the PRC CA systems market in 2006 and 2007. According to Analysys International, in 2007, we had an approximately 48% market share based on the number of smart cards shipped, followed by DVN Holdings Ltd. with approximately 22% market share, Irdeto Access BV with approximately 10% market share, NDS Group with approximately 7% market share, Kudelski SA with approximately 7% market share, Sumavision Technologies Co., Ltd. with approximately 5% market share, and others accounting for the remaining 1%. For more information about risks relating to our competitors, see “Item 3. Key Information—D. Risk Factors—Risks Relating to Our Business and Industry—We face intense competition, which could reduce our market share and harm our financial performance.”

## **Research and Development**

Our success to date has in large part resulted from our strong research and development capabilities. As of December 31, 2007, our research and development team consisted of 224 employees, up from 145 as of December 31, 2006, and we plan to further expand the team during 2008. Our investment in research and development increased to \$4.6 million in 2007 from \$2.2 million in 2006.

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

Many of our current research and development staff are graduates of the PRC’s top science and engineering universities, including Tsinghua University, and have extensive experience in digital television and encryption technologies. Our research team played a leading role in drafting the PRC industry standards for CA systems, electronic program guides and other key industry standards. We are active in the China Digital Rights Management Forum, which aims to develop a PRC standard for digital rights management, and the Audio and Video Coding Standard Workgroup of China, which has developed the PRC’s own video and audio compression technology. In 2006, the Radio and Television Standards Institute of the SARFT awarded us their annual “technology innovator” award, and honored Mr. Jian Han, our chief technology officer, with their “innovative person” award.

Our research and development personnel are actively seeking ways to improve the security of our CA systems, as well as prevent content theft at other stages of the television network operators’ chain of transmission. Other focuses of research include adapting our CA systems for use on new television platforms such as mobile television and IPTV, developing new value-added services that will enhance operator revenues, and developing a new line of digital rights management, products, to allow content providers to control the way their content is distributed and reproduced.

## **Intellectual Property**

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

As of December 31, 2007, we had a total of four patents issued and 15 pending patent applications in the PRC. Our issued patents and pending patent applications relate primarily to digital transmission technologies, encryption and decryption technologies, technologies relating to the production of set-top boxes and smart cards and technologies

relating to value-added services. We have also completed copyright registration of 38 software programs for digital television in the PRC.

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

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We have a non-exclusive license to use the English and Chinese names for “NOVEL-TONGFANG” and a graphic logo, free of charge, pursuant to an agreement with N-T Information Engineering. N-T Information Engineering has registered these names and the logo as trademarks. Our term of use is from June 1, 2004 until such trademark registrations expire at various dates in 2013. In November 2007, we ceased using “NOVEL-TONGFANG” in N-S Digital TV’s name by changing the name from “Beijing Novel-Tongfang Digital TV Technology Co., Ltd.” to “Beijing Novel-Super Digital TV Technology Co., Ltd.” In January 2008, we ceased using the English and Chinese names for “NOVEL-TONGFANG” as trademarks for our products and we currently intend not to use such trademarks in the future. We started to use the English and Chinese names for “NOVEL SUPERTV” in combination with the graphic logo we licensed from N-T Information Engineering as the trademarks for our products. In the meanwhile, we are in the process of acquiring for free the graphic logo from N-T Information Engineering and applying to register the trademarks of the English and Chinese names for “NOVEL SUPERTV”.

In addition, we own four other trademarks that we have not registered. We have registered the domain names [www.superdtv.com.cn](http://www.superdtv.com.cn) and [www.superdtv.cn](http://www.superdtv.cn).

### Insurance

We do not maintain any business insurance or key-man insurance. Insurance companies in the PRC offer limited business insurance products and do not, to our knowledge, offer business liability insurance. While business disruption insurance is available to a limited extent in the PRC, we have determined that the risks of disruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. As a result, we do not have any business liability, disruption or litigation insurance coverage for our operations in the PRC. We generally do not maintain property insurance either, except for insurance that covers the company vehicles.

### Employees

As of December 31, 2007, we had 424 full-time employees, as compared to 270 employees as of December 31, 2006. We have no part-time employees. All of our employees are located in the PRC. The table below shows the number of employees categorized by business area and as a percentage of our workforce as of December 31, 2007:

|                            | Number of employees | Percentage |
|----------------------------|---------------------|------------|
| Research and development   | 224                 | 52.8%      |
| Technical service          | 58                  | 13.7%      |
| Sales and marketing        | 67                  | 15.8%      |
| General and administration | 48                  |            |