LINKTONE LTD.

2006 Annual Report

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Letter to Shareholders

LETTER TO SHAREHOLDERS

Dear Valued Shareholders,


Michael Li

As Linktone's Chief Executive Officer, let me begin by telling you how much I value the trust and confidence you have placed in Linktone. The second half of 2006 became a challenging time for all of us due to the regulatory environment for service providers in China. These stringent operating policies subsequently hurt growth in our core wireless business. While in the short term these policies hurt sales, it is essential to recognize that these regulations will only help improve the industry and increase the user's overall experience as demand for mobile data and audio services further develop. For all of us at the Company, building shareholder value is our top priority, and we are excited about our cross-media strategy and what it means for the mobile industry in China.

By coupling investments in key media partnerships and assets with Linktone's established leadership and expertise in wireless interactive entertainment, our cross media strategy will be fundamental to the next stage of Linktone's evolution.

Financial Review

For the year ended December 31, 2006, Linktone reported a year-over-year increase in total gross revenues of 8% to $79.8 million, compared with $73.6 million for 2005. Full year 2006 GAAP net income was $6.8 million, or $0.26 per fully diluted ADS, compared with $12.4 million, or $0.45 per fully diluted ADS for the prior year.

Linktone's operating activities generated positive cash flow of $14.1 million for 2006. We made a number of strategic investments and acquisitions that have further diversified Linktone's service offerings, and we ended 2006 with a healthy cash and cash equivalent position of $51.4 million.

Business Highlights

We accomplished a number of notable business initiatives in 2006.

- *Acquisition of Ojava*. Ojava Group is a leading mobile game developer and game publisher in the PRC. The primary purposes of the acquisition were to strengthen the Company's overall game service portfolio and development capabilities, and increase its share in the Java gaming market.

- *"Super Boy" TV Program Cooperation*. Linktone provides wireless value-added services in connection with "Super Boy," an interactive television program hosted by Shanghai Media Group. "Super Boy" is a weekly nationwide contest for the next male pop star similar to "SuperGirl" in China and "American Idol" in the U.S. Linktone supports the television program with SMS (short message service) and IVR (interactive voice response) technologies for viewer voting.
- *Joint Venture with Shandong Satellite TV Subsidiary.* Linktone is in the process of establishing a joint venture (JV) with Zhongbang Culture Media (ZCM), a subsidiary of Shandong TV Station (''SDTV''), one of the leading television stations in China. Linktone will exclusively operate wireless value-added services for SDTV, as well as co-production and distribution of programs.
- *Exclusive Partnership with Hainan Satellite ('Travel Channel China").* Linktone has agreed to serve as the exclusive partner to Hainan Satellite, providing interactive wireless value added services for all of its television programming. In addition, Linktone will provide product development, technical support and 24-hour customer service support for Hainan Satellite.
- *Cooperation Agreement with Chinese Youth League Internet, Film and Television Center*. Linktone, through an affiliate entity Shanghai Lingyu Culture and Communication Ltd., will serve as the exclusive partner for advertising on Qinghai Satellite Television.

Strategy Update

We have taken decisive measures to quickly and effectively address the challenges we experienced in the second half of 2006, but it is important to note that we still continue to believe in the development and potential of our core wireless services. We are strategically leveraging these wireless competencies as the channel to reach an even broader audience in China through interactive entertainment and media and the market's convergence of new and traditional media assets.

As part of our go-forward "cross-media" plan, Linktone is now focused on bundling our wireless service expertise with new and traditional media to create substantial cross-selling opportunities and revenue stream diversification. This is an opportunistic time for Linktone as we focus on strengthening our footprint in China's booming television and advertising market.

Meanwhile, we will continue to actively leverage the strategic acquisitions and partnerships we made in 2006 and look for other attractive acquisition opportunities in 2007.

Looking Ahead

As many of our shareholders are aware, China has rapidly become the largest mobile market in the world, with over 461 million subscribers at the end of 2006. Market data shows that number may grow by another 50 million in 2007. We anticipate this trend will continue to be fueled by strong fundamentals, the growing use of 2.5G, and in the near future, 3G mobile technologies that will enable the distribution and consumption of rich multimedia content. With the anticipated full-scale rollout of 3G wireless standard by next year, we also see strong growth opportunities for animation, mobile commerce, flash media, and interactive programming.

To capitalize on this market momentum and improve our operating performance, Linktone will continue to strengthen our content offerings on mobile platforms, explore new business partnerships, reinforce marketing and distribution networks, and streamline the integration of our acquired companies and strategic partnerships. By developing the proper channels, we will be able to lock in an important source of content supply and utilize a wide range of platforms as a powerful distribution network.

I look forward to sharing Linktone's achievements with you in the quarters ahead. We thank you for your continuing support.

Sincerely,

Michael Li
Chief Executive Officer

Management's Discussion and Analysis of Financial Condition and Results of Operation

Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words "expect", "anticipate", "intend", "believe", or similar language. All forward-looking statements included in this annual report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We caution you that our business and financial performance are subject to substantial risks and uncertainties.

Overview

We provide entertainment-oriented telecom value-added and cross media services to both consumers and mobile phone users in China. Our revenues are primarily derived from the sale of various 2G and 2.5G data related services, such as Short Messaging Services ("SMS"), Multimedia Messaging Services ("MMS"), Wireless Application Protocol ("WAP") and JavaTM ("Java games"), and audio-related services, such as Interactive Voice Response Services ("IVR") services and color ring-back tones ("RB"), to consumers through the mobile networks operated by China Mobile and, to a lesser extent, China Unicom, China Telecom and China Netcom. We receive our revenues principally in the form of payments from these telecommunication network operators after the users have paid for our services and the operators have deducted their service and network fees. Users pay for our services by monthly subscription and/or on a per usage basis

Our cross-media strategy focuses on the development of new and traditional media channels while using our core wireless platform to reach a broader audience. We believe that this will provide us with unique content and distribution channels that offer revenue potential in areas of advertising and content distribution. We began executing on this strategy in the fourth quarter of 2006 with our entry into agreements with the Chinese Youth League Internet, Film and Television Center ("CYL") under which we serve as the exclusive advertising agent for Qinghai Satellite Television, a regional satellite television broadcaster in China ("QTV"). We began generating generated $0.3 million in revenues from selling satellite television advertising time slots and program sponsorship in the fourth quarter of 2006.

We achieved net income of $6.8 million for 2006, compared to net income of $12.4 million for 2005. For 2006, we generated $79.8 million in gross revenues,

compared to $73.6 million for 2005, representing an increase of 8.4%. The table below sets forth our gross revenues by service category in 2006, 2005 and 2004:

	Year ended December 31,		
	2004 $ million	2005 $ million	2006 $ million
2G services	40.2	46.7	44.6
Audio-related services	3.7	17.0	21.5
2.5G services	6.4	8.3	11.7
Casual games	–	1.4	1.5
Advertising	–	–	0.3
Others	–	0.2	0.2
Total revenue	**50.3**	**73.6**	**79.8**

Our gross revenues increased primarily as a result of increase in the number of paying users, particularly for our audio-related services and some of our 2.5G services. In particular, our audio-related revenues increased by 26.5% to $21.5 million in 2006 from $17.0 million in 2005, primarily due to our ongoing efforts to attract new users through enhanced promotions, especially print and broadcast media channels. Our 2.5G revenues increased by 41.0% to $11.7 million in 2006 from $8.3 million in 2005, primarily due to increased sales of WAP and Java games services. Our WAP and Java revenues grew significantly in 2006 from a small contribution in 2005, and our gross revenues in 2006 included a new revenue stream beginning in the fourth quarter from television advertising which totaled $0.3 million.

These increases were partially offset by a decrease in our revenues from MMS and SMS due to policy changes implemented by China's mobile operators as discussed further below. In 2006, our 2G, audio-related and 2.5G services accounted for $44.6 million, $21.5 million and $11.7 million of our gross revenues, or 55.9%, 26.9% and 14.7%, respectively. This compares to our 2G, audio-related and 2.5G services revenues for 2005, which accounted for $46.7 million, $17.0 million and $8.3 million of our gross revenues, or 63.5%, 23.1% and 11.3%, respectively.

The presentation of our financial results in this annual report is affected by the fact that we, like other companies in the telecom value-added services industry in China, do not receive or recognize revenue for services we provide that are characterized as billing and transmission failures. These failures primarily result from the users' mobile phone being turned off, the users experiencing problems with the mobile operators' networks or our system or other issues, which, in each case, prevent delivery of our services to our users. The mobile operators' monthly statements to service providers regarding the services provided through their networks currently do not contain billing and transmission failure information on either an aggregate or a service-by-service basis. Although we maintain our own records for reporting the services provided, and we receive separate monthly statements from the mobile operators for each category of service platform (i.e., SMS, MMS, WAP, Java games, IVR and RB services), we can only estimate our actual gross revenues and cost of services by specific service because we are unable to confirm which specific service we transmitted

that resulted in billing and transmission failures. Consequently, we are not able to determine the aggregate amount of billing and transmission failures or definitively calculate and monitor service-by-service gross revenue, margins and other financial information and also cannot definitively determine which of our services are or may be profitable.

The major factors affecting our results of operations and financial condition include:

- *Growth of the Telecom Value-Added Services Market in China.* Our financial results have been, and we expect them to continue to be, affected by the growth in the telecom value-added services market in China, particularly growth in the audio-related and 2.5G market in China. Wireless telephony has become an increasingly important medium of communication. According to the Ministry of Information Industry, the number of mobile subscribers in China increased from 43.2 million as of the end of 1999 to 461.8 million as of December 31, 2006. In 2006, SMS services continued to represent the majority of the telecom value-added services market in China, with approximately 429.7 billion SMS messages sent in 2006. We expect the market for audio-related and 2.5G services to continue to grow at a faster rate than the market for 2G services for the foreseeable future, and our future revenue growth will depend to a significant extent on our continued expansion into the audio-related and 2.5G service markets.

- *Changes in Mobile Operator Policies or the Manner in Which They are Enforced.* In order to reduce subscriber complaints, increase overall customer satisfaction and promote healthy development of the telecom value-added services industry, China's mobile operators introduced significant changes to their operating policies in July 2006. These changes were in accordance with policy directives from China's Ministry of Information Industry ("MII"). For example, China Mobile's new operating policies require that we send double confirmations for new subscriptions and a reminder to existing monthly subscribers of their subscription and fee information, and that inactive users are cancelled. China Unicom also began to require double confirmations on new subscriptions beginning in September 2006. Changes in these policies have, among other things, enabled monthly subscribers to more easily cancel our services and required us to automatically terminate subscription services for our inactive users. These policy changes by the mobile operators beginning in 2005 and as described above negatively affected our revenue from 2G and one of our 2.5G services in 2006. The mobile operators may implement further measures in response to current or future policy directives of MII, which may have a negative material impact on the Company's business, results of operations and financial position.

- *Operator Service Agreements with China Mobile, China Unicom, China Telecom and China Netcom.* Our ability to generate revenue and the terms under which we deliver our services depend to a large extent on our ability to maintain good relationships with the national, provincial and local offices of China Mobile and to a lesser extent, China Unicom, China Telecom and China Netcom and to differentiate our services through, among other things, innovative product development and appealing content from domestic and international content providers.

  Each operator charges us service fees from the gross revenues generated by our services. In addition, to the extent the number of SMS or MMS messages sent by us over China Mobile's network exceeds the number of SMS or MMS messages our customers send to us, we must also pay a per message network fee. We also pay China Unicom, China Telecom and China Netcom network fees in most provinces on the same basis. These service and network fees are reflected in our cost of services, and as our business has grown, these costs have increased from $19.0 million in 2005 to $20.4 million for 2006. Each operator could alter any of the terms of our service agreements with them or terminate the agreements for a variety of reasons in the future, including, for example, to increase their service or network fees to enhance their profitability at the expense of service providers.

- *Costs Associated with Content Provider Relationships.* Our telecom value-added services include the delivery of third-party content, such as Shin Shan cartoons, certain Java games and music downloads for ringtones and ringbacks, to our end user customers. We provide this content typically based on revenue sharing arrangements under which we pay third-party content providers an agreed percentage of the estimated revenues realized from products incorporating their content. Most of our content licenses have a limited term, and grant us non-exclusive rights. Given the high demand for engaging, trendy content in the China telecom value-added services market, we have limited leverage to negotiate significantly more favorable terms with third-party content providers. Payments to third party content providers, were $7.5 million and $7.8 million in 2005 and 2006, respectively. Our net income could be adversely affected in future periods if revenue share payments continue to increase, both in absolute terms as well as a percentage of our gross revenues.

- *Marketing Expenses.* In order to maintain visibility and demand for our SMS and IVR products and our competitive position in the market, we need to make continued investments in media advertising and integrated co-marketing. Our media advertising is typically in the form of TV commercials and magazine placements, while our integrated co-marketing typically takes the form of joint cooperation programs with content providers such as TV programming and event sponsorships. Fee rates for our various marketing channels are becoming increasingly more expensive while generating lower level of gross revenues. Our advertising costs increased from $6.2

million in 2005 to $10.2 million in 2006. Our net income could be adversely affected in future periods if we are not able to effectively manage advertising expenses and maximize the gross revenues we generate from such advertising.

- *Television Advertising and Television Content Production Strategic Initiative.* In October 2006, we entered into agreements to serve as the exclusive advertising agent for QTV and to establish a joint venture to produce most of the programming content for QTV. We believe that our advertising and program sponsorship revenues will increase in the future as we and QTV focus on offering a unique combination of traditional television programming and integrated wireless value-added services. We also believe that companies' advertising budgets will continue to increase as China's economy continues to grow and as disposable income in households continues to rise. However, our advertising revenue could be adversely affected if we fail to attract advertisers to advertise on our various platforms due to the quality and popularity of our television content or general economic conditions which may have a negative impact on companies' advertising budgets.

  In 2006, we paid $4.8 million for the exclusive right to sell advertising time on QTV until December 2013 and expect to invest approximately $15 million in 2007 in programming and distribution initiatives. However, we believe that our net income in 2007 will be adversely affected as such costs, television program content production costs and other related costs which we will incur in 2007 are not likely to generate a corresponding amount of advertising revenue during this period. In particular, we incurred net losses in the first quarter of 2007.

- *Additional Cross-Media Strategic Initiative.* On January 8, 2007, we, through one of our affiliated PRC entities, entered into a contract with Shanghai Dong Fang Long New Media Co., Ltd. ("DFL") to provide interactive telecom value-added services for selected radio and television stations and related internet portals controlled by Shanghai Media Group. We believe that this arrangement will allow us to integrate our services into a wide range of audio and visual content and reach a broad audience. Under the contract, DFL is committed to provide certain content and resources to our affiliated PRC entity which has advanced $1.3 million in January 2007 to DFL for this project.

  In addition, we may from time to time enter into similar new ventures with other strategic partners. Our future results of operations may be materially affected if we fail to realize meaningful returns on our investment in these ventures.

- *Taxes.* Certain of our subsidiaries and affiliated Chinese entities enjoy tax exemptions and reduced tax rates. See "Taxation" below. Such tax treatment increases our net income. Our future results could be materially adversely affected if we are not able to maintain similar tax treatment, particularly as a result of the recently adopted revisions to the Chinese income tax law which will go into effect from January 1, 2008.

- *Repurchase of ADSs.* On September 7, 2005, the Company's shareholders authorized the repurchase of up to $15 million worth of American Depositary Shares or ADSs. By June 23, 2006, the Company had purchased 1,866,600 ADSs in the open market for an aggregate purchase amount of $15 million including brokerage commissions, completing the entire share repurchase program. On August 7, 2006, the Company's board of directors approved a new $20 million stock repurchase program. As of December 31, 2006, the Company had repurchased an additional 1,965,501 ADSs for an aggregate purchase price of $10 million including brokerage commissions.

In summary, our future revenues and results of operations may fluctuate significantly due to a combination of factors, including:

- regulations of our market by the mobile operators and the Chinese government (in particular, the MII),
- terms of our relationships with China Mobile and, to a lesser extent, China Unicom, China Telecom and China Netcom,
- growth and acceptance of various telecom value-added services that we offer in China, in particular our 2.5G and audio-related services,
- the level of billing and transmission failures in the provinces where we derive significant portions of our revenue,
- our ability to expand the content and services that we offer and, in particular, develop and aggregate innovative new content and service offerings not affected by policy changes of the mobile operators,
- our ability to produce popular television content to attract advertisers and execute our cross media strategy,
- our ability to continue to acquire users through print, broadcast and other marketing channels in a cost efficient manner,
- our ability to effectively control operating expenses or make expenditures that effectively differentiate our services and brand in future periods,
- our ability to realize meaningful returns from strategic partnerships, and
- general economic conditions in China.

Our Corporate Structure

We commenced operations as a business division of Intrinsic China Technology Ltd., which was incorporated in the Cayman Islands in November 1999. In April 2001, our affiliated business division which focused on wireless data software was spun-off to a newly established holding company, Intrinsic Technology (Holdings) Ltd., and our company was renamed Linktone Ltd. Due to the significance of the spun-off division relative to that of our company, the transaction was accounted for as a reverse spin-off with our company as the spinnee for accounting purposes.

We conducted our business in China solely through our wholly owned subsidiaries, which were Shanghai

Linktone Consulting Co., Ltd. ("Linktone Consulting"), Shanghai Huitong Information Co., Ltd. ("Huitong"), Shanghai Linktone Internet Technology Co., Ltd. ("Linktone Internet"), Shanghai Linktone Software Co., Ltd. ("Linktone Software"), Wang You Digital Technology Co., Ltd. ("Wang You"), and Beijing Ruida Internet Communication Technology Co., Ltd. ("Ruida") in 2006. In order to meet ownership requirements under Chinese law which place certain restrictions on Linktone, as a foreign company, to operate in certain industries such as value-added telecommunication, Internet and advertising services, we maintain control over the following PRC affiliated companies: (i) Shanghai Weilan Computer Co., Ltd. ("Weilan"), which is 50% owned by each of two of our employees, Baoxin Yao and Wenlei Wang; (ii) Shanghai Unilink Company Ltd. ("Unilink"), which is 50% owned by each of two of our employees, Rong Zhang and Wenjun Hu; (iii) Shenzhen Yuan Hang Technology Co., Ltd. ("Yuan Hang"), which is 50% owned by each of two of our employees, Yuming Cai and Xuan Fan; (iv) Beijing Cosmos Digital Technology Co., Ltd. ("Cosmos"), which is 50% owned by each of two of our employees, Rong Zhang and Teng Zhao; such equity interests are in the process of being transferred to two other employees, Hongjie Qi and Miao Yan; (v) Hainan Zhong Tong Computer Network Co., Ltd. ("Zhong Tong"), which is 50% owned by our former employee, Jinhua Yuan, which is in the process of being transferred to our employee, Enoch Huang, and 50% by our employee Teng Zhao; (vi) Beijing Lian Fei Wireless Communication Technology Co., Ltd. ("Lian Fei"), which is 50% owned by each of two of our employees, Jing Wang and Rong Li; (vii) Shanghai Qimingxing E-commerce Co., Ltd. ("Qimingxing"), which is 50% owned by each of two of our employees, Di Qian and Lijin Shen; (viii) Beijing Ojava Wireless Information Technology Co., Ltd. ("Beijing Ojava"), which is 50% owned by each of two of our employees, Xinyong Ding and Jun Xi; and (ix) Shanghai Ling Yu Cultural and Communication Ltd. ("Ling Yu"), which is 50% owned by Unilink and 50% owned by Qimingxing. In 2007, we established Zhong Qing Wei Lian Cultural Communication Co., Ltd, ("Wei Lian") to produce television and interactive wireless programs for QTV. Wei Lian is 60% owned by Weilan and 40% owned by Lian Fei. It is expected that 51% of Wei Lian's shareholding will be transferred to CYL.

Under the current shareholding structure, Weilan, Unilink, Cosmos, Zhong Tong, Lian Fei, Qimingxing and Beijing Ojava have inter-provincial value-added telecommunication services licenses issued by the MII. Each of Weilan, Unilink, Cosmos, Zhong Tong, Lian Fei, Qimingxing and Beijing Ojava offers our services through one or more of the telecommunications network operators in China. Yuan Hang offers services related to our online gaming business. Ling Yu acts as the exclusive advertising agent and Wei Lian as a television program producer for QTV. We hold no direct ownership interest in these companies.

We, our Chinese affiliated entities and their respective shareholders are parties to a series of agreements governing the provision of our wireless valued-added

and advertising services. In addition, as of December 31, 2006, we had provided long-term interest free loans to the shareholders of our Chinese affiliated entities with an aggregate outstanding balance of approximately $13.1 million. The proceeds from these loans have been used to fund investments in our Chinese affiliated entities. See "Arrangements with Consolidated Affiliates" below.

Our primary internal source of funds is dividend payments from our wholly owned subsidiaries in China and British Virgin Islands, Linktone Consulting, Huitong, Linktone Internet, Linktone Software, Brilliant, Wang You, Ojava Overseas Ltd. ("Ojava Overseas") and Ruida. Under current Chinese tax regulations, dividends paid to us from Chinese entities are not subject to Chinese income or withholding tax. However, Chinese legal restrictions permit payment of dividends only out of net income as determined in accordance with Chinese accounting standards and regulations. Under the new Chinese income tax law which will go into effect from January 2008, such dividends paid to foreign investors may be subject to income or withholding tax. Much of the detailed implementation guidance has yet to be provided by the China government, and we are currently evaluating the impact of these changes to us, see "Taxation" below. Under current Chinese law, Linktone Consulting, Huitong, Linktone Internet, Linktone Software, Wang You and Ruida are also required to set aside a portion of their net income each year to fund certain reserve funds. These reserves are not distributable as cash dividends. Dividends paid to us by Brilliant and Ojava Overseas, which were incorporated in the British Virgin Islands, are not subject to tax.

Arrangements with Consolidated Affiliates

Current Chinese laws and regulations impose significant restrictions on foreign ownership of value-added telecommunication, online gaming and advertising services businesses in China. Therefore, we conduct substantially all of our operations in China through a series of agreements with our affiliated Chinese entities, which were Weilan, Unilink, Yuan Hang, Cosmos, Zhong Tong, Lian Fei, Qimingxing, Beijing Ojava and Ling Yu in 2006. These companies are variable interest entities (VIEs) under FASB Interpretation No. 46R, or FIN 46R, and accordingly, have been consolidated into our financial statements. Transactions between these entities and our company and subsidiaries are eliminated in consolidation.

We believe that the terms of these agreements are no less favorable than we could obtain from disinterested parties. The material terms of the agreements among us, our respective affiliated Chinese entities and their shareholders are substantially identical except for the amount of the loans extended to the shareholders of each entity and the amount of license fees paid by each entity. We believe that the shareholders of our affiliated Chinese entities will not receive any personal benefits from these agreements, except as shareholders of our company. The principal terms of these agreements with our affiliated Chinese entities are described below.

Powers of Attorney. Each of the shareholders of our affiliated Chinese entities have irrevocably appointed Colin Sung, chief financial officer of Linktone Ltd., as attorney-in-fact, to vote on their behalf on all matters on which they are entitled to vote with respect to affiliated Chinese entities as the case may be, including matters relating to the transfer of any or all of their respective equity interests in our affiliated Chinese entities and the appointment of the directors and general manager of our affiliated Chinese entities. The term of each of the powers of attorney is 10 years. These powers of attorney do not extend to votes by the shareholders of our company or subsidiaries.

Because the purpose of the irrevocable powers of attorney is to allow us to exercise sufficient control over our affiliated Chinese entities, each such power by its terms is valid only for so long as the designated attorney-in-fact remains an employee of one of our subsidiaries. If the attorney-in-fact ceases to be an employee of any of our subsidiaries or if our subsidiaries otherwise issue a written notice to dismiss or replace the attorney-in-fact, the power of attorney will terminate automatically and be re-assigned to another employee.

Operating Agreements. We guarantee the performance by our affiliated Chinese entities of contracts, agreements or transactions with third parties. In return, our affiliated Chinese entities have granted us a security interest over all of their assets, including all of their accounts receivable. We also have the right of first refusal with respect to future loan guarantees. In addition, our affiliated Chinese entities and their shareholders have each agreed that they will not enter into any transaction, or fail to take any action, that would substantially affect their assets, rights and obligations, or business without our prior written consent. They will also appoint persons designated by us as the directors, officers and other senior management personnel of our affiliated Chinese entities, as well as accept our guidance regarding their day-to-day operations, financial management and the hiring and dismissal of their employees. While we have the right to terminate all our agreements with our affiliated Chinese entities if any of our agreements with them expires or is terminated, our affiliated Chinese entities may not terminate the operating agreements during the term of the agreements, which is 10 years.

Exclusive Consulting Services Agreements. We provide some of our affiliated Chinese entities with exclusive consulting services related to legal, finance, human resources and office administration. The term of these services agreements is renewable every year. We charged Weilan, Unilink, Yuan Hang, Cosmos, Lian Fei, Zhong Tong and Qimingxing an aggregate fee of $2.1 million for these services in 2006. The service fees payable to us are subject to our adjustment from time to time based on the actual operating results of our affiliated Chinese entities.

Trademark, Domain Name and Software License Agreements. In 2006, we granted Weilan and Unilink a license to use our domain name (*www.linktone.com*)

and our registered trademarks. Linktone Consulting has also granted Weilan and Unilink licenses to use certain of its domain names. The licensee of each of the licenses described above pays us an annual license fee of RMB10,000 ($1,254). Because of the insignificant amounts involved, we waived these fees in 2006. In addition, Huitong and Linktone Internet have granted Weilan, Unilink, Lian Fei, Zhong Tong and Qimingxing multiple licenses to use various mobile phone software such as software programs relating to our SMS, MMS, WAP, RB and IVR platforms, databases and games. We charged Weilan, Unilink, Lian Fei, Zhong Tong and Qimingxing an aggregate fee of $43.7 million for the use of this software in 2006.

The license agreements for trademark and domain names will terminate upon the earlier of 10 years or the expiration of our right to use the relevant domain names and trademarks. The term of the software license agreements is one to two years. Our affiliated Chinese entities cannot assign or transfer their rights under the licenses to any third party, and cannot use the licensed trademarks in television, newspapers, magazines, the Internet or other public media without our prior written consent.

Domain Name Transfer Arrangements. In order to meet local requirements, we transferred to Weilan our ownership right in our domain name (*www.linktone.com.cn*) in December 2006.

Contracts Relating to the Exclusive Purchase Right of Equity Interest. Under the Contracts Relating to the Exclusive Purchase Right of Equity Interest among us, each of our affiliated Chinese entities and their respective shareholders, we or our designee has an exclusive option to purchase from each such shareholder all or part of his or her equity interest in our affiliated Chinese entities at book value, to the extent permitted by Chinese law. The term of these agreements is 10 years, renewable by us for an additional 10-year term at our sole discretion.

Loan Agreements. We have extended interest-free loans to the shareholders of our affiliated Chinese entities for the purpose of investing in our affiliated Chinese entities as registered capital and to make payments to the selling shareholders from whom we acquired certain of our affiliated Chinese entities for settlement of purchase price consideration pursuant to applicable acquisition agreements. The term of these loans in each case is 10 years. The shareholders of our affiliated Chinese entities can only repay the loans by transferring to us or our designees all of their equity interest in the respective affiliated Chinese entity. The following table sets forth the date the loan agreement was entered into, the borrower, the affiliated Chinese entity, the interest, the maturity date and the amount of each loan, as of December 31, 2006.

Date of loan Agreement	Borrower	Affiliated Entity	Interest	Maturity date	Outstanding balance	
					(in thousands of RMB)	(in thousands of $)
November 27, 2003	Baoxin Yao	Weilan	None	November 26, 2013	2,798.7	338.1
November 27, 2003	Wenlei Wang	Weilan	None	November 26, 2013	2,365.8	285.8
August 25, 2004	Wenjun Hu	Unilink	None	August 24, 2014	5,000.0	604.1
August 25, 2004	Rong Zhang	Unilink	None	August 24, 2014	5,000.0	604.1
May 31, 2005	Yuming Cai	Yuan Hang	None	May 30, 2015	2,403.9	290.4
May 31, 2005	Xuan Fan	Yuan Hang	None	May 30, 2015	2,403.9	290.4
June 30, 2005	Teng Zhao	Cosmos	None	June 29, 2015	16,953.1	2,073.8
June 30, 2005	Rong Zhang	Cosmos	None	June 29, 2015	16,953.1	2,073.8
June 30, 2005	Jing Wang	Lian Fei	None	June 29, 2015	7,738.6	939.5
June 30, 2005	Rong Li	Lian Fei	None	June 29, 2015	8,928.8	1,083.3
June 30, 2005	Teng Zhao	Zhong Tong	None	June 29, 2015	6,850.6	826.9
June 30, 2005	Jinhua Yuan	Zhong Tong	None	June 29, 2015	6,850.6	826.9
August 31, 2005	Di Qian	Qimingxing	None	August 30, 2015	7,528.5	933.9
August 31, 2005	Lijin Shen	Qimingxing	None	August 30, 2015	7,528.5	933.9
August 15, 2006	Xinyong Ding	Beijing Ojava	None	August 14, 2016	4,000.0	501.7
August 15, 2006	Jun Xi	Beijing Ojava	None	August 14, 2016	4,000.0	501.7
Total					**107,304.1**	**13,108.3**

To the extent these loan agreements relate to loans made to the shareholders of our affiliated Chinese entities in order to make payments to former shareholders of certain of our affiliated Chinese entities, the loan amounts due under such loan agreements may be updated in the future to account for further purchase price considerations that may be payable pursuant applicable acquisition agreements.

Equity Interests Pledge Agreements. The shareholders of Weilan, Unilink, Yuan Hang, Cosmos, Zhong Tong, Lian Fei, Qimingxing and Beijing Ojava have pledged their respective equity interests in these entities to guarantee the performance and the payment of the service fees by these entities under the Exclusive Consulting Services Agreements and Software License Agreements described above. If our Chinese affiliated entities breach any of their obligations under the Equity Interests Pledge Agreements, we are entitled to sell the equity interests held by the relevant shareholders, and retain the proceeds of such sale or require any of them to transfer to us his or her equity interest in the applicable affiliated entity.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We evaluate our estimates on an on-going basis based on historical experience and on various other assumptions we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

Revenue and Cost of Services Recognition

Substantially all of our revenues are derived from telecom value-added services to mobile phone users through the platforms of various subsidiaries of the mobile operators. We recognize all revenues in the period in which the service is rendered, provided that persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Fees for these services are charged on a per message basis or on a monthly subscription basis, and vary according to the type of products and services delivered.

We contract with the mobile operators for the transmission of services as well as for billing and collection services. We measure our revenues based on the total amount paid by our customers, which the mobile operators bill and collect on our behalf. For the transmission, billing and collection services, the mobile operators retain a fixed percentage fee. To the extent that the number of SMS and MMS messages sent by us over the mobile operators' network exceeds the number of messages our customers send to us, we must also pay a per message network fee.

The mobile operators provide us statements after month-end indicating the amount of fees that were charged to users for telecom value-added services that we provided during that month and the portion of fees that are due to us in accordance with our contractual arrangements with the mobile operators. The mobile operators deliver these statements to us typically within 20 to 60 days following month-end, and we typically receive payment within 30 to 90 days following receipt of the statement. In addition, we have developed our own internal system that records the number of messages sent to and messages received from mobile users. Generally, there are differences between the

expected value of delivered messages and the fees charged by the mobile operators for the delivered messages. These differences may result from the users' mobile phones being turned off, problems with the mobile operators' networks or our system or other issues, which prevent delivery of our services to our users. These are known in the industry as billing and transmission failures. We do not recognize revenues for services which result in billing and transmission failures. The ratio of mobile operators' confirmed revenues generated from our services as a percentage of the expected value of delivered messages based on our own internal records was 103% for 2005 to 101% for 2006, as we became more experienced in our estimation methodology. Also, if a user does not pay the applicable fees for our services to the mobile operators, the mobile operators usually will not pay us for those services, and our expenses incurred in connection with such services are included in our cost of services.

We are also required to pay most of our content providers a percentage of the revenue received from or confirmed by the mobile operators with respect to services incorporating the content providers' products. In calculating the fees payable to these providers, we make estimates to take into account of adjustments made to delivered services by operators which may have been applicable to the services incorporating the providers' products and reduce the fees payable by us accordingly. Nonetheless, as estimates involve making assumptions which may prove inaccurate, we have in the past paid, and may continue to pay, such providers fees which are disproportionate to what we have been paid for the relevant service. After we make payments to these providers for a particular period, we may ask for refunds or make an additional payment, or make further adjustments or reconciliations with respect to fees payable for future periods as a result of billing and transmission failures arising in prior periods.

For content providers which are paid on a fixed fee basis, we do not incur additional charges as their content is used. Accordingly, billing and transmission failures do not affect our cost of services for services incorporating content from these providers. For 2006, most of our key content providers were paid an initial fee and the revenue share to be paid was first offset against the initial fee until the initial fee was fully utilized and then payment was made based on the revenue share amount agreed with content providers.

We record our revenues in the period in which the services are performed.

Approximately 98% and 99.5% of our revenues for the years ended December 31, 2005 and 2006, respectively, were confirmed by monthly statements received by us from provincial mobile operators prior to the finalization of the financial statements for such years.

Our gross revenues include the gross amounts billed to customers, rather than the amounts billed net of the mobile operators' service and other fees. According to Emerging Issue Task Force Issue No. 99-19, recognizing revenue on a gross basis in this manner is appropriate

if we act as a principal, rather than as an agent, in connection with the provision of our services. Factors which support a conclusion that we are acting as a principal include:

- our ability to adjust the cost of services by adjusting the design or marketing of the service,
- our ability to determine prices within ranges prescribed by the operators,
- our assumption of risk of non-payment by customers, and
- our ability to control content of services and suppliers of that content.

In our case, we have some ability to adjust the ratio of our revenues to cost of services (which include the operators' service and other fees) by, for example, changing the design and marketing of our services to decrease the number of messages that we send which go unmatched by users' replies and thus incur network fee. In addition, although the prices of our services must be approved by the mobile operators in advance, we have been able to adjust our prices from time to time to reflect or react to changes in the market. In addition, the mobile operators will not usually pay us if users of our services do not pay them and will not pay us if users do not receive the services due to billing and transmission failures. As a result, we in fact bear the credit and delivery risk for our portion of the revenues generated with respect to our services. Finally, we have discretion to select the content for our services and the providers of that content, provided that it does not violate applicable Chinese law or the policies of the mobile operators. Based on these factors, we have concluded that recognizing revenues on a gross basis is appropriate.

Share-based Compensation

Effective January 1, 2006, the Group adopted the provisions of SFAS 123R, Share-Based Payment for share-based employee compensation arrangements. The statement requires the measurement of the cost of employee services received in exchange for an award of equity instruments (such as employee stock options) at the fair value on the grant date. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (the requisite service period). The Group calculates the fair value of each option grant on the date of grant using the Black-Scholes option pricing model. The Group recognizes the compensation costs, net of a forfeiture rate, on a straight-line basis over the requisite service period of the award.

The determination of fair value of awards on the grant date using an option pricing model requires a number of complex and subjective assumptions, including our expected share price volatility over the term of the awards, the expected exercise behavior of our staff, and the expected dividend yield. We estimate our share price volatility based on a six year period of historical data of similar entities in the industry. In the absence of sufficient historical data in the exercise behavior of our staff, we estimate for the short term using the shortcut

method which applies the mid point of the life of the option and average vesting period.

In addition, we are required to estimate forfeitures at the time of grant and record share-based compensation expense only for those awards that are expected to vest. If actual forfeitures differ from those estimates, we may need to revise those estimates used in subsequent periods.

The assumptions and estimates used in calculating share-based compensation expense involve inherent uncertainties and the use of management judgment. Although we believe the assumptions and estimates we have made are reasonable and appropriate, changes in factors and assumptions could materially affect our results.

Goodwill

We performed our goodwill impairment test in December 2006. Based on our forecasted discounted cash flows, we concluded there was no impairment of the carrying value of the goodwill as of December 31, 2006. The process of evaluating the potential impairment of goodwill is highly subjective and requires the use of significant judgment. We determine the fair value of each reporting unit by discounting to present value the expected future cash flows of each reporting unit. We then compare the carrying value to the fair value of each reporting unit. If the carrying amount of the reporting unit is greater than its fair value, we recognize an impairment loss based on the excess of the carrying amount over the fair value. Estimates of future cash flows and the use of the appropriate discount rate are critical to these assessments. Our future results could be adversely affected by an impairment charge if the expected net cash flow for these reporting units does not materialize or there are significant changes to the discount rates.

Impairment of long-lived assets and intangible assets

Long-lived assets and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of asset may not be recoverable. We assess the recoverability of the long-lived assets and intangible assets by comparing the carrying amount to the estimated future undiscounted cash flow associated with the related assets. We recognize impairment of long-lived assets and intangible assets in the event that the net book value of such assets exceeds the estimated future undiscounted cash flow attributable to such assets. Changes in these estimates and assumptions could materially impact our financial position and results of operations.

Loan Receivable Valuation

In connection with our strategic investment in 9Sky International Ltd, Shanghai Yue Sheng Information Technology Co., Ltd. and Shanghai Yin Zhi Yue Information Technology Co., Ltd. (collectively known as “9Sky entities”), we had an outstanding loan in the principal amount of $0.8 million to these entities as of December 31, 2006. This loan was to be repaid by the

9Sky entities in installments beginning in March 2007. In July 2007, we reached an agreement with one of the 9Sky founders to obtain a pledge of 1.1 million of his ordinary shares of 9Sky International Ltd. against the outstanding amount due under the loan after one year of $672,014 and accumulated interest. We have agreed that 9Sky International Ltd. shall repay the outstanding amounts due under the loan by April 30, 2008. We also have the right to exercise our rights under the share pledge by the 9Sky founder in the event 9Sky International Ltd. fails to repay the outstanding amounts under the loan by April 30, 2008 and to require the 9Sky founder to repurchase the shares from us for cash, at a value of $1 per share, beginning in November 2008 in the event 9Sky International Ltd. fails to repay the outstanding amounts under the loan by such date.

Based on the assessment of the financial position and business prospects of the 9Sky entities, including the recent financing of 9Sky International Ltd, our management believes that the outstanding loan due from 9Sky was not impaired and no provision was necessary at December 31, 2006. However, if the 9Sky entities fail to make repayments and are not able to achieve the results and maintain the financial position as expected, or if the 9Sky founder fails to buy back the shares, our future results could be adversely affected by a loan impairment charge.

Income Taxes

Our provisions for income taxes, deferred tax assets and liabilities, and the extent to which deferred tax assets can be recognized, require significant management judgment. We make our judgments, assumptions and estimates by taking into account of current PRC tax laws and our interpretation of current PRC tax laws. Changes in tax laws or our interpretation of tax laws could significantly impact our provisions for income taxes.

We make a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized based on our estimate of future taxable income and prudent and feasible tax planning strategies. Actual taxable income in future years may differ from our current estimates and cause our valuation allowance to be inaccurate and thus materially impact our financial position and operating results.

Revenues

As described in “Critical Accounting Policies - Revenue and Cost of Services Recognition,” we generate revenues primarily from service fees paid by mobile phone users who use our services through the mobile operators. Our telecom value-added services fees are charged on a monthly subscription or per use basis. Fees for our 2G SMS-based services currently range from RMB0.1 ($0.01) to RMB2.0 ($0.25) per message and from RMB2.0 ($0.25) to RMB15.0 ($1.88) per month for subscription services. Fees for 2.5G MMS, WAP and Java services currently range from RMB1.0 ($0.12) to RMB10.0 ($1.25) per message and from RMB5.0 ($0.63) to RMB30.0 ($3.76) per month for

subscription services. Fees for audio-related services range from RMB0.5 ($0.06) to RMB3.0 ($0.38) per audio content download. For 2006, our 2G, audio-related and 2.5G services represented 55.9%, 26.9% and 14.7%, respectively, of our gross revenues.

We also generate revenues by offering services through the fixed line networks of China Telecom and China Netcom. This revenue was nominal in 2004 but represented 4.3% and 13.4% of our total gross revenues for 2005 and 2006, respectively.

We through our affiliated Chinese entity, Ling Yu, acts as the exclusive advertising agent for QTV. We earned $0.3 million in revenues from selling advertising time slots on QTV in 2006. This revenue was not a significant part of our total gross revenues for 2006.

Cost of Services

Our cost of services includes the following:

- Service and network fees payable by us to the mobile operators,
- Payments to certain content and marketing providers for the use of their content, and
- Television program production costs.

Service and network fees are deemed paid when the mobile operators remit to us our portion of the fees paid by users net of the service and network fees described above.

We pay our content and marketing providers directly, and those payments are generally in the form of a fixed periodic fee, or a percentage of our aggregate net revenue received from or confirmed by the mobile operators with respect to services provided that incorporate the providers' products, or a combination of fixed and variable amounts.

The following table sets forth the amount of each category of cost of services for the periods indicated:

	Year ended December 31,		
	2004 (audited)	2005 (audited)	2006 (audited)
Cost of services:			
Operators' fees	$13,639,288	$18,963,832	$20,354,204
Payments to content and marketing providers	1,666,128	7,507,174	7,763,248
Program production and others	–	12,688	865,375
Total	**$15,305,416**	**$26,483,694**	**$28,982,827**

Operating Expenses

Our operating expenses include product development, selling and marketing and other general and administrative expenses.

Product Development Expenses

Our product development expenses consist primarily of the salary and welfare expenses of our technical support team, which is responsible for our LT-IAG technology platform and other technical support, and our product development team, which focuses on

aggregating, customizing and localizing our services. This category of expenses also includes depreciation and amortization of computers and software related to the activities of those teams.

Our SMS-based content and applications have been principally developed in-house. In 2003, we began allocating product development resources to next generation MMS, WAP and Java services, as well as audio-related services. We develop slightly more than half of our MMS, WAP, Java and audio-related services content in-house with the remainder aggregated from third parties. For the year ended December 31, 2006, approximately 31%, 31%, 11%, 19% and 8% of our product development expenditures were related to our 2G services, 2.5G services, audio-related services, general office information technology support and new businesses, respectively. We expect that the portion of our product development expenditures devoted to 2.5G and audio-related services will increase moderately in the future.

Although the monthly statements we receive from the mobile operators do not include breakdowns of gross revenues by service and not all of the affiliates of the mobile operators provide daily reports on services sent and received, we utilize a number of resources to plan and refine our product development activities. For example, our internal records of the services we transmit to the mobile operators for delivery to the ultimate user provide us with extensive information about the popularity of our services, such as gross usage and the number of repeat users. However, we can only estimate the revenue those services generate due to the mobile operators' unitemized monthly statements. Nevertheless, our focus on maintaining, expanding and strengthening close relationships with the operators helps to keep us informed on upcoming marketing and product initiatives by the mobile operators and rollouts of new mobile technology standards, which enable us to tailor our product development efforts to address these trends.

We depreciate our computer hardware and office equipment on a straight-line basis over their estimated useful lives as follows:

Computer hardware/equipment	36-60 months
Office equipment	12-36 months

Selling and Marketing Expenses

Our selling and marketing expenses consist primarily of the direct costs attributable to our sales and marketing activities, such as travel, entertainment, advertising expenses and cost of promotions. It also includes the salary and welfare expenses of the staff in our sales, marketing, customer research and service departments.

Other General and Administrative Expenses

Our other general and administrative expenses consist primarily of the salary and welfare expenses of our business development department and other administrative functions, such as legal, human

resources, finance, office administration and senior management. Other general and administrative expenses also include fees for professional services (e.g., audit, tax, legal and recruitment), office rentals, severance payments made to senior management in connection with our restructuring plan in the February 2006, bandwidth leasing and server custody fees charged by the mobile operators and the amortization of leasehold improvements. Leasehold improvements are amortized on a straight-line basis over the lesser of the relevant lease term or the assets' estimated useful lives.

Taxation

Under the current laws of the Cayman Islands and British Virgin Islands, we are not subject to a tax on income or capital gain. However, our revenues are primarily derived from our affiliated Chinese entities. Chinese companies are generally subject to Enterprise Income Tax (EIT) comprising a national income tax and local tax. Linktone Consulting and Weilan are subject to a 30% national income tax and a 3% local tax. Huitong and Linktone Internet qualify as "foreign investment production enterprises established in a coastal economic development zone in an old urban district" under applicable tax rules, and accordingly are subject to a 24.0% national income tax and a 3.0% local tax in China. Additionally, Huitong and Linktone Internet are entitled to an exemption from the national income and local tax for the first two years after cumulative profitability and a 50.0% reduction for the subsequent three years. In 2006, Huitong was designated as one of the top China National Software enterprises and the preferential national income tax rate was 10%. Our affiliated Chinese entities Unilink and Qimingxing are currently considered "small businesses" under applicable tax rules, and are subject to a 2.4% tax on revenue and 4.8% tax on the difference between revenue and cost of services, rather than on income. Because Zhong Tong, Wang You, Linktone Software and Ling Yu are located in economic development zones in coastal cities, they are subject to a preferential national income tax rate of 15%, and are permanently exempt from local tax. Yuan Hang, Cosmos, Lian Fei and Beijing Ojava qualify as "high technology" enterprises, and are therefore entitled to: (i) with respect to Cosmos, Lian Fei and Beijing Ojava, a three year national and local tax exemption followed by three years of 50% reduction in national and full exemption in local income tax rates, commencing from the first year of operations and (ii) with respect to Shenzhen Yuan Hang, a two year national and local tax exemption followed by three years of 50% reduction in national and full exemption in local income tax rates, commencing from the first year of profitability.

If our income is generated from a permanent establishment in China, the income of such permanent establishment would be subject to a 30.0% national income tax and 3.0% local income tax. Income of our company that is not connected to a permanent establishment in China would be subject to a 10.0% withholding tax on gross receipts from profit, interest, rentals, royalties and other income earned in China.

Since Linktone Consulting, Huitong, Linktone Internet, Linktone Software, Wang You and Ruida are our wholly-owned subsidiaries and are considered permanent establishments in China for tax purposes, the income generated by these entities is subject to EIT, and the dividends distributed from these entities to our company is exempt from Chinese withholding tax.

Payments for software license fees and related technical consulting services provided by Huitong and Linktone Internet to some of our Chinese affiliated companies are subject to a 17.0% value-added tax, or VAT. Under applicable tax regulations, Huitong and Linktone Internet are entitled to a tax refund equivalent to the portion of VAT expense that is in excess of 3.0%. This VAT expense is shown in our "Consolidated Statements of Operations" as a reduction in our revenue. For the year ended December 31, 2006, Huitong and Linktone Internet paid a total $7.6 million in VAT and received a $6.2 million tax refund. As of December 31, 2006, Huitong and Linktone Internet accrued VAT refund receivable and payable of $0.8 million and $1.0 million, respectively.

We are subject to a business tax on our revenues derived from services in China, which is generally 3% to 9% of the revenue. Business tax applies to the gross revenues recognized by our Chinese affiliated entities and to the service fees charged to those entities by Linktone Consulting. The related business taxes paid for the services provided to customers and consulting services are accrued for as a reduction of revenues and in operating expenses respectively.

Subject to the approval of the relevant tax authorities, Linktone Group had total tax loss carryforwards of approximately $2.0 million as of December 31, 2006 for EIT purposes. Approximately $1.4 million, $0.3 million and $0.3 million of such losses will expire in 2008, 2009 and 2011, respectively. These tax loss carryforwards give rise to potential deferred tax assets totaling $0.6 million. For more information regarding our tax loss carryforwards and deferred tax assets, see "Critical Accounting Policies and Estimates - Deferred Tax Valuation Allowance" above.

Capital Expenditures

Our capital expenditures for 2004, 2005 and 2006 were approximately $2.4 million, $2.0 million and $1.2 million respectively, consisting of the purchase of computer and office equipment and leasehold improvements. Substantially all of our capital expenditures for 2006 were incurred in connection with the expansion of our business. We anticipate that we will have capital expenditures in the next 12 months of approximately $1.5 million for software and technology infrastructure products which we expect to finance with internal funds.

Results of Operations

The following table sets forth a summary of our audited consolidated statements of operations for the periods indicated and as a percentage of gross revenues. Our historical operating results are not necessarily indicative of the results for any future period.

	Year ended December 31,					
	2004 (audited)	%	2005 (audited)	%	2006 (audited)	%
Gross revenues	$50,318,744	100.0%	$73,608,603	100.0%	$79,841,694	100.0%
Net revenues	48,083,700	95.6%	70,487,256	95.8%	76,536,150	95.9%
Cost of services	(15,305,416)	(30.4)%	(26,483,694)	(36.0)%	(28,982,827)	(36.3)%
Gross profit	32,778,284	65.2%	44,003,562	59.8%	47,553,323	59.6%
Operating expenses:						
Product development	(2,807,720)	(5.6)%	(6,229,976)	(8.5)%	(7,372,074)	(9.2)%
Selling and marketing	(8,794,568)	(17.5)%	(14,719,763)	(20.0)%	(22,728,906)	(28.5)%
Other general and administrative	(10,274,754)	(20.4)%	(11,786,995)	(16.0)%	(11,789,984)	(14.8)%
Total operating expenses	(21,877,042)	(43.5)%	(32,736,734)	(44.5)%	(41,890,964)	(52.5)%
Income from operations	10,901,242	21.7%	11,266,828	15.3%	5,662,359	7.1%
Interest income	815,447	1.6%	1,965,801	2.7%	1,589,180	2.0%
Other income	346,652	0.7%	720,763	0.9%	862,830	1.1%
Income tax expense	(997,307)	(2.0)%	(1,504,329)	(2.0)%	(1,267,183)	(1.6)%
Minority interest	–	–	–	–	(54,595)	(0.1)%
Income after tax	$11,066,034	22.0%	$12,449,063	16.9%	$6,792,591	8.5%

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Gross Revenues

Gross revenues increased by 8.4% to $79.8 million in 2006 from $73.6 million in 2005, primarily as a result of increases in the number of paying users, particularly for our audio-related services and certain of our 2.5G services. Our audio-related revenues increased by 26.5% to $21.5 million in 2006 from $17.0 million in 2005. The increase was primarily due to our ongoing efforts to attract new users through enhanced

promotions, especially print and broadcast media channels. Our 2.5G revenues, particularly our WAP services and Java games, increased by 41.0% to $11.7 million for the year ended December 31, 2006 from $8.3 million in 2005. The acquisition of the Ojava Group in early 2006 contributed to the significant growth in our Java games business. Our MMS revenue decreased by 19.2% in 2006 from $6.5 million in 2005 to $5.2 million in 2006, primarily due to a decrease in the number of monthly subscriptions as a result of policy changes implemented by China's mobile operators. In 2006, our gross revenues also included a new revenue stream from advertising of $0.3 million as a result of the arrangement of Ling Yu with QTV. Growth in sales of our audio-related and 2.5G services contributed to 72.6% and 22.7% respectively, of our total increase in gross revenue for 2006. In 2006, RB and IVR services accounted for 14.3% and 28.4%, respectively, of our gross revenues. In 2006, MMS, WAP and Java services accounted for 10.4%, 7.4% and 5.5%, respectively, of our gross revenues.

These increases above were partially offset by decreases in our 2G revenues, which decreased by 4.5% to $44.6 million in 2006 from $46.7 million in 2005. The decrease in our 2G revenues was primarily due to a decrease in the number of monthly subscriptions as a result of changes in the mobile operators' policies in 2006. See "Overview" above.

Revenues related to services offered to China Netcom & China Telecom, China Unicom, and China Mobile customers represented 13.4%, 8.9% and 75.7% of total revenues, respectively, compared to 4.3%, 9.4% and 84.7%, respectively in 2005, reflecting a more diversified revenue stream.

Cost of Services

Cost of services increased by 9.4% to $29.0 million in 2006 from $26.5 million in 2005. The increase was primarily due to increases in service fees paid to the mobile operators. The increase in service fees was mainly due to a change in our product mix following the increase in our revenue from audio-related services which pay a higher percentage of service fees to the mobile operators in comparison to other services. Other costs in 2006 mainly related to costs in connection with advertising services and costs for a joint marketing project. In 2006, our total service and network fees paid to the mobile operators were $20.4 million, representing 70.3% of our total cost of services, fees paid to content and marketing partners were $7.8 million, representing 26.9% of our total cost of services, and other costs were $0.8 million, representing 2.8% of our total cost of services, compared to $19.0 million, representing 71.7% of our total cost of services, $7.5 million, representing 28.3% of our total cost of services, and $0.01 million, representing 1% of our total cost of services, respectively for 2005.

Operating Expenses

Our operating expenses increased to $41.9 million in 2006 from $32.7 million in 2005. Operating expenses as a percentage of gross revenues increased to 52.5% in 2006 from 44.4% in 2005. The increase was mainly

due to higher marketing spending during a competitive and challenging regulatory environment in order to maintain our market share and leadership position in the sector in 2006.

Product development expenses increased by 19.4% to $7.4 million in 2006 from $6.2 million in 2005, primarily due to costs in connection with our reorganization plan carried out from February to April 2006. Under the reorganization plan, we discontinued our development of casual games which resulted in certain charges arising from termination of some game content agreements. This increase in product development expenses was partially offset by a cost reduction effort resulting in our product development and technology support teams decreasing from 312 and 148 employees, respectively, as of December 31, 2005, to 217 and 110 employees, respectively, as of December 31, 2006. Staff costs for product development decreased to $3.9 million, or 9.3% of our total operating expenses, in 2006 from $4.4 million, or 13.5% of our total operating expenses, in 2005.

Selling and marketing expenses increased by 54.4% to $22.7 million in 2006 from $14.7 million in 2005, primarily due to increased investment in advertising and sales activities in online and offline (traditional) media. Advertising and promotion activities increased to $15.1 million, or 36.0% of our total operating expenses, in 2006 from $8.6 million, or 26.3% of our total operating expenses, in 2005. This increase was offset in part by the fact that staff costs decreased to $2.7 million, or 6.4% of our total operating expenses, in 2006 from $2.9 million, or 8.9% of our total operating expenses, in 2005 as a result of the reduction in the number of selling and marketing employees from 280 in 2005 to 182 employees in 2006. In 2005 and 2006, approximately 50%, 17% and 33% and 45%, 7% and 48%, respectively, of such expenses were incurred to promote our 2G, 2.5G and audio-related services, respectively.

Other general and administrative expenses remained stable at $11.8 million in 2006 and 2005, due to our ongoing effort to control costs.

Interest and other income

Interest income totaled $1.6 million and $2.0 million in 2006 and 2005, respectively. The decrease was mainly due to lower balance of cash, cash equivalents and short term investments.

Other income totaled $ 0.9 million and $0.7 million in 2006 and 2005, respectively. Other income mainly comprises investment income and subsidy income from local governments based on business and income taxes paid by us. The increase was mainly due to higher subsidy income received in 2006 from higher taxes paid during 2005 as subsidy income is derived from taxes paid in the preceding year.

Income tax expense

Income tax expense was $1.3 million and $1.5 million in 2006 and 2005, respectively. The effective tax rate increased from 11% in 2005 to 16% in 2006. The increase was primarily due to increase in valuation allowance for the deferred tax assets from net operating

losses. We expect our effective tax rate to continue to increase in the future, as we experience further expiration of tax holidays.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Gross Revenues

Gross revenues increased by 46.3% to $73.6 million for the year ended December 31, 2005 from $50.3 million in 2004, primarily as a result of increases in the number of paying users, particularly for our audio-related services, as well as growth in our average revenue per user in our SMS and 2.5G services in 2005. We estimate that our user base expanded to an average of 7.7 million users per month during 2005, reaching a peak of an average of 10.0 million users in August 2005, compared with our estimate of an average of 6.8 million users per month during 2004. This increase was primarily due to our ongoing efforts to attract new users from a broader geographic base as well as gaining customers from our competitors through increased marketing channels, especially print and broadcast media channels, and an expanded sales network. Our user base also increased as a result of the overall growth of the wireless (and, to a lesser extent, fixed line) value-added services market in China, particularly for audio-related and 2.5G services.

In addition, we estimate that our average revenue per user increased to $1.00 per month during 2005, compared to $0.61 per month during 2004. This increase was primarily due to our enhanced product portfolio for all categories of our services. Growth in sales of our audio-related, 2G and 2.5G services contributed to 57.1%, 28.0% and 7.9%, respectively, of our total increase in gross revenues for 2005 compared to 2004. In 2005, RB and IVR services accounted for 11.0% and 12.0%, respectively, of our gross revenues. In 2005, MMS and WAP services accounted for 8.8% and 2.0%, respectively, of our gross revenues.

Our gross revenues for 2005 were negatively affected, however, by various sanctions imposed by China Mobile in 2005. For example, due to previously announced sanctions from China Mobile in December 2004 for violating certain of its customer service policies, we were not able to bill WAP users from January 1, 2005 until October 10, 2005. In addition, China Mobile suspended approval of any new product applications by us for its wireless platforms, including SMS, MMS, WAP, Java™, IVR and RB, between January 1, 2005 and June 30, 2005. These sanctions did not affect our ability to offer our existing telecom value-added services through China Mobile's networks. We are also subject on occasion to monetary fines and forfeited income for inadvertent contravention of customer service policies. The monetary fines are recognized as selling and marketing expenses. For 2005, the amount of fines was negligible, compared to $0.7 million for 2004.

Cost of Services

Our cost of services increased by 73.2% to $26.5 million in 2005 from $15.3 million in 2004, primarily due to the overall growth of our business resulting in increased

service and network fees being paid by us to the mobile operators. Cost of services also increased in part due to increased revenue share payments to our content providers and co-marketing partners, reflecting a greater percentage of revenues derived from third party content. In 2005, our total service and network fees paid to the operators were $19.0 million, representing 71.7% of our total cost of services, and fees paid to content and marketing partners were $7.5 million, representing 28.3% of our total cost of services, compared to $13.6 million, representing 88.9% of our total cost of services, and $1.7 million, representing 11.1% of our total cost of services, respectively, for the same period in 2004.

Operating Expenses

Our operating expenses increased to $32.7 million in 2005 from $21.9 million in 2004. Operating expenses as a percentage of gross revenues increased to 44.5% in 2005 from 43.5% in 2004. The increase was mainly due to the fact that the rate of growth in our operating expenses, in particular, our selling and marketing and product development expenses, outpaced the rate of growth of our revenue. Depreciation and amortization expenses for computers and equipment in relation to our total operating expenses were not material for 2005 and 2004.

Product development expenses increased by 121.4% to $6.2 million in 2005 from $2.8 million in 2004, primarily due to an increase in staff costs as a result of additional hiring to expand our product development and technology support teams, which increased from 123 and 122 employees, respectively, as of December 31, 2004 to 312 and 148 employees, respectively, as of December 31, 2005. Staff costs for product development increased to $4.4 million, or 13.5% of our total operating expenses, in 2005 from $2.4 million, or 11.0% of our total operating expenses, in 2004.

Selling and marketing expenses increased by 67.0% to $14.7 million in 2005 from $8.8 million in 2004, primarily due to increased investment in advertising and sales activities in online and offline media, as well as an increase in the number of sales and marketing employees from 227 as of December 31, 2004 to 280 as of December 31, 2005. Advertising and sales activities increased to $8.6 million, or 26.3% of our total operating expenses, in 2005 from $4.3 million, or 19.6% of our total operating expenses, in 2004. Staff costs increased to $2.9 million, or 8.9% of our total operating expenses, in 2005 from $1.9 million, or 8.7% of our total operating expenses, in 2004. In 2004 and 2005, approximately 55%, 44% and 1% and 50%, 17% and 33%, respectively, of such expenses were incurred to promote our 2G, 2.5G and audio-related services, respectively.

Other general and administrative expenses increased by 15.7% to $11.8 million in 2005 from $10.2 million in 2004, primarily due to an increase in staff costs as a result of additional hiring of staff from 46 to 85 employees, as well as an increase in professional service fees such as for legal, audit and recruitment. The majority of new hires were in our legal, finance and human resources departments. These staff costs

increased to $2.9 million, or 8.9% of our total operating expenses, in 2005 from $2.1 million, or 9.6% of our total operating expenses, in 2004.

In 2004 and 2005, we recorded stock-based compensation charges as a separate cost item in the statement of operations. Effective from the second quarter of 2006, such charges were reclassified in the same line items as cash compensation paid to the same employees, according to the guidance provided under SAB 107. As stock based compensation charges in 2004 and 2005 relate to staff under other general and administrative expenses, these charges were reclassified to other general and administrative expenses.

Interest and other income

Interest income totaled $2.0 million and $0.8 million in 2005 and 2004, respectively. The increase was primarily due to an increase in the balance of short term investments which generates higher interest income.

Other income totaled $ 0.7 million and $0.3 million in 2005 and 2004, respectively. Other income mainly comprises investment income and subsidy income from local governments based on business and income taxes paid by us. The increase was mainly due to higher subsidy income received in 2005 from higher taxes paid during 2004 as subsidy income is derived from taxes paid in the preceding year.

Income tax expense

Income tax expense was $1.5 million and $1.0 million in 2005 and 2004, respectively. The effective tax rate increased from 8% in 2004 to 11% in 2005. The income was primarily due to increase in valuation allowance for the deferred tax assets from net operating losses and the expiration of tax holiday of one of the most profitable subsidiaries. We expect our effective tax rate to continue to increase in the future, as we experience further expiration of tax holidays.

Liquidity and Capital Resources

Our primary sources of liquidity are the proceeds from our initial public offering in March 2004 and cash flow from operations. The following table sets forth the summary of our cash flows for the periods indicated:

	For the year ended December 31,		
	2004 (audited)	2005 (audited)	2006 (audited)
Net cash provided by operating activities	$9,654,127	$9,561,944	$14,123,332
Net cash (used in)/provided by investing activities	(17,266,029)	(34,440,154)	20,819,864
Net cash (used in)/provided by financing activities	65,412,374	(2,832,327)	(20,670,822)
Foreign currency translation adjustment	264	549,586	920,034
Net increase in cash and cash equivalents	57,800,736	(27,160,951)	15,192,408
Cash and cash equivalents, beginning of year	5,612,893	63,413,629	36,252,678
Cash and cash equivalents, end of year	$63,413,629	$36,252,678	$51,445,086

The ability of our subsidiaries to obtain cash or other assets from our affiliated Chinese entities, Weilan, Unilink, Yuan Hang, Cosmos, Zhong Tong, Lian Fei, Qimingxing and Beijing Ojava and Ling Yu depends on the effectiveness and enforceability of our agreements with those entities and their owners. A description of these agreements is set forth under "Arrangements with Consolidated Affiliates" above. In turn, the ability of our subsidiaries to convert Renminbi into U.S. dollars and transfer them to our company is subject to the Chinese foreign exchange regulations, including primarily the restriction on foreign invested enterprises that they may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents.

Pursuant to various software license and service agreements, our subsidiaries charged our Chinese affiliated entities an aggregate fee of $45.8 million for the year ended December 31, 2006. After these charges, as of December 31, 2006, approximately $6.0 million, $0.5 million, $1.6 million, $0.3 million, $0.3 million, $0.2 million, $0.4 million, $0.1 million of profits (determined based on invoiced revenue) remained in Weilan, Unilink, Yuan Hang, Cosmos, Zhong Tong, Lian Fei, Qimingxing and Beijing Ojava, respectively. Of the profit remaining in Weilan, Unilink and Yuan Hang, $7.0 million related to 2004 and prior years, $1.1 million related to 2005 and $1.3 million related to 2006. For tax planning reasons and because we usually charge our affiliated Chinese entities fees for the current year

only, we do not anticipate transferring such cumulative retained profits relating to earlier years to our subsidiaries via service charges in the future. In addition, because Weilan, Unilink and Yuan Hang are only affiliated entities of us rather than subsidiaries, such profits cannot be transferred to us in the form of cash dividends. However, our subsidiaries normally have access to the cash or other assets retained in Weilan, Unilink, Yuan Hang, Cosmos, Zhong Tong, Lian Fei, Qimingxing, Beijing Ojava and Ling Yu via inter-company advances.

Operating Activities

Cash provided by operating activities was $9.7 million, $9.6 million and $14.1 million for 2004, 2005 and 2006, respectively. For 2004, 2005 and 2006, cash provided by operating activities consisted primarily of our operating profit.

Investing Activities

Net cash used in investing activities in 2004 and 2005 was approximately $17.3 million and $34.4 million, respectively. In 2004, cash expenditures consisted primarily of the purchase of short term investments and fixed assets, including computers and office equipment and leasehold improvements, in connection with the expansion of our business. In 2005, cash expenditures included the acquisitions of Brilliant, Cosmos, Zhong Tong, Lian Fei and Qimingxing, our strategic investment in 9Sky, and the purchase of short term investments and fixed assets such as computers and office equipment and leasehold improvements. Net Cash provided by investing activities in 2006 was $20.8 million which consisted primarily of proceeds from sales of short-term investments. Such proceeds were offset in part by the purchase of fixed assets and amounts invested to acquire Ojava Overseas and make final earn-out payments in connection with the acquisitions of Brilliant and Cosmos.

We had no material commitments for capital expenditures as of December 31, 2004, 2005 and 2006. During 2004, 2005 and 2006, we spent approximately $2.4 million, $2.0 million and $1.2 million, respectively, for renovations of our new corporate offices and for the purchase of computer and office equipment.

Financing Activities

Cash used in financing activities was $2.8 million and $20.7 million for 2005 and 2006, respectively, which consisted primarily of funds used to finance our ADS repurchase program. Cash provided by financing activities was $65.4 million for 2004, which consisted of the net proceeds from our initial public offering and from the exercise of stock options.

We have no written treasury or borrowing policy. We keep almost all of our cash in U.S. dollar or RMB denominated bank accounts, short-term time deposits or short-term, investment grade fixed income securities for two principal purposes: to finance our operations and to manage the interest rate and currency risks arising from our operations. We adjust the amount of cash held in U.S. dollars and RMB from time to time to maximize our interest rate returns and to ensure that

we have sufficient RMB for our operational needs, including for lease and other commitments. We have not historically financed our operations through borrowings and have not used derivative instruments to hedge market risks.

We believe that current cash and cash equivalents will be sufficient to meet anticipated working capital (net cash used in operating activities) commitments and capital expenditures, including those committed for under the contracts with CYL and others, for the foreseeable future. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these sources are insufficient to satisfy cash requirements, we may seek to sell additional equity or debt securities or to obtain a credit facility. The sale of additional equity or convertible debt securities could result in additional dilution to shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financial covenants that would restrict operations. Financing may not be available in amounts or on terms acceptable to us, if at all.

Research and Development

We believe that a key part of our future success will depend on our ability to develop and enhance our services by leveraging our expertise in entertainment-oriented wireless value-added and cross media services. Our product development activities are led by our 217-member product development department based in Shanghai, Beijing and Shenzhen, of which approximately 153 work on new services such as MMS, WAP and Java games and the remainder focus on SMS-based services, audio-related services and casual gaming. Our total expenditures for research and development were $2.8 million, $6.2 million and $7.4 million for the years ended December 31, 2004, 2005 and 2006.

We develop the content for our services in-house, aggregate it from domestic and international providers or through acquisitions. We plan to enter into additional relationships with domestic and international providers, in particular with respect to the development of games, music and content for all of our 2.5G services, in order to fully utilize the technological benefits of 2.5G and the sophisticated premium content which users will demand. For aggregated third party content, most of our efforts involve customization, localization and related development activities of the content for the Chinese market to create appealing, user-friendly products.

Our services development team in Shanghai and Beijing focuses on MMS and WAP products, as well as Java games. We currently develop or aggregate from third parties, a variety of action and adventure Java games. For this purpose, we have a game development team which is highly experienced working in the Java programming language to customize and localize games for the Chinese market. The team capabilities were further enhanced with the acquisition of Beijing Ojava.

Certain provincial and local offices of the mobile operators use different software and technology, and our product development department must conform our services so that they are interoperable with China Mobile's, China Unicom's, China Telecom's and China Netcom's networks at all levels.

Intellectual Property and Proprietary Rights

We rely primarily on a combination of copyright laws and contractual restrictions to establish and protect our intellectual property rights. We require our employees to enter into agreements to keep confidential all information relating to our customers, methods, business and trade secrets during and after their employment with us. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes, whether or not patentable or copyrightable, made by them during their employment are our property. They also sign agreements to substantiate our sole and exclusive right to those works and to transfer any ownership that they may claim in those works to us.

While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. This is particularly the case in China where the laws may not protect our proprietary rights as fully as in the United States. Infringement or misappropriation of our intellectual property could materially harm our business. We have registered 116 Internet and WAP domain names in English and Chinese, of which our primary domain names are listed below.

- *www.linktone.com,*
- *www.linktone.com.cn,*
- *www.linktone.sh.cn,*
- *www.lt2000.com.cn,*
- *www.lt2000.net,*
- *www.ul9000.com,*
- *www.ul9000.com.cn,*
- *www.ul9000.cn,*
- *www.soring.cn,*
- *www.i-liao.com,*
- *wap.linktone.com,*
- *wap.linktone.com.cn,*
- *www.i-liao.com,*
- *wap.linktone.com,*
- *wap.linktone.com.cn,*
- *www.my1828.com,*
- *www.smschina.com,*
- *www.8228.com,*
- *www.yhgame.com,*
- *www.vrhappy.com,*
- *www.qchannel.cn,*

- *www.channelq.cn, and*
- *www.youthtv.cn.*

We have registered 104 trademarks with China's Trademark Office and one trademark in each of Hong Kong, Singapore and Taiwan, relating to our company name and logo and some of our services. We are in the process of applying for 16 additional trademarks in China and two trademarks in the United States.

China's trademark law adopts a "first-to-file" system for obtaining trademark rights. As a result, the first applicant to file an application for registration of a mark will preempt all other applicants. Prior use of unregistered marks, except for statutorily defined "well known" marks, is generally not a basis for legal action in China. We may not be able to successfully defend or claim any legal rights in those trademarks for which applications have been made but for which the Trademark Office has not issued a registration certificate.

We have also obtained 27 copyright certificates in China for cartoons and images and 32 copyright certificates for computer software.

Many parties are actively developing and seeking patent protection for wireless services-related technologies. We expect these parties to continue to take steps to protect these technologies, including seeking patent protection. There may be patents issued or pending that are held by others and that cover significant parts of our technology, business methods or services. Disputes over rights to these technologies are likely to arise in the future. We cannot be certain that our products do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others.

Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any recent trends that are likely to have a material effect on our business.

Off-Balance Sheet Arrangements

We do not have any outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We do not engage in trading activities involving non-exchange traded contracts.

Tabular Disclosure of Contractual Obligations

We have entered into leasing arrangements relating to our office premises. We also have commitments in respect of advertising agreements with third parties, the purchase of software and technology products and our obligations with respect to CYL. The following table sets forth our commitments as of December 31, 2006:

	Office Premises	Advertising Commitments	Software and Technology Purchases	Cooperation with CYL	Total
Less than one year	$897,968	$1,492,974	$126,870	$1,920,934	$4,438,746
1 - 3 years	598,131	–	–	16,007,786	16,605,917
3 - 5 years	–	–	–	11,525,606	11,525,606
> 5 years	–	–	–	5,762,803	5,762,803
Total	$1,496,099	$1,492,974	$126,870	$35,217,129	$38,333,072

Inflation

Inflation in China has not had a material impact on our results of operations in recent years. According to the National Bureau of Statistics of China, the change in the Consumer Price Index in China was 3.9%, 1.8% and 1.3% in 2004, 2005 and 2006, respectively.

Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our exposure to risk for changes in interest rates relates primarily to our investments in short-term financial instruments. Investments in both fixed rate and floating rate interest earning instruments carry some interest rate risk. The fair value of fixed rate securities may fall due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Partly as a result of this, our future interest income may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if we are forced to sell securities that have fallen in estimated fair value due to changes in interest rates. However, as substantially all of our cash equivalents consist of bank deposits and short-term money market instruments, we do not expect any material change with respect to our net income as a result of an interest rate change.

Foreign Currency Risk

Substantially all our revenues and expenses are denominated in Renminbi, but a substantial portion of our cash is kept in U.S. dollars. Although we believe

that, in general, our exposure to foreign exchange risks should be limited, our cash flows and revenues will be affected by the foreign exchange rate between U.S. dollars and Renminbi. It is possible that the Chinese government may elect to loosen further its current controls over the extent to which the Renminbi is allowed to fluctuate in value in relation to foreign currencies. Our business and the price of our ordinary shares and ADSs could be negatively affected by a revaluation of the Renminbi against the U.S. dollar or by other fluctuations in prevailing Renminbi-U.S. dollar exchange rates. For example, to the extent that we need to convert U.S. dollars into Renminbi for our operational needs and should the Renminbi appreciate against the U.S. dollar at that time, our cash flows would be reduced which could materially adversely affect our business. Conversely, if we decide to convert our Renminbi into U.S. dollars for the purpose of declaring dividends on our ordinary shares or for other business purposes and the U.S. dollar appreciates against the Renminbi, the U.S. dollar equivalent of our earnings from our subsidiaries in China would be reduced.

We do not engage in any hedging activities, and we may in the future experience economic loss as a result of any foreign currency exchange rate fluctuations. During the year ended December 31, 2006, the foreign currency translation adjustments to our comprehensive income were $2.2 million and the currency loss was $0.05 million, primarily as a result of the Chinese Renminbi appreciating against the U.S. dollar. The following is a sensitivity analysis showing the impact of hypothetical changes in the value of the Renminbi against the U.S. dollar as of December 31, 2006 on our results for 2006:

Change in the Value of Chinese Renminbi against the U.S. Dollar from Actual Value as of December 31, 2006	Additional Translation Adjustments to Comprehensive Income (in thousands)	Additional Transaction Gain/(Loss) (in thousands)
2.5% Appreciation	$1,242	$(47)
5% Appreciation	$2,485	$(93)
2.5% Depreciation	-$1,242	$47
5% Depreciation	-$2,485	$93

Index to Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF LINKTONE LTD.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Linktone Ltd. ("the Company") and its subsidiaries at December 31, 2005 and 2006, and the results of their operations and their cash flows for each of the three years ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 4(m) to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in 2006.

PricewaterhouseCoopers Zhong Tian

PricewaterhouseCoopers Zhong Tian CPAs Limited Company

Shanghai, People's Republic of China

July 12, 2007

CONSOLIDATED BALANCE SHEETS

(In U.S. dollars, except share data)

	Note	As of December 31, 2005	As of December 31, 2006
Assets			
Current assets:			
Cash and cash equivalents	7	$ 36,252,678	51,445,086
Short term investments	8	41,580,530	1,012,230
Accounts receivable, net	9	15,945,662	12,371,700
Tax refund receivable	10	2,131,128	784,506
Deposits and other receivables	11	5,136,949	3,813,562
Deferred tax assets	20	811,014	1,020,608
Total current assets		101,857,961	70,447,692
Property and equipment, net	14	3,565,446	2,852,735
Intangible assets	15	2,234,185	2,162,993
Goodwill	6	10,171,219	16,518,898
Other long term assets	16	–	5,475,631
Deferred tax assets	20	1,051,469	691,321
Total assets		$118,880,280	$ 98,149,270
Liabilities and shareholders' equity			
Current liabilities:			
Taxes payable	17	$ 5,898,782	$ 3,011,537
Accrued liabilities and other payables	18	11,886,705	5,109,264
Deferred revenue		93,327	247,823
Deferred tax liabilities	20	881,279	576,600
Total current liabilities		18,760,093	8,945,224
Long term liabilities			
Other long term liabilities		30,276	55,203
Total liabilities		18,790,369	9,000,427
Commitments and contingencies	24	–	–
Shareholders' equity			
Ordinary shares ($0.0001 par value; 500,000,000 shares authorized, 257,317,900 and 260,870,490 shares issued and outstanding as of December 31, 2005 and December 31, 2006)	5	25,732	26,087
Additional paid-in capital	5, 22	78,674,885	77,041,914
Treasury Stock	22	–	(11,362,575)
Statutory reserves	19	2,007,776	2,344,525
Accumulated other comprehensive income			
Unrealized (loss)/gain on investment on marketable securities		(96,317)	33,177
Cumulative translation adjustments		823,154	2,172,265
Retained earnings		18,654,681	18,893,450
Total shareholders' equity		100,089,911	89,148,843
Total liabilities and shareholders' equity		$118,880,280	$ 98,149,270

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

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In U.S. dollars, except per share data)

	Note	For the year ended December 31,		
		2004	2005	2006
Gross revenues	12	$ 50,318,744	$ 73,608,603	$ 79,841,694
Sales tax		(2,235,044)	(3,121,347)	(3,305,544)
Net revenues		48,083,700	70,487,256	76,536,150
Cost of services		(15,305,416)	(26,483,694)	(28,982,827)
Gross profit		32,778,284	44,003,562	47,553,323
Operating expenses:				
Product development		(2,807,720)	(6,229,976)	(7,372,074)
Selling and marketing		(8,794,568)	(14,719,763)	(22,728,906)
Other general and administrative		(10,274,754)	(11,786,995)	(11,789,984)
Total operating expenses		(21,877,042)	(32,736,734)	(41,890,964)
Income from operations		10,901,242	11,266,828	5,662,359
Interest income		815,447	1,965,801	1,589,180
Other income, net		346,652	720,763	862,830
Income before tax		12,063,341	13,953,392	8,114,369
Income tax expense	20	(997,307)	(1,504,329)	(1,267,183)
Minority interest		–	–	(54,595)
Net income		11,066,034	12,449,063	6,792,591
Accretion on Series B convertible redeemable preferred shares		(28,206)	–	–
Amount allocated to participating preferred shareholders		(794,307)	–	–
Net income attributable to ordinary shareholders		$ 10,243,521	$ 12,449,063	$ 6,792,591
Other comprehensive income/(loss)		(64,414)	791,662	1,478,605
Comprehensive income		$ 11,001,620	$ 13,240,725	$ 8,271,196
Earnings per share:	25			
Basic		$ 0.05	$ 0.05	$ 0.03
Diluted		$ 0.04	$ 0.05	$ 0.03
Weighted average ordinary shares:				
Basic		224,569,476	257,020,040	253,850,193
Diluted		248,081,126	275,385,579	259,529,531

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In U.S. dollars, except share data)

	Ordinary shares		Additional paid-in capital	Treasury Stock	Convertible preferred shares	Deferred stock based compensation	Statutory reserves	Accumulated other comprehensive income/(loss)	Retained earnings/ (Accumulated Deficit)	Total shareholders' equity
	Shares	Amount								
Balance as of December 31, 2003	97,390,000	9,739	5,811,354	-	3,525,388	(4,691,825)	500,000	(411)	(947,626)	4,206,619
Issuance of ordinary shares in initial public offering	51,500,000	5,150	67,046,483	-	-	-	-	-	-	67,051,633
Costs of initial public offering	-	-	(1,941,409)	-	-	-	-	-	-	(1,941,409)
Conversion of redeemable preferred shares to ordinary shares	41,294,500	4,129	3,579,539	-	-	-	-	-	-	3,583,668
Conversion of convertible preferred shares to ordinary shares	59,870,500	5,987	3,519,401	-	(3,525,388)	-	-	-	-	-
Issuance of ordinary shares from exercise of stock options	3,717,990	372	301,778	-	-	-	-	-	-	302,150
Accretion of series B redeemable convertible preferred shares	-	-	28,206	-	-	-	-	-	(28,206)	-
Deferred stock-based compensation	-	-	-	-	-	3,464,807	-	-	-	3,464,807
Other comprehensive income:										
Translation adjustment	-	-	-	-	-	-	-	264	-	264
Unrealized loss on investments in marketable securities	-	-	-	-	-	-	-	(64,678)	-	(64,678)
Net income	-	-	-	-	-	-	-	-	11,066,034	11,066,034
Appropriation to Statutory reserves	-	-	-	-	-	-	1,031,760	-	(1,031,760)	-
Balance as of December 31, 2004	253,772,990	$ 25,377	$ 78,345,352	$ -	$ -	$ (1,227,018)	$ 1,531,760	$ (64,825)	$ 9,058,442	$ 87,669,088
Issuance of ordinary shares from exercise of stock options	6,924,910	693	568,777	-	-	-	-	-	-	569,470
Retirement of shares from stock repurchase	(3,380,000)	(338)	(1,024,651)	-	-	-	-	-	(2,376,808)	(3,401,797)
Deferred stock-based compensation	-	-	785,407	-	-	1,227,018	-	-	-	2,012,425
Other comprehensive income:										
Translation adjustment	-	-	-	-	-	-	-	823,301	-	823,301
Unrealized loss on investments in marketable securities	-	-	-	-	-	-	-	(31,639)	-	(31,639)
Net income	-	-	-	-	-	-	-	-	12,449,063	12,449,063
Appropriation to Statutory reserves	-	-	-	-	-	-	476,016	-	(476,016)	-
Balance as of December 31, 2005	257,317,900	$ 25,732	$ 78,674,885	$ -	$ -	$ -	$ 2,007,776	$ 726,837	$ 18,654,681	$ 100,089,911
Issuance of ordinary shares from exercise of stock options	16,839,040	1,684	857,574	-	-	-	-	-	-	859,258
Retirement of shares from stock repurchase	(13,286,000)	(1,329)	(3,949,103)	-	-	-	-	-	(6,217,073)	(10,167,505)
Treasury stocks	-	-	-	(11,362,575)	-	-	-	-	-	(11,362,575)
Stock-based compensation	-	-	1,458,558	-	-	-	-	-	-	1,458,558
Other comprehensive income:										
Translation adjustment	-	-	-	-	-	-	-	1,349,111	-	1,349,111
Unrealized gain on investments in marketable securities	-	-	-	-	-	-	-	129,494	-	129,494
Net income	-	-	-	-	-	-	-	-	6,792,591	6,792,591
Appropriation to Statutory reserves	-	-	-	-	-	-	336,749	-	(336,749)	-
Balance as of December 31, 2006	260,870,940	$ 26,087	$ 77,041,914	$ (11,362,575)	$ -	$ -	$ 2,344,525	$ 2,205,442	$ 18,893,450	$ 89,148,843

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In U.S. dollars)

	For the year ended December 31,		
	2004	2005	2006
Cash flow from operating activities			
Net income	$ 11,066,034	$ 12,449,063	$ 6,792,591
Adjustments to reconcile net income to net cash provided by operating activities:			
Share-based compensation costs	3,464,807	2,012,425	1,458,558
Loss on disposal of fixed assets	49,064	–	55,254
Depreciation	429,516	1,419,609	1,843,997
Amortization/write off of intangible assets	–	760,299	1,931,361
Provision for bad debt accounts	176,813	(190,054)	361,102
Deferred income tax benefits	(64,878)	(914,668)	(171,172)
Loss on foreign exchange	–	36,415	50,676
Realized gain on short term investments	(81,094)	(1,060,041)	(1,258,818)
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	(7,529,729)	(4,550,229)	4,136,728
Tax refund receivable	(2,597,167)	532,431	1,372,894
Deposits and other receivables	(1,198,857)	(561,247)	359,967
Taxes payable	4,092,219	689,980	(2,987,805)
Accrued liabilities and other payables	1,847,399	(1,062,039)	177,999
Net cash provided by operating activities	9,654,127	9,561,944	14,123,332
Cash flow from investing activities			
Purchase of property and equipment	(2,422,079)	(1,967,541)	(1,249,298)
Purchase of intangible assets	–	(306,050)	(124,735)
Purchase of television advertising agency right	–	–	(4,802,336)
Proceeds from sale of short term investments	22,181	27,001,194	41,990,510
Proceed from disposals of fixed assets	–	–	1,295
Cash paid for short term investments	(14,866,131)	(52,692,957)	–
Cash paid for business acquisitions, net off cash acquired	–	(5,459,324)	(14,818,906)
Cash paid for convertible loans	–	(581,782)	(176,666)
Cash paid to staff for business acquisitions	–	(433,694)	–
Net cash (used in)/provided by investing activities	(17,266,029)	(34,440,154)	20,819,864
Cash flow from financing activities:			
Proceeds from initial public offering, net of issuance costs paid	65,110,224	–	–
Proceeds from the exercise of stock options	302,150	569,470	859,258
Cash paid for repurchase of stock	–	(3,401,797)	(21,530,080)
Net cash provided by/(used in) financing activities	65,412,374	(2,832,327)	(20,670,822)
Effect of exchange rate change on cash	264	549,586	920,034
Net (decrease)/increase in cash and cash equivalents	57,800,736	(27,160,951)	15,192,408
Cash and cash equivalents, beginning of year	5,612,893	63,413,629	36,252,678
Cash and cash equivalents, end of year	$ 63,413,629	$ 36,252,678	51,445,086
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Cash paid for business and other taxes on revenues	$ 1,224,397	$ 8,800,560	$ 9,991,035
Cash received for value added tax refund	–	4,960,196	6,233,769
Cash paid for income tax	518,262	607,940	2,652,773
Cash paid for interest	–	–	–

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

1 Organization and Nature of Operations

Linktone Ltd. ("Linktone" or the "Company"), a Cayman Islands corporation, is a provider of telecom media, entertainment and communication services or telecom value added services ("VAS") to mobile and fixed phone users in the People's Republic of China ("PRC"). The Company specializes in the development, aggregation, marketing and distribution of consumer telecom applications for access by mobile and fixed phone users in the PRC.

The accompanying consolidated financial statements include the results of operations of the Company, its subsidiaries, Shanghai Linktone Consulting Co., Ltd. ("Linktone Consulting"), Shanghai Huitong Information Co., Ltd. ("Huitong"), Shanghai Linktone Internet Technology Co., Ltd. ("Linktone Internet"), Shanghai Linktone Software Co., Ltd. ("Linktone Software"), Brilliant Concept Investment Ltd. ("Brilliant"), Wang You Digital Technology Co., Ltd. ("Wang You"), Ojava Overseas Limited ("Ojava Overseas") and Beijing Ruida Internet Communication Technology Co., Ltd. ("Ruida"), and variable interest entities ("VIE" or "VIEs") for which the Company is the primary beneficiary. Ojava Overseas and Ruida were acquired by the Company in January 2006 (note 6). The Company, its subsidiaries and consolidated VIEs (see below) are collectively referred to as the "Group".

In October 2006, the Group entered into agreements with the Chinese Youth League Internet, Film and Television Center ("CYL") to serve as the exclusive advertising agent and to establish a joint venture to produce television and interactive telecom programs for Qinghai Satellite Television ("QTV"). The Group had paid $4,802,336 (note 16) in connection with such agreements as of December 31, 2006.

The business in which the Group is engaged is subject to a number of industry-specific risk factors, including, but not limited to, dependence on mobile and fixed line network operators, rapid development of the market, large number of competitors, and evolving regulatory environment.

To comply with PRC laws and regulations that prohibit or restrict foreign ownership of companies that provide value-added telecommunications services, which includes telecom value-added services, Internet content services, and television content production and advertising services, the Company conducts substantially all of its operations via its VIEs. These VIEs are wholly owned by certain employees of the Company. The capital is funded by the Company and recorded as interest-free loans to these PRC employees. The portion of the loans for capital injection is eliminated with the capital of the VIEs during consolidation.

Under various contractual agreements, employee shareholders of the VIEs are required to transfer their ownership in these entities to the Company's subsidiaries in the PRC when permitted by PRC laws and regulations or to designees of the Company at any time for the amount of loans outstanding. All voting rights of the VIEs are assigned to the Company and the Company has the right to appoint all directors and senior management personnel of the VIEs. As of December 31, 2006, the Company has entered into consulting service and or software licensing agreements with these VIEs under which the Company provides consulting and software products to these VIEs in exchange for substantially some or all net income of the VIEs. In addition, employee shareholders of the VIEs have pledged their shares in the VIEs as collateral for the non-payment of loans or for the fees for consulting services and use of software due to the Company. The interest-free loans to the employee shareholders of VIEs listed below as of December 31, 2005 and 2006 were $8.4 million and $13.1 million, respectively.

The following is a summary of the VIEs of the Company:

- Shanghai Weilan Computer Co., Ltd. ("Weilan"), a PRC company controlled through contractual agreements. Weilan was registered on December 2, 1999 and is 50% owned by each of two of the Company's employees,

Baoxin Yao and Wenlei Wang. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $0.6 million.

- Shanghai Unilink Company Ltd. ("Unilink"), a PRC company controlled through contractual agreements. Unilink was registered in June 2003 and is 50% owned by each of two of the Company's employees, Rong Zhang and Wenjun Hu. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $1.2 million.
- Shenzhen Yuan Hang Technology Co., Ltd. ("Yuan Hang"), a PRC company controlled through contractual agreements. Yuan Hang was registered in June 2001 and acquired by the Company in May 2005 (note 6). Yuan Hang is 50% owned by each of two of the Company's employees, Yuming Cai and Xuan Fan. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $0.6 million.
- Beijing Cosmos Digital Technology Co., Ltd. ("Cosmos"), a PRC company controlled through contractual agreements. Cosmos was registered in May 2003 and acquired by the Company in June 2005 (note 6). Cosmos is 50% owned by each of two of the Company's employees, Rong Zhang and Teng Zhao. The equity interests are in the process of being transferred to the Company's employees, Hongjie Qi and Miao Yan. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $1.7 million and $4.1 million, respectively.
- Hainan Zhong Tong Computer Network Co., Ltd. ("Zhong Tong"), a PRC company controlled through contractual agreements. Zhong Tong was registered in October 2000, and acquired by the Company in June 2005 (note 6). Zhong Tong is 50% owned by the Company's former employee, Jinhua Yuan, whose equity interests are in the process of being transferred to the Company's employee, Yi Huang and 50% owned by the Company's employee Teng Zhao. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $1.7 million.
- Beijing Lian Fei Wireless Communication Technology Co., Ltd. ("Lian Fei"), a PRC company controlled through contractual agreements. Lian Fei was registered in June 2002, and acquired by the Company in June 2005 (note 6). Lian Fei is 50% owned by each of two of the Company's employees, Jing Wang and Rong Li. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $1.7 million and $2.0 million respectively.
- Shanghai Qimingxing E-commerce Co., Ltd. ("Qimingxing"), a PRC company controlled through contractual agreements. Qimingxing was registered in February 2000, and acquired by the Company in August 2005 (note 6). Qimingxing is 50% owned by each of two of the Company's employees Qian Di and Lijin Shen. As of December 31, 2005 and 2006, total interest free loans to shareholders amounted to $0.9 million and 1.9 million respectively.
- Beijing Ojava Wireless Information Technology Co., Ltd. ("Beijing Ojava"), a PRC company controlled through contractual agreements. Beijing Ojava was registered in February 2004, and acquired by the Company in January 2006 (note 6). Beijing Ojava is 50% owned by each of the two of the Company's employees Xinyong Ding and Jun Xi. As of December 31, 2006, total interest free loans to shareholders amounted to $1.0 million

In November 2006, a VIE, Shanghai Ling Yu Culture and Communication Co., Ltd. ("Ling Yu") was established to act as the exclusive advertising agent of QTV. Ling Yu is 50% owned by Unilink and 50% owned by Qimingxing.

All the above VIEs are engaged in the business of providing VAS to mobile phone users in China via third party operators except Yuan Hang and Ling Yu. Yuan Hang is engaged in providing online gaming services in China while Ling Yu is engaged in the advertising agency business.

2 Basis of presentation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

All transactions and balances between the Group's businesses have been eliminated upon consolidation.

3 Use of estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

4 Summary of significant accounting policies

(a) Basis of consolidation

The consolidated financial statements include the financial statements of the Company, its subsidiaries, and the VIEs for which the Company is the primary beneficiary. All subsidiaries are wholly-owned by the Company, and the Company does not hold any investments accounted for under the cost or equity method.

The Company has adopted FASB Interpretation No. 46R ("FIN 46R"), Consolidation of variable interest entities - an interpretation of ARB No. 51, which requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

The Company began to consolidate the operating results of acquired subsidiaries and VIEs as follows:

(a) Brilliant, Wang You and Yuan Hang from June 2005;

(b) Cosmos, Zhong Tong and Lian Fei from July 2005;

(c) Qimingxing from September 2005; and

(d) Ojava Overseas, Ruida and Beijing Ojava from February 2006.

As of December 31, 2005 and 2006, the aggregate accumulated profits of all VIEs were approximately $9.4 million and $9.1 million, respectively, and have been reflected in the consolidated financial statements.

(b) Cash equivalents

The Group considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents are composed primarily of investments in commercial paper and money market accounts that are stated at costs, plus accrued interest, which approximates fair value.

(c) Short-term investments

Short-term marketable securities are classified as available-for-sale and carried at estimated fair value with unrealized gains and losses recorded as a component of accumulated other comprehensive income. Management determines the appropriate classification of its short-term investments and re-evaluates such determination at each balance sheet date.

(d) Accounts receivable

An allowance for doubtful accounts is provided based on an ageing analysis of accounts receivable balances, historical bad debt rates, repayment patterns, customer credit worthiness and industry trend analysis. The Group also makes a specific allowance if there is strong evidence showing that the receivable is likely to be irrecoverable. Accounts receivable in the balance sheets are stated net of such allowance of $148,237 and $509,339 as of December 31, 2005 and 2006, respectively.

(e) Property and equipment, net

Property and equipment are stated at cost less accumulated depreciation.

Property and equipment are depreciated over their estimated useful lives on a straight-line basis with an estimated residual value of zero. The estimated useful lives are as follows:

Computer hardware/equipment	36-60 months
Office equipment	12-36 months
Leasehold improvements	the shorter of their estimated useful lives or the lease term

Expenditures for repairs and maintenance are expensed as incurred. The gain or loss on disposal of property and equipment, if any, is the difference between the net sales proceeds and the carrying amount of the relevant assets, and is recognized in the statement of operations.

(f) Goodwill and intangible assets

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its subsidiaries and variable interest entities. The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 142 "Goodwill and Intangible Assets" ("SFAS 142"). Under SFAS 142, goodwill is no longer amortized, but tested for impairment upon first adoption and annually thereafter, or more frequently if events or changes in circumstances indicate that it might be impaired. The Company assesses goodwill for impairment in accordance with SFAS 142. In December of each year, the Company tests impairment of goodwill at the reporting unit level and recognizes impairment in the event that the carrying value exceeds the fair value of each reporting unit.

The Company applies the criteria specified in SFAS No. 141 "Business Combinations" ("SFAS 141") to determine whether an intangible asset should be recognized separately from goodwill. Intangible assets acquired through business acquisitions are recognized as assets separate from goodwill if they satisfy either the "contractual-legal" or "separability" criteria. Under SFAS 142, intangible assets with definite lives are amortized over their estimated useful life. Intangible assets, such as purchased technology, licenses, domain names, partnership, and non-compete agreements, arising from the acquisitions of subsidiaries and variable interest entities are recognized and measured at fair value upon acquisition. Intangible assets are amortized over their estimated average useful lives from one to three years. The Company reviews the amortization methods and estimated useful lives of intangible assets regularly.

(g) Impairment of long-lived assets and intangible assets

Long-lived assets and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company assesses the recoverability of the long-lived assets and intangible assets (other than goodwill) by comparing the carrying amount to the estimated future undiscounted cash flow associated with the related assets. The Company recognizes impairment of long-lived assets and intangible assets in the event that the net book value of such assets exceeds the estimated future undiscounted cash flow attributable to such assets. The Company uses estimates and judgments in its impairment tests and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be different. No impairment of long-lived assets and intangible assets was recognized for any of the years presented.

(h) Television advertising right

Television advertising right for QTV is stated at cost less accumulated amortization and amortized over the contract period.

(i) Revenue and cost of services recognition

Telecom value added services

The vast majority of the Group's revenues are derived from entertainment-oriented telecom value-added services including Short Messaging Services ("SMS"), Multimedia Messaging Services ("MMS"), Wireless Application Protocol ("WAP"), JavaTM ("Java games"), Interactive Voice Response Services ("IVR") and Ring Back ("RB") services (IVR and RB, collectively known as "Audio Related Services") to phone users through various subsidiaries of China Mobile Communications Corporation ("China Mobile"), China United Communications Corporation ("China Unicom"), China Telecom Corporation and China Netcom Corporation (collectively the "Operators"). Fees for these services are charged on a per message basis or on a monthly subscription basis, and vary according to the type of products and services delivered.

The Group recognizes all revenues in the period in which the services are performed, provided that persuasive evidence of a contractual arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. A substantial portion of the Group's revenue is recorded based on monthly statements received from provincial level subsidiaries of the Operators. In certain instances, when a statement is not received within a reasonable period of time, the Group is required to make an estimate of the revenues and cost of services earned during the period covered by the statement. On a quarterly basis, the Group evaluates its estimates based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. For the years ended December 31, 2005 and 2006, approximately 2% and 0.5% of the Group's revenues were estimated respectively.

The Group contracts with the Operators for the transmission of telecom value-added services as well as for billing and collection services. The Group measures its revenues based on the total amount paid by its customers, for which the Operators bill and collect on the Group's behalf. For this billing and collection service, the Operators retain a fixed percentage fee, which is reflected as a cost of services in the financial statements. In addition, for SMS and MMS services, the Operators charge the Group a network usage fee based on a fixed per message rate multiplied by the excess of messages sent over messages received. These network usage fees are likewise retained by the Operators, and are reflected as a cost of services in the financial statements. Network usage fees charged to the Group are

reduced for messages received by the Group because the Operators separately charge the sender a fee for these transmissions. The Group has assessed its relationship with the Operators and the terms of the fee arrangements under Emerging Issues Task Force Issue No. 99-19, and has concluded that reporting the gross amounts billed to its customers is appropriate.

The Group licenses content from independent content providers. Certain of these agreements determine the fees payable for content based on a percentage of revenues of the Group generated from the use of the content. The Group records its revenues inclusive of fees to be paid to content providers as the Group acts as the principal in these arrangements.

Casual Online Games Services

The Group currently provides its casual online game services through its subsidiaries, Brilliant and Wang You, and VIE, Yuan Hang. The Group receives subscription fees from distributors for the sales of game cards, in either physical or virtual form, with certain number of game points incorporated in the cards. The corresponding revenue is recognized as the game points are consumed by game players in games. Any sold game cards which are not activated by users and activated points which are not consumed in games constitute deferred revenue.

Advertising services

The Group through its VIE, Ling Yu acts as the exclusive advertising agent for QTV. The Group receives advertising revenue from selling advertising time slots and program sponsorships on QTV. Advertising revenues are recognized ratably over the displayed period of the contract. Payments for advertising received in advance are deferred until earned.

(j) Income and other taxes

The Group accounts for income tax using SFAS No. 109 “Accounting for Income Taxes,” which requires the asset and liability approach for financial accounting and reporting for income taxes. Under this approach, deferred taxes are provided for the tax consequences of temporary differences by applying enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The tax basis of an asset or liability is the amount attributed to that asset or liability for tax purposes. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of the deferred tax asset will not be realized. Shanghai Unilink and Qimingxing are currently considered small businesses and are subject to a 2.4% tax on revenues and 4.8% on the difference between revenue and cost of service, as defined for tax purposes.

The Group is also subject to business taxes of 3-9% on the provision of taxable services, which includes services provided to customers and in certain instances consultancy services to the VIEs. The related business taxes paid for the services provided to customers and consultancy services are accrued for as a reduction of revenues and in operating expenses respectively.

Huitong and Linktone Internet charge software license fees to the VIEs which are subject to value added tax (“VAT”) at 17%. The Group is entitled to a tax refund equivalent to the portion of VAT expense in excess of 3%. The 3% portion of VAT expense is accrued for as a reduction of revenues.

(k) Advertising expenses

Advertising expenses generally represent the cost of promotions to create or stimulate a positive image of the Group or a desire to buy the Group's products and services, and are expensed as incurred. Advertising expenses totaled $3,441,117, $6,151,167 and $10,172,051 during the years ended December 31, 2004, 2005 and 2006, respectively.

(l) Product development expenses

Product development expenses consist primarily of compensation and related costs for employees associated with the development of the content of the Group's products and development, enhancement to and maintenance of related product technical platforms and customer databases.

The Group accounts for the cost of developing the content of the products in accordance with FAS 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed" and would capitalize, if criteria under FAS 86 were met, direct costs incurred during the development phase and amortize on a straight-line basis over the estimated product life or on the ratio of current revenues to total projected product revenue, which ever is greater.

The Group accounts for product development costs of the technical platform and customer database under SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" and would capitalize, if criteria under SOP 98-1 were met, direct costs associated in developing or obtaining internal-use computer software during the application development stage. Costs incurred in the enhancement and maintenance of the Group's existing platforms and database are charged to product development expense as incurred.

To date, the amount of costs qualifying for capitalization under FAS 86 and SOP98-1 has been immaterial and as a result, all product development costs have been expensed as incurred.

(m) Share-based compensation

Effective January 1, 2006, the Group adopted the provisions of SFAS 123R, Share-Based Payment for share-based employee compensation arrangements. The statement requires the measurement of the cost of employee services received in exchange for an award of equity instruments (such as employee stock options) at the fair value on the grant date. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (the requisite service period).

The Group recognizes the compensation costs, net of a forfeiture rate, on a straight-line basis over the requisite service period of the award. Forfeitures are estimated at the time of the grant and revised in subsequent periods if actual forfeitures differ from those estimates. Upon adoption, the Group elected the modified prospective method and therefore has not restated results for prior periods. The valuation provisions of SFAS 123R apply to new grants and unvested grants that were outstanding as of the effective date. Estimated compensation for unvested grants as of the effective date are recognized over the remaining service period using the compensation cost estimated for the SFAS123 pro forma disclosures.

(n) Subsidy income

Local governments in some provinces in China grant the Group subsidy income based on a certain percentage of business taxes and income taxes paid by the Group either on a monthly or annually basis. The Group records this local government subsidy income in other income as the income is received. Local government subsidy income totaled $311,873, $618,812 and $611,394 during the years ended December 31, 2004, 2005 and 2006, respectively.

(o) Foreign currency translation

The Company's functional and reporting currency is the U.S. dollar ("US$"). The functional currency of the Company's operating subsidiaries and consolidated VIEs in China is the Renminbi ("RMB"). Transactions denominated in currencies other than RMB are translated into RMB at the exchange rates quoted by the People's Bank of China (the "PBOC") prevailing at the dates of the transactions. Gains and losses resulting from foreign currency transactions are included in the consolidated statement of operations. Monetary assets and liabilities denominated in foreign currencies are translated into RMB using the applicable exchange rates quoted by the PBOC at the balance sheet dates. All such exchange gains and losses are included in the statement of operations. All assets and liabilities of our subsidiaries and consolidated VIEs in China are translated into US$ at the exchange rates in effect at the balance sheet date and revenues and expenses are translated into US$ at the average exchange rates in effect during the reporting periods. The exchange differences resulting from translating the PRC entity financial statements into US$ are included in Accumulated Other Comprehensive Income which is a separate component of shareholders' equity on the consolidated balance sheets.

(p) Comprehensive income

Comprehensive income is defined as the change in equity of the Group during a period from transactions and other events and circumstances excluding transactions resulting from investments by owners and distributions to owners. Accumulated other comprehensive income of the Group represents the cumulative foreign currency translation adjustment and unrealized gain or loss on short term investments.

(q) Earnings per share

In accordance with SFAS No. 128 "Computation of Earnings Per Share," basic earnings per share is computed by dividing net income attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of the ordinary shares issuable upon the conversion of the convertible preferred shares (using the if-converted method) and ordinary shares issuable upon the exercise of outstanding share options (using the treasury stock method). Options to purchase ordinary shares that were anti-dilutive were excluded from the calculation of diluted net income per share.

The Company has adopted the consensus reached in EITF 03-06, "Participating Securities and the Two-Class Method under SFAS No. 128," which provides further guidance on the definition of participating securities and requires the use of the two-class method in calculating earnings per share for enterprises with participating securities. The Company determined that all of its preferred stock outstanding through March 31, 2004 qualified as participating securities.

(r) Segment reporting

The Group follows SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information." The Group operates and manages its telecom value added service business, casual game business and advertising as three separate segments. For the years ended December 31, 2005 and 2006, the casual game and advertising businesses were not material, accounting for 1.9% and nil and 1.8% and 0.4% of the Group's total revenue, respectively. The Group generates its revenues solely from China and accordingly, no geographical segments are presented.

(s) Recent Accounting Pronouncements

In June 2006, FASB ratified the provisions of EITF Issue No. 06-3 "How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement" ("EITF 06-3"), which requires the Company to disclose how it accounts for taxes imposed on and concurrent with a specific revenue-producing transaction. EITF 06-3 will be effective for the Company starting January 1, 2007. The Company does not believe that the application of EITF 06-03 will have a material effect on its financial position, cash flow and results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This interpretation requires that the Company recognizes and discloses in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 became effective on January 1, 2007, with the cumulative effect of the change in accounting principle, if any, recorded as an adjustment to opening retained earnings. The Company does not believe that the application of FIN 48 will have a material effect on its financial position, cash flow and results of operations.

In September 2006, the SEC released SAB No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on the SEC's views on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The provisions of SAB 108 would be effective for the Company for the fiscal year ended December 31, 2006. The adoption of SAB 108 did not have a material effect on the Company's financial position, cash flows nor results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No.157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 will be effective for the Company starting January 1, 2008. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial position, cash flows and results of operations.

In February 2007, the FASB issued SFAS 159 "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 will be effective for the Company on January 1, 2008. The Company does not believe the adoption of SFAS 159 will have a material effect on its financial position, cash flow and results of operations.

5 Preferred shares

In connection with a re-organization in April 2001, the Company capitalized 66,172 shares of Series B redeemable convertible preferred shares at an assigned value of $274,303 and 336,848 shares of Series A convertible preferred stock at an assigned value of $1,245,200. Concurrently with the reorganization, the Company issued warrants to purchase 110,287 shares of Series B redeemable convertible preferred shares with an exercise price of $0.01 per share, which were exercised on May 30, 2001. Subsequent to the reorganization, the Company issued an additional 34,980 shares of Series A preferred shares in 2001 for consideration of $9.85 per share, and an additional 3,555 shares of Series A preferred share in 2002 for consideration of $9.84 per share.

In April 2001, the Company issued 245,203 shares of Series C redeemable convertible preferred shares ("Series C") for consideration of $8.15 per share.

In July 2001, the Company issued 101,570 shares of Series D convertible preferred shares ("Series D") for consideration of $9.84 per share.

In February 2002, the Company issued 101,570 shares of Series E redeemable convertible preferred shares ("Series E") for consideration of $9.84 per share.

Holders of the Company's preferred stock had various rights and preferences as follows:

Voting

Holders of preferred shares had voting rights equal to the voting rights to which the ordinary shares then issuable upon conversion of such preferred share were entitled.

Dividends

The holder of each preferred share was entitled to participate in dividends, when and if declared by the Board of Directors. No dividends have been declared by the Board of Directors from inception of the Company through December 31, 2006.

Liquidation

In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the Group, or the sale of all or substantially all of its assets, holders of Series B, C, D and E preferred shareholders, and Icon (a specified holder of Series A preferred shares), each as a class, were entitled to receive $1,500,000, $2,000,000, $1,000,000, $999,997 and $750,000, respectively, after which the remaining liquidation proceeds would be distributed pro rata amongst all the shareholders, including the Series A preferred shareholders other than Icon, in accordance with each shareholder's respective shareholding percentages, with each preferred share participating as if converted into ordinary shares.

Conversion

Each preferred share was convertible into one ordinary share, as such conversion may be adjusted from time to time, including stock splits, in accordance with the conversion provisions in the Company's Articles of Incorporation. Each preferred share was to be automatically converted into such number of ordinary shares, as such conversion may be adjusted, upon (i) the closing of a qualified initial public offering ("IPO"), or (ii) upon the terms and conditions as each may be agreed between the Company and the holders of the relevant shares.

Mandatory redemption

The holders of Series B and Series C shares were entitled to redeem all of the outstanding Series B and Series C shares on or after April 30, 2007. The holders of Series E shares were entitled to redeem all of the outstanding Series E shares on or after September 3, 2007.

The redemption price for the original Series B shares capitalized upon spin-off was $1,500,000. The redemption price for the Series B shares purchased upon exercise of the Series B warrants was $1,100. Due to the insignificance of the redemption price, these Series B shares purchased upon the exercise of Series B warrants were classified as convertible preferred shares in shareholders' equity. The redemption prices of the Series C and Series E shares were $2,000,000 and $1,000,000, respectively. If on the redemption date the number of shares that may be legally redeemed by the Group was less than the number of such shares to be redeemed, then the shares to be redeemed were to be

allocated to Series B redeemable preferred shareholders and Series C redeemable preferred shareholders pro rata in accordance with each of its shareholding percentage at such time, and the remaining shares that may not legally be redeemed would be carried forward until the Group had legally available funds for such redemption.

Each of the Company's preferred shares was converted into 100 ordinary shares upon the closing of the Company's IPO on March 4, 2004.

6 Business Combinations

The Group accounts for its business combinations using the purchase method of accounting. This method requires that the acquisition cost be allocated to the assets, including separately identifiable tangible and intangible assets, and liabilities the Group has acquired based on their estimated fair values. The Company makes estimates and judgments in determining the fair value of the acquired assets and liabilities, based on independent appraisal reports as well as its experience with similar assets and liabilities in similar industries. If different judgments or assumptions were used, the amounts assigned to the individual acquired assets or liabilities could be materially affected.

(a) Acquisition of Brilliant

In May 2005, the Company completed the acquisition of Brilliant Concept Investments Ltd. ("Brilliant"), a British Virgin Islands limited liability corporation. As a result of such acquisition, Brilliant became a wholly-owned subsidiary of Linktone. Brilliant, through its subsidiary Wang You and exclusive contractual arrangements with a local entity, Yuan Hang, is engaged in providing online gaming services in the PRC. Brilliant, its subsidiary and affiliated company are collectively known as Brilliant Group. As a result of the acquisition, Yuan Hang became a VIE of Linktone. The primary purpose of the acquisition was to complement and leverage Linktone's core VAS business as the Company built a robust interactive entertainment community.

The aggregate purchase price was comprised of initial consideration and contingent consideration calculated on an earn out basis at 65% of 8 times the Brilliant Group's net profit for the year 2005. The initial consideration was comprised of $3,141,374 cash to the selling shareholders and $238,016 legal and professional costs related to the acquisition. The contingent consideration based on Brilliant Group's net profit for the year 2005 was $5,643,934 and was recorded as additional goodwill.

The total purchase price of $9,023,324 was allocated as follows:

Cash	$ 379,025
Other current assets	234,170
Fixed assets	97,143
Intangible assets	602,000
Current liabilities	(322,511)
Goodwill	8,033,497
Purchase price	$ 9,023,324

Amortizable intangible assets acquired, including customer lists, technology, operating licenses and agreements and non-compete agreements with certain Brilliant's executives, have an estimated average useful life of approximately one year. The amortization expense of intangible assets for the years ended December 31, 2005 and 2006 was $387,146 and $214,854, respectively. As of December 31, 2006, total goodwill recorded for the Brilliant acquisition

was $8,033,497, representing the excess of the total purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The operating results of Brilliant Group were consolidated with those of the Company beginning in June 2005.

(b) Acquisition of Cosmos

In June 2005, the Company completed the acquisition of Cosmos, a privately held provider of WAP services to China Unicom. As a result of such acquisition, Cosmos became a VIE of Linktone. The primary purposes of the acquisition were to strengthen the Company's overall WAP service portfolio and development capabilities and increase its share in the 2.5 VAS market.

The aggregate purchase price was comprised of an initial consideration and contingent consideration. The initial consideration was comprised of three elements: (a) $845,768 cash paid to Cosmos to settle a shareholders' loan (b) $230,307 cash paid to the selling shareholders for the net working capital of Cosmos as of May 31, 2005 and (c) approximately $295,570 in legal and professional costs related to the acquisition. The contingent consideration was calculated on an earn out basis at approximately 3.8 times Cosmos's net profit for the period from May 1, 2005 to March 31, 2006. In April 2006, the Company finalized the contingent consideration to be $3,020,600 and updated the purchase price allocation. The total purchase price was $4,392,245, of which goodwill was $2,149,792.

The total purchase price of $4,392,245 was allocated as follows:

Cash	$ 938,630
Other current assets	358,817
Fixed assets	34,307
Intangible assets	1,325,000
Current liabilities	(414,301)
Goodwill	2,149,792
Purchase price	$ 4,392,245

Amortizable intangible assets acquired, including technology, value-added service provider ("VASP") licenses and agreements and non-compete agreements with certain Cosmos executives, have an estimated average useful life of approximately 3.3 years. The amortization expense of intangible assets for the years ended December 31, 2005 and 2006 were $187,627 and $410,408, respectively. As of December 31, 2006, total goodwill recorded for the Cosmos Acquisition was $2,149,792, representing the excess of the total purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The operating results of Cosmos were consolidated with those of the Company starting July 1, 2005 after the Company took effective control over the operations of Cosmos.

(c) Acquisition of Zhong Tong

In June 2005, the Company completed the acquisition of Zhong Tong, a privately held provider of SMS services to China Mobile. As a result of such acquisition, Zhong Tong became a VIE of Linktone. The primary purpose of the acquisition was to provide a separate network access code for the Company's specific project.

The aggregate purchase price was $1,715,923 and comprised of three elements: (a) $730,696 cash to selling shareholders; (b) $966,592 cash paid to Zhong Tong to settle shareholders' loans and (c) approximately $18,635 in legal and professional costs related to the acquisition.

The purchase price of $1,715,923 was allocated as follows:

Cash	$ 1,029,137
Other current assets	165,847
Fixed assets	21,057
Intangible assets	230,436
Current liabilities	(227,909)
Goodwill	497,355
Purchase price	$ 1,715,923

Amortizable intangible assets acquired, including VASP licenses and agreements have an estimated average useful life of approximately 3.3 years. The amortization expense of intangible assets for the years ended December 31, 2005 and 2006 was $34,922 and $69,844 respectively. As of December 31, 2005, total goodwill recorded for the Zhong Tong acquisition was $497,355, representing the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The operating results of Zhong Tong were consolidated with those of the Company beginning in July 2005.

(d) Acquisition of Lian Fei

In June 2005, the Company completed the acquisition of Lian Fei, a privately held provider of VAS services to China Mobile. As a result of such acquisition, Lian Fei became a VIE of Linktone. The primary purpose of the acquisition was to provide a separate network access code in order to increase the Company's market share in the PRC VAS market.

The aggregate purchase price was $2,025,395 and comprised of three elements: (a) $1,472,866 cash to selling shareholders; (b) $543,708 cash paid to Lian Fei to settle shareholders' loans and (c) approximately $8,821 in legal and professional costs related to the acquisition.

The purchase price of $2,025,395 was allocated as follows:

Cash	$ 601,712
Other current assets	441,994
Intangible assets	283,284
Current liabilities	(286,833)
Goodwill	985,238
Purchase price	$ 2,025,395

Amortizable intangible assets acquired, including VASP licenses and agreements have an estimated average useful life of 3.3 years. The amortization expense of intangible assets for the years ended December 31, 2005 and 2006 was $43,096 and $86,192 respectively. As of December 31, 2006, total goodwill recorded for the Lian Fei acquisition was $985,238, representing the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The operating results of Lian Fei were consolidated with those of the Company beginning in July 2005.

(e) Acquisition of Qimingxing

In August 2005, the Company completed the acquisition of Qimingxing, a privately held provider of VAS services to China Mobile. As a result of such acquisition, Qimingxing became a VIE of Linktone. The primary purpose of the acquisition was to provide a separate network access code in order to increase market share in the PRC VAS market.

The aggregate purchase price was $1,866,072 and comprised of three elements: (a) $747,052 cash to selling shareholders; (b) $1,110,015 cash payable to Qimingxing to settle shareholders' loans and (c) approximately $9,005 in legal and professional costs related to the acquisition.

The purchase price of $1,866,072 was allocated as follows:

Cash	$ 1,026
Other current assets	1,154,451
Intangible assets	233,764
Current liabilities	(10,341)
Goodwill	487,172
Purchase price	$ 1,866,072

Amortizable intangible assets acquired, including VASP licenses and agreements have an estimated average useful life of approximately 3.3 years. The amortization expense of intangible assets for the years ended December 31, 2005 and 2006 was $23,841and $71,524 respectively. As of December 31, 2006, total goodwill recorded for the Qimingxing acquisition was $487,172, representing the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The operating results of Qimingxing were consolidated with those of the Company beginning in September 2005.

(f) Acquisition of Ojava

On December 20, 2005, the Company entered into definitive agreements to acquire a 51% share of Ojava Overseas, a British Virgin Islands limited liability corporation, and an 80% share of Beijing Ojava, a local entity in the PRC with exclusive contractual arrangements with Ojava Overseas through its PRC subsidiary, Ruida. Ojava Overseas, Ruida and Beijing Ojava are collectively known as Ojava Group. Ojava Group is a leading mobile game developer and game publisher in the PRC. The primary purposes of the acquisition were to strengthen the Company's overall game service portfolio and development capabilities and increase its share in the Java games market.

The initial aggregate purchase price is comprised of two elements: $1,803,157 cash to shareholders of Ojava Overseas and $992,457 paid to Beijing Ojava to settle shareholders' loans.

The above acquisition was completed in January 2006 and the operating results of Ojava Group were consolidated with those of the Company starting from February 2006 at the acquired percentage of shareholdings.

On August 1, 2006, the Company entered into a supplementary agreement to acquire the remaining shares of Ojava Group for $4.7 million cash paid to shareholders of Ojava Group and contingent consideration based on an earn out at a factor from 0 to 0.5 of net profit of the Ojava Group and the Group's Java games' profitability from July 1, 2006 to June 30, 2007.

The Company also incurred approximately $50,375 in legal and professional costs related to the acquisition.

The full operating results of Ojava Group were consolidated with those of the Company beginning in August 2006.

The purchase price of $7,545,989 was allocated as follows:

Cash	$ 1,031,875
Fixed assets	27,579
Other long term assets	69,472
Other current assets	752,505
Intangible assets	1,555,000
Current liabilities	(256,286)
Goodwill	4,365,844
Purchase price	$ 7,545,989

For the year ended December 31, 2006, intangible assets acquired from Ojava Group were as follows:

Technology	$ 860,213
Licenses	24,578
Partnerhsip and non-compete agreements	626,726
Domain names	43,483
Total	$ 1,555,000

Amortizable intangible assets acquired, including technology, VASP licenses and agreements, domain names and non-compete agreements with certain Ojava's executives, have an estimated average useful life of approximately 1.83 years. The amortization expense of intangible assets for the years ended December 31, 2006 was $734,422. As of December 31, 2006, total goodwill recorded for the Ojava acquisition was $4,365,844, representing the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired.

The following table summarizes the goodwill arising from the above acquisitions:

	Year ended December 31,	
	2005	2006
Brilliant	$ 8,099,207	$ 8,033,497
Cosmos	102,247	2,149,792
Zhong Tong	497,355	497,355
Lian Fei	985,238	985,238
Qimingxing	487,172	487,172
Ojava	–	4,365,844
Total	$ 10,171,219	$ 16,518,898

In accordance with SFAS 142, goodwill is not amortized but is subject to an annual impairment assessment. The Company performed impairment tests relating to goodwill arising from the above acquisitions and concluded there was no impairment of the carrying value of the goodwill as of December 31, 2006 and 2005.

Based on an assessment on all the acquired companies' financial performance made by the Group in 2005, only Brilliant Group is considered material to the Group. The following un-audited pro forma financial information reflects the consolidated results of operations of the Group as if the acquisition of Brilliant Group had taken place on January 1, 2005. The pro forma information includes adjustment for amortization of intangible assets acquired. The pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been affected on the assumed date.

(Pro forma)	2005 (unaudited)
Net revenue	$ 73,918,603
Net income	12,306,063
Earnings per basic share	0.05
Earnings per dilutive share	0.04

The Group completed its acquisition of Ojava Group in January 2006 and began consolidating the operating results of the Ojava Group in February 2006. Given this business combination was completed near the beginning of the year, management believes the presentation of the pro forma financial information with regard to a summary of the results of operations of the Group assuming the acquisition of the Ojava Group had occurred on January 1, 2006 is not necessary.

7 Cash and Cash equivalents

	Year ended December 31,	
	2005	2006
Cash	$ 24,527,083	$ 24,550,214
Commercial paper and investment in money market accounts	11,725,595	26,894,872
Total	$ 36,252,678	$ 51,445,086

Interest income earned from the above cash and cash equivalents amounted to $734,372, $1,005,854 and $697,661 for the years ended December 31, 2004, 2005 and 2006, respectively.

8 Short term investments

The investments in marketable debt securities and time deposits with an original maturity of three months or more are classified as available for sale securities. The Company invests in securities with the intent to make such funds readily available for operating or acquisition purposes and, accordingly, classifies them as short term investments. All these marketable debt securities are due within one year and the aggregate fair values of these securities as of December 31, 2005 and 2006 were $41,580,530 and $1,012,230, respectively.

During the years ended December 31, 2005 and December 31, 2006, the Group recorded $96,317 and nil of unrealized loss on its marketable debt securities, respectively, as a component of comprehensive income. The Company

considered that the declines in value were not other than temporary, because the declines in market value were attributable to changes in interest rates, not credit quality. The Company has the ability and intent to hold these investments until maturity. Investments in available for sale at fair value were as follows:

	As of December 31, 2005			
	Cost	Accrued interest	Unrealized loss	Estimated fair value
Government and government agency bonds	$ 18,493,880	$ 262,393	$ (21,410)	$ 18,734,863
Corporate bonds	21,110,705	570,742	(74,907)	21,606,540
Time deposit	1,239,127	–	–	1,239,127
Total	$ 40,843,712	$ 833,135	$ (96,317)	$ 41,580,530

	As of December 31, 2006			
	Cost	Accrued interest	Unrealized loss	Estimated fair value
Time deposits	$ 1,012,230	–	–	$ 1,012,230

9 Accounts receivable, net

	Year ended December 31,	
	2005	2006
Accounts receivable	$ 16,093,899	$ 12,881,039
Less: Allowance for doubtful accounts	(148,237)	(509,339)
	$ 15,945,662	$ 12,371,700
Movement in allowance for doubtful accounts:		
Balance at beginning of year	$ (338,291)	$ (148,237)
Collection/(charge to expense)	190,054	(361,102)
Balance at end of year	$ (148,237)	$ (509,339)

10 Tax refund receivable

Pursuant to various software license agreements between Huitong and Linktone Internet and the VIEs, Huitong and Linktone Internet charge software license fees to the VIEs which are subject to VAT at 17%. Under the applicable tax regulations, Huitong and Linktone Internet are entitled to a tax refund equivalent to the portion of VAT expenses in excess of 3%. This receivable relates to the 14% VAT refund.

11 Deposits and other receivables

	Year ended December 31,	
	2005	2006
Rental and other deposits	$ 579,899	$ 576,312
Staff advances	833,047	456,560
Convertible loan receivable	581,782	86,434
Prepayments to advertising suppliers, content and other providers	2,325,879	2,629,119
Prepayment for acquisition of VIEs	604,120	–
Restricted cash	122,868	–
Others	89,354	65,137
Total	$ 5,136,949	$ 3,813,562

Staff advances include advances to employees for settlement of investment related payables for acquisition of VIEs. The settlements are expected to be made within a year. As of December 31, 2005 and December 31, 2006, such advances amounted to $433,694 and nil, respectively.

Convertible loan receivable relates to part of the drawdown of an interest free convertible loan totaling $2,555,000, pursuant to senior secured convertible loan agreements, signed with 9 Sky International Ltd. and its related parties, Shanghai Yue Sheng Information Technology Co., Ltd. and Shanghai Yin Zhi Yue Information Technology Co., Ltd. (collectively, known as "9 Sky entities") and the shareholders' representatives of 9 Sky entities on October 12, 2005. These loans were convertible into a certain percentage of shares of the 9 Sky entities upon occurrence of certain conditions within six months of October 12, 2005.

The Company paid $581,782 and $176,666 to 9 Sky International Ltd. and its related parties in 2005 and 2006 respectively. Due to a change in business strategy, in June 2006, the Company decided not to convert these loans with a total balance of $758,448 into shares of the 9 Sky entities and entered into a loan repayment agreement with 9 Sky entities and its shareholders. This agreement superseded all prior agreements and required the loans to be repaid by September 30, 2006. Interest would be charged on over due loan amounts at 6% per annum.

In December 2006, the Company signed a supplementary loan repayment agreement with the 9 Sky entities and its shareholders. This supplementary loan repayment replaces the original loan repayment agreement and sets out the repayments of loan principal and interests as follows: (i) repayment of loan principal of $9,597 and interest charges of $41,580 for 2006 by March 31, 2007; (ii) repayment of loan principal of $76,837 and interest charges of $3,750 by September 30, 2007 and (iii) repayment of loan principal of $672,014 (included in long term asset note (16)) and interest charges of $67,201 by March 31, 2008. The interest rate on over due loan amounts was increased to 10% per annum effective from January 2007. The loan principal due as of March 31, 2007 has been repaid in 2007.

In July 2007, the Company has reached an agreement with one of the 9Sky founders to obtain a pledge of his 1.1 million common shares against the outstanding 9Sky International Ltd. loan due after one year of $672,014 and the cumulative interest charges. Pursuant to this legally binding and enforceable arrangement, the Company has agreed that 9Sky International Ltd. would repay the $672,014 outstanding loan and the related interest charges by April 30, 2008. The Company also has the right to convert the aforementioned outstanding loan and interest charges into 1.1 million ordinary shares of 9Sky International Ltd., in the event of payment default by 9Sky International Ltd. The

Company also has the right to sell these shares back to the 9Sky founder for cash, at a value of $1 per share, by November 2008.

Based on its assessment of the financial position and business prospects of the 9Sky entities (as supported by share transactions between 9Sky and unrelated third parties), management believes that the outstanding loan due from 9Sky was not impaired and no provision was necessary at December 31, 2006.

Restricted cash relates mainly to proceeds from the exercise of stock options received on behalf of employees. The related liability to employees is recorded in accrued liabilities and other payables (note 18).

12 Components of revenue

The Group's revenue comprises 2G (mainly SMS), 2.5G services including MMS, WAP and Java games, audio related services including RB and IVR services, casual games, and advertising. Gross revenues for the years ended December 31, 2004, 2005 and 2006 are as follows:

	Year ended December 31,		
	2004	2005	2006
2G	$ 40,180,566	$ 46,702,269	$ 44,658,274
Audio related services	3,659,007	16,963,773	21,501,567
2.5G services	6,449,366	8,300,826	11,691,995
Casual games	–	1,374,995	1,467,409
Advertising	–	–	334,040
Others	29,805	266,740	188,409
Total revenue	$ 50,318,744	$ 73,608,603	$ 79,841,694

13 Concentrations

(a) Dependence on the Operators

The Group's revenue is mainly derived from cooperative arrangements with the Operators in Mainland China. The Operators are entitled to a portion of the revenues earned from the transmission of telecom short messages as well as for the billing and collection of service. If the strategic relationship with either the Operators in the PRC is terminated or scaled-back, or if the Operators alter the revenue sharing arrangements, the Group's telecom value-added service business would be adversely affected.

Revenues earned from China Mobile for the years ended December 31, 2004, 2005 and 2006 were approximately $44,313,720, $62,416,761 and $60,174,473, respectively representing 88%, 85% and 75% of revenues, respectively.

Amounts due from China Mobile as of December 31, 2004, 2005 and 2006 amounted to approximately $9,319,663, $13,173,196 and $9,440,740, respectively, representing 89%, 83% and 76% of accounts receivable, respectively.

(b) Credit risk

The Group depends on the billing system of the Operators to charge the mobile phone users through mobile phone bills and collect payments from the users on behalf of the Group. The Group generally does not require collateral for its accounts receivable. The Group has not experienced any significant credit losses for any periods presented.

14 Property and equipment, net

	Year ended December 31,	
	2005	2006
Computer hardware/equipment	$ 2,983,058	$ 3,840,325
Office equipment	1,002,484	1,202,471
Leasehold improvements	1,585,997	1,400,199
	5,571,539	6,442,995
Less: Accumulated depreciation	(2,006,093)	(3,590,260)
Net book value	$ 3,565,446	$ 2,852,735

During the years ended December 31, 2004, 2005 and 2006, the depreciation charges amounted to approximately $429,516, $1,419,609 and $1,843,997, respectively.

Upon retirement or disposal of fixed assets, the cost and related amount of accumulated depreciation or amortization are eliminated from the asset and accumulated depreciation accounts, respectively.

15 Intangible assets

The following table summarizes intangible assets, net:

	December 31, 2005			December 31, 2006		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Technology	$ 704,000	$ (195,003)	$ 508,997	$ 1,831,344	$ (902,928)	$ 928,416
Customer base	28,000	(18,015)	9,985	28,000	(28,000)	–
Licenses	754,200	(96,919)	657,281	478,778	(271,434)	207,344
Partnership and non-compete agreements	1,469,420	(444,804)	1,024,616	2,104,146	(1,121,387)	982,759
Domain names	38,864	(5,558)	33,306	82,347	(37,873)	44,474
	$ 2,994,484	$ (760,299)	$ 2,234,185	$ 4,524,615	$(2,361,622)	$ 2,162,993

Based on the intangible assets subject to amortization, the Company estimates amortization expenses for each of the succeeding five years as follows:

2007	$ 1,532,489
2008	584,954
2009	8,974
2010	8,974
2011	8,974
Total	$ 2,144,365

16 Other long term assets

	December 31,	
	2005	2006
Television advertising agency right	$ –	$ 4,802,336
Loan receivable	–	672,014
Others	–	1,281
Total	$ –	$ 5,475,631

Television advertising agency right relates to the prepaid right to be the exclusive advertising agent for QTV for the period from January 1, 2007 to December 31, 2013.

The loan receivable is from the 9 Sky entities to be repaid in 2008 as described in more detail in note 11.

17 Taxes payable

	December 31,	
	2005	2006
Value added taxes	$ 2,625,588	$ 621,055
Business taxes	501,028	845,034
Enterprise income taxes	2,465,238	1,259,180
Other taxes	306,928	286,268
Total	$ 5,898,782	$ 3,011,537

18 Accrued liabilities and other payables

	December 31,	
	2005	2006
Payable for acquisition of subsidiaries and VIEs	$ 6,921,973	$ –
Accrued liabilities	3,321,904	3,182,749
Accrued payroll	293,989	706,777
Accrued welfare benefits	382,226	494,859
Option proceeds due to staff	122,868	–
Payable for purchase of fixed assets	272,575	88,000
Other payables	571,170	636,879
Total	$ 11,886,705	$ 5,109,264

19 Mainland China contribution plan and profit appropriation

Full time employees of the Company and its subsidiaries in the PRC participate in a government-mandated multi-employer defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require that the Company and its subsidiaries accrue for these benefits based on certain percentages of the employees' salaries. The total provision for such employee benefits was $655,887, $1,334,964 and $1,508,846 for the years ended December 31, 2004, 2005 and 2006, respectively.

The Company is required to make contributions to the plan out of the amounts accrued for medical and pension benefits to the relevant local labor bureaus. The contributions for the years ended December 31, 2004, 2005 and 2006 amounted to $509,744, $1,318,296 and $1,484,218, respectively. The local labor bureaus are responsible for the medical benefits and the pensions to be paid to these employees. The Company has no further commitments beyond its monthly contributions.

The Company's subsidiaries and VIEs in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. Its subsidiaries, in accordance with the laws on Enterprise with Foreign Investment of China, must make appropriations to (i) general reserve and (ii) enterprise expansion fund. The general reserve fund requires annual appropriations of 10% of after-tax profit (as determined under PRC GAAP at each year-end) until such fund has reached 50% of the company's registered capital; enterprise expansion fund appropriation is at the company's discretion. The Company's VIEs, in accordance with the China Company Laws, must make appropriations to a (i) statutory reserve fund and (ii) discretionary surplus fund. Until January 1, 2006, contributions to a statutory public welfare fund were also required. The statutory reserve fund requires annual appropriations of 10% of after-tax profit (as determined under PRC GAAP at each year-end) until such fund has reached 50% of the company's registered capital; the statutory public welfare fund requires annual appropriations of at least 5~10% of after-tax profit (as determined under PRC GAAP at each year-end before 2006); other fund appropriation is at the company's discretion.

The general reserve fund and statutory reserve fund can only be used for specific purposes, such as setting off of accumulated losses, enterprise expansion or increasing the registered capital. The enterprise expansion fund was mainly used to expand the production and operation; it also may be used for increasing the registered capital. The

statutory public welfare fund must be used for capital expenditures for the collective welfare of employees. These funds are not transferable to the Company in the form of cash dividends, loans or advances.

In respect of the years ended December 31, 2005 and 2006, the Group appropriated after-tax profits of $476,016 and $336,749, respectively, to the general reserve and statutory reserve fund and statutory public welfare funds; the Group made no appropriations to the enterprise expansion fund and discretionary surplus fund. As of December 31, 2005 and 2006, the Group had appropriated $2,007,776 and $2,344,525, respectively to non-distributable reserve funds.

20 Income Taxes

Cayman Islands and British Virgin Islands

Under the current laws of the Cayman Islands and British Virgin Islands, Linktone, Brilliant and Ojava Overseas are not subject to tax on income or capital gains.

China

The Company's subsidiaries and VIEs are subject to Enterprise Income Taxes ("EIT) of the PRC at a statutory rate which comprises national income tax and local income tax.

The statutory rate varies among the subsidiaries and VIEs as follows:

Linktone Consulting, Weilan, Wang You and Ruida:

The applicable statutory rate is 33% which comprises 30% national income tax and 3% local income tax.

Zhong Tong, Linktone Software and Ling Yu:

Since these entities are located in either the economic development zones in coastal cities or Pudong new district, they are subject to a preferential statutory rate of 15% which comprises 15% national income tax and zero local income tax.

Huitong and Linktone Internet:

These entities qualify as foreign investment production enterprises and were established in a coastal economic development zone in the old urban district. The applicable tax rate is 27% which comprises 24% national income tax and 3% local income tax. In addition, they are entitled to a two year EIT exemption followed by three years with a 50% reduction in the tax rate, commencing from the first profitable year. Huitong was entitled to tax exemption in 2003 and 2004 and was at its first 50% reduction in tax rate year in 2005. Linktone Internet was entitled to its first two years of tax exemption in 2005 and 2006.

In 2006, Huitong was designated as one of the top China National Software enterprises and the preferential applicable national income tax rate is 10%. Huitong was entitled to its second year of 50% reduction in tax rate in 2006, when the applicable local income tax rate was 1.5%.

Yuan Hang, Cosmos, Lian Fei and Ojava:

These entities qualify as high technology enterprises. Lian Fei, Cosmos and Ojava are entitled to a three year tax exemption followed by three years with a 50% reduction in the tax rate, commencing from the first operating year. Yuan Hang is entitled to a two year exemption followed by three years with a 50% reduction in the tax rate, commencing

from the first profitable year. Lian Fei was entitled to tax exemption from 2002 to 2004, Cosmos was entitled to tax exemption from 2003 to 2005 and Ojava was entitled to tax exemption from 2004 to 2006. Yuan Hang was entitled to tax exemption in 2004 and 2005.

Unilink and Qimingxing are currently considered as small businesses and are subject to a tax on revenue instead of income.

The provision for taxes on income consists of:

	Year ended December 31,		
	2004	2005	2006
Current	$ (1,062,185)	$ (2,420,655)	$ (1,421,308)
Deferred	64,878	916,326	154,125
Total	$ (997,307)	$ (1,504,329)	$ (1,267,183)

Reconciliation of the difference between statutory tax rate and the effective tax rate:

The following is a reconciliation between statutory EIT rate and the Group's effective tax rate:

	Year ended December 31,		
	2004	2005	2006
Statutory EIT rate	33%	33%	33%
Effect of tax holiday	(28)%	(25)%	(32)%
Non-deductible expenses incurred outside the PRC	5%	4%	4%
Non-deductible share-based compensation	9%	5%	6%
Other non-deductible expenses/non-taxable income	1%	1%	8%
Change in valuation allowance	(8)%	(1)%	0%
Differential statutory tax rates applicable to certain subsidiaries	(4)%	(5)%	(9)%
Adjustment to prior year tax provision	–	(1)%	6%
Effective EIT rate	8%	11%	16%

The aggregate dollar and per share effect of the tax holiday in 2004, 2005 and 2006 was $3,785,401, $3,450,000 and $2,623,000 and $0.02, $0.01 and $0.01 per diluted and basic ordinary share, respectively.

Other non-taxable income consists primarily of income at Unilink and Qimingxing that is subject to a tax on revenue instead of income.

The Group's deferred tax assets and deferred tax liabilities at each balance sheet date are as follows:

	Year ended December 31,	
	2005	2006
Deferred tax assets:		
Establishment costs	$ 53,176	$ 18,768
Plant, property and equipment	243,414	317,006
Intangibles	121,074	268,136
Deferred income	–	13,082
Accrual and other liabilities	525,376	346,020
Advertising expenses	393,964	704,900
Net operating losses	845,466	614,139
Total deferred tax assets	2,182,470	2,282,051
Valuation allowance	(319,987)	(294,518)
Total deferred tax assets, net of valuation allowance	$ 1,862,483	$ 1,987,533
Deferred tax liabilities:		
Accrued income	(711,147)	(829,718)
Plant, property and equipment	–	(20,068)
Intangibles	(170,132)	(2,418)
Total deferred tax liabilities	$ (881,279)	$ (852,204)
Net deferred tax assets	981,204	1,135,329
Deferred tax assets – current	811,014	1,020,608
Deferred tax liabilities – current	(881,279)	(576,600)
Deferred tax assets – non current	1,051,469	691,321
Net deferred tax assets	$ 981,204	$ 1,135,329

Subject to the approval of the relevant tax authorities, the Group had total tax loss carryforwards of approximately $2.0 million as of December 31, 2006 for EIT purposes. Approximately $1.4 million, $0.3 million and $0.3 million of such losses will expire in 2008, 2009 and 2011, respectively. These tax loss carryforwards give rise to potential deferred tax assets totaling $0.6 million. Under the current tax planning, the management expects that the Group will not generate enough taxable income to utilize a portion of loss carry forwards. The Group adjusted the valuation allowance based on the probability assessment as of December 31, 2006.

21 Financial instruments

The carrying amount of the Group's cash and cash equivalents approximates their fair value due to the short maturity of those instruments. The Group's short-term investments are carried at their fair value. The carrying value of receivables and payables approximated their market values based on their short-term maturities.

22 Capital structure

On September 7, 2005, the Company's shareholders authorized the repurchase of up to $15 million worth of American Depositary Shares or ADSs. By June 23, 2006, the Company had purchased 1,866,600 ADSs in the open market for an aggregate purchase amount of $15 million including brokerage commission, completing the entire share repurchase program. Out of these 1,866,600 ADSs, 1,666,600 ADSs have been retired.

On August 7, 2006, the Company's board of directors approved a new $20 million stock repurchase program. As of December 31, 2006, the Company had repurchased 1,965,501 ADSs for a total consideration of $10 million including brokerage commissions. These shares repurchased, totaling 2,165,501 ADSs are being held by the Company as treasury stock. Treasury stock is accounted for on the cost basis.

23 Stock option plans

The Board of Directors has approved two stock option plans that provide for the issuance of up to 45,946,024 ordinary shares. The plans provide for the grant to employees of incentive share options and for grants to employees, directors and consultants of non-statutory share options. Options are granted with a term of up to 10 years and generally vest over a four year term. The plans are administered by the compensation committee designated by the Board of Directors.

Share-based Compensation

Prior to the adoption of SFAS 123R, the Group accounted for share-based employee compensation arrangements in accordance with APB No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations. Under APB No. 25, compensation cost was recognized based on the difference, if any, between the estimated fair value of the Group's ordinary shares on the measurement date and the amount an employee must pay to acquire the shares. The measurement date was determined when the number of shares and the exercise price were fixed. Total compensation cost as determined at the date of option grant was recorded in shareholders' equity as additional paid-in capital with an offsetting entry to deferred stock-based compensation. Deferred stock-based compensation was amortized on a straight-line basis and charged to expense over the vesting period of the underlying options. The Group provided the disclosures required under SFAS No. 148, accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123, showing the estimated effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123.

The pro forma information for share-based compensation in 2004 and 2005 is as follows:

	Year ended December 31,	
	2004	2005
Net income	$ 11,066,034	$ 12,449,063
Add: Compensation expense for employees under APB No. 25	3,464,807	2,012,425
Less: Compensation expense for employees under fair value based methods	(1,183,519)	(2,653,862)
Pro forma net income	13,347,322	11,807,626
Accretion on Series B convertible redeemable preferred shares	(28,206)	–
Amount allocated to participating preferred shareholders	(958,473)	–
Pro forma net income attributable to ordinary shareholders	$ 12,360,643	$ 11,807,626
Basic earnings per share		
– As reported	$ 0.05	$ 0.05
– Pro forma	$ 0.06	$ 0.05
Diluted earnings per share		
– As reported	$ 0.04	$ 0.05
– Pro forma	$ 0.05	$ 0.04

Impact of SFAS No. 123R

The Group adopted SFAS No. 123R using the modified prospective transition method beginning January 1, 2006. Estimated compensation costs for unvested grants as January 1, 2006 are recognized over the remaining service period using the compensation cost estimated for the SFAS 123 pro forma disclosures. Compensation for new grants are recognized using the grant date fair value method, net of a forfeiture rate, on a straight-line basis over the requisite service period of the award.

The impact on the results for share-based compensation in 2006 was to reduce net income by $1,458,558 with details as follows:

	For the year ended December 31, 2006
Product development	$ 313,317
Selling and marketing	364,582
Other general and administrative	780,659
Total share-based compensation	$ 1,458,558
Impact on net income per share:	
Basic	$ 0.006
Diluted	$ 0.006

Valuation assumptions

The Company calculated the fair value of each option grant on the date of grant using the Black-Scholes option pricing model. The following are the assumptions used for each respective period:

		Year ended December 31,		
		2004	2005	2006
Risk-free interest rate (%)		1.73-3.61	1.73-4.36	4.50-4.91
Expected life (years)	(1)	2-5	2-6	2-6
Expected dividend yield (%)	(2)	0	0	0
Volatility (%)		80	60	60

(1) In the absence of sufficient historical data in the exercise behavior of our staff, the Company decided for the short term to use the shortcut method which applies the mid point of option life and average vesting period.

(2) The Company used a 6-year period of historical data of similar entities in the industry to estimate expected stock price volatility used in the computation of stock based compensation under the fair value method.

Award Activity Information

The following table summarizes the option activity under the Company's stock option (shares) program for the periods presented:

	Year ended December 31,							
	2004		2005		2006			
	Options outstanding	Weighted average exercise price	Options outstanding	Weighted average exercise price	Options Outstanding	Weighted Average Exercise Price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at beginning of period	31,900,300	$0.10	35,235,090	$0.30	32,838,400	$0.40		
Granted	9,639,900	$1.07	8,380,500	$0.78	7,550,000	$0.69		
Exercised	(3,717,990)	$0.08	(6,924,910)	$0.08	(16,839,040)	$0.05		
Forfeited/cancelled	(2,587,120)	$1.04	(3,852,280)	$0.90	(8,828,719)	$0.84		
Outstanding at period end	35,235,090	$0.30	32,838,400	$0.40	14,720,641	$0.67	7.84	1,072,926
Weighted average fair value of options granted during period		$0.64		$0.45		$0.41		
Vested and expected to vest as of December 31, 2006					6,962,252	$0.61	6.70	1,074,222
Vested and exercisable as of December 31, 2006					5,764,539	$0.59	6.18	1,074,222

The weighted average fair value of options granted during fiscal years 2004, 2005 and 2006 was $0.64, $0.45 and $0.41, respectively. The total intrinsic value of options exercised during fiscal 2006 was $11.6 million. The intrinsic value is calculated as the difference between the market value on the date of exercise and the exercise price of the shares.

As of December 31, 2006, there was $3.3 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards granted to the Company's employees. This cost is expected to be recognized over a weighted averaged period of 2.9 years. Total compensation cost may be adjusted for future changes in estimated forfeitures.

The aggregate intrinsic value of options outstanding and options exercisable as of December 31, 2006 was $1.1 million. The aggregate intrinsic value is calculated as the difference between the market value as of December 31, 2006 and the exercise price of the shares.

The following is additional information relating to options outstanding as of December 31, 2006:

	Options outstanding as at December 31, 2006			Options exercisable as at December 31, 2006		
Range of exercise price	Options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price
$0.07 – $0.10	2,488,200	4.21	0.09	2,488,200	4.21	0.09
$0.66 – $0.78	9,295,840	8.98	0.68	1,043,938	7.44	0.69
$1.02 – $1.10	2,686,701	7.33	1.08	2,038,751	7.38	1.08
$1.37 – $1.40	249,900	7.32	1.38	193,650	7.29	1.38
	14,720,641	7.84	0.67	5,764,539	6.02	0.59

24 Commitments and contingencies

(a) Operating lease commitments

The Group rents offices under operating lease agreements. The net aggregate minimum future lease payments under non-cancelable operating leases as of December 31, 2006 are as follows:

2007	$ 897,968
2008	532,252
2009	65,879
	$ 1,496,099

As of December 31, 2006, the Group had no operating lease commitments beyond February 2009.

For the years ended December 31, 2004, 2005 and 2006 the Group incurred rental expense of approximately $925,280, $1,439,903 and $1,653,787, respectively.

(b) Other commitments

	Year ended December 2006
Advertisement agreements with third parties	$ 1,492,974
Purchase of property and equipment	126,870
	$ 1,619,844

The Group's agreements with CYL for advertising agency and management fees for QTV have these future minimum fees as of December 31, 2006 as follows:

Cooperation with CYL on QTV:

2007	$ 1,920,934
2008	4,482,180
2009	5,762,803
2010	5,762,803
2011	5,762,803
2012	5,762,803
2013	5,762,803
	$ 35,217,129

(c) Legal proceedings

In June 2006, Shenzhen Tencent Computer System Co.,Ltd. ("Tencent"), which operates an instant messaging service platform QQ filed a lawsuit against Weilan and Linktone Consulting alleging infringement of intellectual property rights of QQ and unfair competition and claiming damages of $641,026 from the Group. The Group launched a platform called "iliao" or "ichat" in 2005 which Tencent claimed to be similar to its QQ. The Group's "iliao" platform was licensed from ACL Wireless Co., Ltd ("ACL"), an Indian company and the Group paid ACL certain monthly license fees. Based on advice from PRC legal counsel, management believes that it is reasonably possible that the Group could incur a loss with respect to this litigation, whether through reaching a final judgment on the merits or through settlement. However, as of the date of the report, it is not possible to estimate the range of such loss, if any. Accordingly, no provision has been made as of December 31, 2006.

In December 2006, Yuan Hang filed a lawsuit against Tencent for infringement of its registered trade marks for two of its most popular casual games, "Wa Ken" and "Bao Huang" claiming damages of $669,231. Yuan Hang registered these trade marks in September 2003 and the lawsuit alleges similar games with the same names and trade marks appeared in the QQ game internet portal in February 2005. No benefit from this claim has been recorded.

Both cases are in discovery.

(d) Mainland Chinese market macro-economic and regulatory and uncertainties

The Chinese market in which the Group operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability of the Group to develop its telecom internet business and to provide internet and television content in the PRC. Though the PRC has, since 1978, implemented a wide range of market-oriented economic reforms, continued reforms and progress towards a full market-oriented economy are uncertain. In addition, the telecommunication, information, television, advertising and media industries remain highly regulated. Restrictions are currently in place or are unclear regarding in what specific industry segments foreign owned entities, like the Group, may operate. The Group's legal structure and scope of operations in the PRC could be subject to restrictions which could result in severe limitations on the Group's ability to conduct business in the PRC, and this could have a material adverse impact on the Group's financial position, results of operations and cash flows.

(e) Other risks

The Group's sales, purchase and expense transactions are generally denominated in RMB and a significant portion of the Group's assets and liabilities are denominated in RMB. The RMB is not freely convertible into foreign currencies. In Mainland China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions at exchange rates set by the People's Bank of China ("PBOC"). Remittances in currencies other than RMB by the Group in Mainland China must be processed through the PBOC or other Mainland China foreign exchange regulatory bodies and require certain supporting documentation in order to effect the remittance.

25 Earnings per share

The following table sets forth the computation of basic and diluted net earnings per share for the periods indicated based on the requirements of SFAS 128:

	Year ended December 31,		
	2004	2005	2006
Numerator:			
Net income for the year	$ 11,066,034	$ 12,449,063	$ 6,792,591
Accretion for Series B Redeemable Convertible Preferred Shares	(28,206)	–	–
Amount allocated to participating preferred shareholders	(794,307)	–	–
Numerator for basic earnings per share	$ 10,243,521	$ 12,449,063	$ 6,792,591
Numerator for diluted earnings per share	$ 10,243,521	$ 12,449,063	$ 6,792,591
Denominator:			
Denominator for basic earnings per share – weighted-average ordinary shares outstanding	224,569,476	257,020,040	253,850,193
Effect of dilutive option securities	23,511,650	18,365,539	5,679,338
Denominator for diluted earnings per share	248,081,126	275,385,579	259,529,531
Basic earnings per share	$ 0.05	$ 0.05	$ 0.03
Diluted earnings per share	$ 0.04	$ 0.05	$ 0.03

Prior to the Company's IPO in March 2004, the Company's Preferred Shares were not included in the calculation of diluted earnings per share because of their anti-dilutive effects.

26 Subsequent events

On January 8, 2007, Linktone, through a VIE entered into a contract with Shanghai Dong Fang Long New Media Co., Ltd. ("DFL"), a subsidiary of Shanghai Media Group ("SMG") to provide interactive telecom value added services for selected radio and television stations and related internet portals under SMG Group. DFL is committed to provide certain content and resources as set out in the contract from SMG to Linktone to develop telecom value added services for access by mobile phone users through codes of Linktone and DFL. If content and resources are made available to Linktone by DFL in a manner as set out in the contract and total revenue from the collaboration of Linktone and DFL achieves $16.1 million in 2007, Linktone guarantees DFL's share of revenue to be $11.3 million. If total revenue from the collaboration achieves $25.6 million, Linktone guarantees DFL's share of revenue to be $12.8 million. In accordance with the contract, the Group advanced $1.3 million in January 2007 to DFL.

On March 1, 2007, a VIE, Zhong Qing Wei Lian Cultural Communication Co., Ltd. was established for the purpose of producing television and interactive telecom programs for QTV. It is 60.0% owned by Weilan and 40% owned by Lian Fei. 51% of the company's shareholding will be transferred to CYL.

In March 2007, the National People's Congress (China's top legislature) enacted several changes to the Chinese income tax system which will be effective on January 1, 2008. The changes include a change in tax rates, a new tax incentive policy for certain industry sectors and projects supported by the government, new anti-avoidance rules on tax arrangements, potential exemptions from/reductions to China's withholding tax for China-source income and the introduction of a tax regime that subjects tax resident enterprises to the income tax, based upon worldwide income. Much of the detailed implementation guidance has yet to be provided by the China government, and the Group is currently evaluating the impact of these changes on the Group.

In May 2007, the Group entered into an agreement with eChinaCash, Inc., ("eCC") to purchase 49% of the equity of eChinaMobile (BVI) Ltd. ("eChinaMobile"), a wholly owned subsidiary of eCC. eCC is a US incorporated, Beijing based company that builds and maintains customer loyalty affinity programs and payment card programs for large corporations and financial institutions which include Chinese blue chip companies. The primary objective of eChinaMobile is to establish a platform to provide telecom value added service and original content to eCC's and Linktone's clients through the cross selling opportunities that arise through having access to each others extensive database of users.

In June 2007, the Group entered into an agreement with Shanghai Homer & Landau Cartoon Cultural Communication Co., Ltd. ("SHLCC") to establish a joint venture in Shanghai to operate VAS services using the content and promotional channels of SHLCC and its related party, Hunan Greatdreams Cartoon Media Co., Ltd.

CORPORATE INFORMATION

Company Profile

Linktone Ltd. is one of the leading providers of wireless interactive entertainment products and services in China. Linktone provides a diverse portfolio of services to wireless consumers, with a particular focus on media, entertainment and communications. These services are promoted through the Company's own marketing channels and through the networks of the mobile operators in China. Through in-house development and alliances with international and local branded content partners, Linktone develops, aggregates and distributes innovative and engaging products to maximize the breadth, quality and diversity of its offerings.

Background

Established in November 1999, Linktone Ltd. is incorporated in the Cayman Islands. The company primarily conducts its business through its wholly owned subsidiaries, which collectively have become one of China's leading wireless value-added service providers. With a diverse services portfolio, strong partnerships with mobile operators and content providers, and strong revenue and profit growth, Linktone commands a strong industry leadership position. Linktone is headquartered in Shanghai, China with regional offices in Beijing and Guangzhou and local offices in 25 provinces. As of December 31, 2006, the company had more than 600 employees.

Management

Michael Guangxin Li	Chief Executive Officer and Director
Colin Sung	Chief Financial Officer
Maggie Su	Executive Vice President of Operations
Ping Mei	Senior Vice President of Sales

Board of Directors

Elaine La Roche[†*(1)(2)(3)]	Investment Executive, Cantor Fitzgerald
Thomas Hubbs[*(1)(2)(3)]	CFO and Executive Vice President, Bytemobile, Inc.
Allan Kwan[*(2)(3)]	Partner Oak Ventures
Jun Wu[*(1)(2)(3)]	Founder; CEO, HAW Technology Co., Ltd.
Mark Begert	Independent Director, ChinaEdu
Michael Guangxin Li	CEO, Linktone Ltd.
Colin Sung	CFO, Linktone Ltd.

† Chairperson of the Board
* Independent director
(1) Member of audit committee
(2) Member of compensation committee
(3) Member of nominating committee

Depository for American Depositary Shares

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4 New York Plaza,
New York
NY 10004

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Hong Kong

Legal Counsel

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People's Republic of China

Independent Registered Public Accounting Firm

PricewaterhouseCoopers Zhong Tian CPAs Limited Company
PricewaterhouseCoopers Center
202 Hu Bin Road, Shanghai 200021
People's Republic of China

Market Data

Stock exchange	:	National Association of Securities Dealers Automatic Quotation System (NASDAQ)
Ticker symbol	:	LTON
IPO date	:	March 4, 2004
Industry	:	Wireless value-added services, telecom services

Investor Relations

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Annual General Shareholder Meeting

Linktone will host its 2007 annual general shareholder meeting at 10:00 am on [•], 2007, Shanghai time (10:00 pm on [•], 2007, U.S. Eastern Time) at its corporate headquarters at the following address: 12/F Cross Tower, 318 Fu Zhou Road, Huang Pu District, Shanghai, 200001, People's Republic of China.

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