

eFuture Information Technology Inc.

Form 20-F

June 28, 2007

Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

---

**FORM 20-F**

---

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006**

OR

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

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

Date of event requiring this shell company report \_\_\_\_\_

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 333-126007

---

**E-FUTURE INFORMATION TECHNOLOGY INC.**

(Exact name of Registrant as specified in its charter)

---

**Cayman Islands**

(Jurisdiction of incorporation or organization)

**No. 10 Building**

**BUT Software Park**

**No. 1 Disheng North Street**

**BDA, Yizhuang District**

**Beijing 100176, People's Republic of China**

**86-10-51650988**

(Address of principal executive offices)

---

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

Ordinary Shares, par value \$0.0756 per share

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

None.

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

None.

---

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:** 2,633,500 Ordinary Shares

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

**Indicate by check mark which financial statement item the registrant has elected to follow.**

Item 17  Item 18

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

---

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS</u></b>	<b>1</b>
<b><u>PART I</u></b>	
ITEM 1 <u>Identity of Directors, Senior Management and Advisers</u>	1
ITEM 2 <u>Offer Statistics And Expected Timetable</u>	1
ITEM 3 <u>Key Information</u>	2
ITEM 4 <u>Information on the Company</u>	15
ITEM 4A <u>Unresolved Staff Comments</u>	37
ITEM 5 <u>Operating and Financial Review and Prospects</u>	37
ITEM 6 <u>Directors, Senior Management and Employees</u>	55
ITEM 7 <u>Major Shareholders and Related Party Transactions</u>	61
ITEM 8 <u>Financial Information</u>	63
ITEM 9 <u>The Offer and Listing</u>	63
ITEM 10 <u>Additional Information</u>	64
ITEM 11 <u>Quantitative And Qualitative Disclosures About Market Risk</u>	73
ITEM 12 <u>Description of Securities other than Equity Securities</u>	74
<b><u>PART II</u></b>	
ITEM 13 <u>Defaults, Dividend Arrearages and Delinquencies</u>	74
ITEM 14 <u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	74
ITEM 15 <u>Controls and Procedures</u>	74
ITEM 15T <u>Controls and Procedures</u>	75
ITEM 16 <u>Reserved</u>	75
ITEM 16A <u>Audit Committee Financial Expert</u>	75
ITEM 16B <u>Code of Ethics</u>	75
ITEM 16C <u>Principal Accountant Fees And Services</u>	75
ITEM 16D <u>Exemptions From The Listing Standards For Audit Committees</u>	76
ITEM 16E <u>Purchases Of Equity Securities By The Issuer And Affiliated Purchasers</u>	76
<b><u>PART III</u></b>	
ITEM 17 <u>Financial Statements</u>	76
ITEM 18 <u>Financial Statements</u>	76
ITEM 19 <u>Exhibits</u>	76
<b><u>SIGNATURES</u></b>	<b>S-1</b>

**Table of Contents**

**SPECIAL CAUTIONARY NOTICE REGARDING**

**FORWARD-LOOKING STATEMENTS**

Certain matters discussed in this report, including matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended (the Securities Act), and the Securities Exchange Act of 1934, as amended (the Exchange Act), and involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from the future results, performance or achievements expressed or implied by such forward-looking statements. The words expect, anticipate, intend, plan, believe, seek, estimate and similar expressions are intended to identify such forward-looking statements. Our actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation, those discussed under Item 3 - Key Information-Risk Factors, Item 4 - Information on the Company, Item 5 - Operating and Financial Review and Prospects, and elsewhere in this report, as well as factors which may be identified from time to time in our other filings with the Securities and Exchange Commission (the SEC) or in the documents where such forward-looking statements appear. All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by these cautionary statements.

The forward-looking statements contained in this report reflect our views and assumptions only as of the date this report is signed. Except as required by law, we assume no responsibility for updating any forward-looking statements.

**PART I**

Unless the context requires otherwise, references in this report to e-Future, the Company, we, us, and our refer to e-Future Information Technology, Inc. and our wholly-owned subsidiary, e-Future (Beijing) Tornado Information Technology Inc.

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

Not applicable.

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

Not applicable.

**Table of Contents****Item 3. Key Information****A. Selected Financial Data**

	RMB					USD For the Year Ended December 31, 2006 (Unaudited)
	2002	For the Year Ended December 31,			2006	
	2002	2003	2004	2005	2006	
Total Sales	¥ 36,176,310	¥ 28,453,099	¥ 34,703,297	¥ 39,244,001	¥ 47,843,530	\$ 6,130,563
Income (Loss) From Operations	(5,825,259)	(1,165,482)	5,197,762	5,843,028	7,976,967	1,022,151
Net Income (Loss)	(6,140,366)	(1,529,859)	4,525,190	5,470,263	8,104,726	1,038,521
Basic Earnings (Loss) Per Share	(6.66)	(1.66)	4.91	4.43	4.80	0.61
Diluted Earnings (Loss) Per Share	(6.66)	(1.66)	2.90	3.50	4.43	0.57

	RMB					USD As of December 31, 2006 (Unaudited)
	2002	2003	As of December 31, 2004	2005	2006	
Total Assets	¥ 31,637,536	¥ 34,746,298	¥ 25,893,808	¥ 31,657,674	¥ 83,025,047	10,638,645
Total Current Liabilities	(31,591,125)	(35,705,675)	(21,981,899)	(19,565,356)	(18,476,058)	(2,367,482)
Long-term Liabilities	(30,405,072)	(30,583,993)	(30,583,993)			
Net Assets	(30,358,661)	(31,543,370)	(26,672,084)	12,092,318	64,548,989	8,271,163
Capital Stock						
(Excluding Long Term Debt and Redeemable Preferred Stock)	576,817	576,817	576,817	938,550	1,647,781	211,143

*Exchange Rate Information*

Our business is primarily conducted in China and all of our revenues are denominated in RMB. However, periodic reports made to shareholders will include current period amounts translated into U.S. dollars using the then current exchange rates, for the convenience of the readers. The conversion of RMB into U.S. dollars in this annual financial report is based on the noon buying rate in The City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. Unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual financial report were made at a rate of RMB 7.8041 to US\$1.00, the noon buying rate in effect as of December 30, 2006. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, or at all. The government of the People's Republic of China (the PRC) imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade. The Company does not currently engage in currency hedging transactions. The following table sets forth information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated.

**Table of Contents**

Period	Period-End	Noon Buying Rate		
		Average (1) (RMB per US Dollar)	Low	High
2002	8.2800	8.2770	8.2800	8.2669
2003	8.2767	8.2772	8.2800	8.2765
2004	8.2765	8.2768	8.2771	8.2765
2005	8.0702	8.1940	8.0702	8.2765
2006	7.8041	7.9723	7.8041	8.0702
December	7.8041	7.8220	7.8041	7.8350
2007				
January	7.7714	7.7876	7.7705	7.8127
February	7.7410	7.7502	7.7410	7.7632
March	7.7232	7.7369	7.7232	7.7454
April	7.7090	7.7247	7.7090	7.7345
May	7.6516	7.6773	7.6463	7.7065
June (through June 27th)	7.6210	7.6351	7.6175	7.6680

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

**B. Capitalization and Indebtedness**

Not applicable.

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

Not applicable.

**D. Risk Factors**

You should carefully consider all of the information in this Annual Report and, in particular, the risks outlined below.

***Our customers are Chinese companies engaged in retail, distribution and logistics industries, and, consequently, our financial performance is dependent upon the economic conditions of these industries.***

We have derived most of our revenues to date from the license of software products and related services to the Chinese retail, distribution and logistics industries, and our future growth is critically

## **Table of Contents**

dependent on increased sales to these particular industries. The success of our customers is intrinsically linked to economic conditions in these industries, which in turn are subject to intense competitive pressures and are affected by overall economic conditions. We believe the license of our software solutions and the purchase of our related services is discretionary and generally involves a significant commitment of capital. As a result, although we believe our products can assist China's retailers, distributors, wholesalers, and logistics companies in a competitive environment, demand for our products and services could be disproportionately affected by instability or downturns in the retailing, distribution, wholesaling and logistics industries, which may cause customers to exit the industry or delay, cancel or reduce any planned expenditures for information management systems and software products. We have previously experienced this effect in connection with the impact that severe acute respiratory syndrome, or SARS, placed upon China's retailing industry in recent years. There can be no assurance that we will be able to continue our historical revenue growth or sustain our profitability on a quarterly or annual basis or that our results of operations will not be adversely affected by continuing or future downturns in these industries. Any adverse change in the Chinese retail, distribution and logistics industries could adversely affect the level of software expenditure by the participants in these industries, which, in turn, could result in a material reduction in our sales.

***Although we achieved profitability for the first time in 2004, since our formation we have generated a significant shareholders' deficit, and we cannot provide any assurance that our recent profitability will continue.***

Though we achieved profitability since 2004, however, we had a shareholders' deficit of RMB 26,672,084 as of December 31, 2004, RMB 30,583,993 was attributable to the issuance of mandatorily redeemable, convertible preferred stock in 2001 which was classified for accounting purposes as a long-term liability. The holders of these preferred shares converted them into ordinary shares on June 16, 2005. As of December 31, 2006, our shareholders' deficit was replaced with shareholders' equity of RMB 64,548,989. While we have recently achieved profitability, there can be no assurance, however, that we will be able to continue our growth or profitability.

***In 2006, revenues from the service fee increased 72.8% comparing to 2005, such growth will require our officers to manage our business efficiently while recruiting a significant number of new employees to assist in further development and implementation of our software.***

In 2006, our service income increased significantly comparing to 2005, which mainly due to our efforts on focusing on services and expanded our direct sales force in key geographic markets. The growth in the size and complexity of our business has placed and is expected to continue to place a significant strain on our management and operations. Continued growth, will require us to recruit and hire a substantial number of new employees, including consulting and product development personnel. In particular, our ability to undertake new projects and increase license revenues is substantially dependent on the availability of our consulting personnel to assist in the licensing and implementation of our software solutions. We will not be able to continue to increase our business at historical rates without adding significant numbers of personnel skilled in software implementation and integration. Although we have not incurred significant difficulty in the hiring and training of skilled employees to date, there can be no assurance that we will effectively locate, retain or train additional personnel in the future. In the event we are unable to sufficiently increase our integration and implementation workforce over time, we may be required to forego licensing opportunities. Our ability to compete effectively and to manage future growth, if any, also will depend on our ability to continue to implement and improve operational, financial and management information systems on a timely basis.



## **Table of Contents**

***We are heavily dependent upon the services of technical and managerial personnel that possess skills to develop and implement supply chain management software, and we may have to actively compete for their services.***

We are heavily dependent upon our ability to attract, retain and motivate skilled technical, managerial and consulting personnel, especially highly skilled engineers involved in ongoing product development and consulting personnel. Our ability to install, maintain and enhance our supply chain management software is substantially dependent upon our ability to locate, hire and train qualified personnel. As supply chain management concepts have only recently been adopted in China, the number of qualified technical, managerial and consulting personnel is limited. Many of our technical, managerial and consulting personnel possess skills that would be valuable to all companies engaged in software development, and the Chinese software industry is characterized by a high level of employee mobility and aggressive recruiting of skilled personnel. Consequently, we expect that we will have to actively compete with other Chinese software developers for these employees. Our ability to profitably operate is substantially dependent upon our ability to locate, hire, train and retain our technical, managerial and consulting personnel. Although we have not experienced difficulty locating, hiring, training or retaining our employees to date, there can be no assurance that we will be able to retain our current personnel, or that we will be able to attract, assimilate other personnel in the future. If we are unable to effectively obtain and maintain skilled personnel, the quality of our software products and the effectiveness of installation and training could be materially impaired.

***Competition within the Chinese market for our software products is significant.***

We believe that while the Chinese market for supply chain management software is subject to intense competition, the number of significant competitors is relatively limited. For example, in 2006, total revenues for software and maintenance in the Chinese enterprise application software market were approximately \$50,000,000 and we generated approximately \$4,700,000. As such, while we believe that we effectively compete in our market, our competitors occupy a substantial competitive position. There can be no assurance that we will be able to effectively compete in our industry on an ongoing basis.

***Our financial performance is dependent upon the sale and implementation of supply chain management software and related services, a single, concentrated group of products.***

We derive all of our revenues from the license and implementation of eight software applications for the Chinese supply chain industry, an industry that did not effectively exist in China in recent years and consulting services. The life cycle of our software is difficult to estimate due in large measure to the potential effect of new software, applications and enhancements, including those we introduce, the maturation in the Chinese retail distribution, wholesaling and logistics industries. To the extent we are unable to continually improve our supply chain management software to address the changing needs of the Chinese supply chain front market, we may experience a significant decline in the demand for our programs. In such a scenario, our revenues may significantly decline.

**Table of Contents**

*The market for supply chain management software is intensely competitive.*

We believe the principal competitive factors in our markets are:

product quality;

reliability;

performance;

price;

vendor and product reputation;

Financial stability;

features and functions;

ease of use; and

quality of support.

A number of companies offer competitive products addressing certain of our target markets. In the enterprise systems market, we compete with in-house systems developed by our targeted customers and with third-party developers. In addition, we believe that new market entrants may attempt to develop fully integrated enterprise-level systems targeting the Chinese supply chain. Many of our existing competitors, as well as a number of potential new competitors, have significantly greater financial, technical and marketing resources than we do. We cannot guaranty that we will be able to compete successfully against current or future competitors. As a result of this product concentration and uncertain product life cycles, we may not be as protected from new competition or industry downturns as a more diversified competitor.

***Our financial performance is directly related to our ability to adapt to technological change and evolving standards when developing and improving our supply chain management software products.***

The software development industry is subject to rapid technological change, changing customer requirements, frequent new product introductions and evolving industry standards that may render existing software obsolete. In addition, as the Chinese economy has only recently begun to incorporate various Western economic factors, the concept of supply chain management has only recently been adopted by Chinese businesses. As a result, our position in the Chinese supply chain management software industry could be eroded rapidly by the speed with which Chinese businesses continue to adopt Western business practices and technological advancements that we do not embrace. The life cycles of our software are difficult to estimate. Our software products must keep pace with technological developments, conform to evolving industry standards and address the increasingly sophisticated needs of Chinese retailers, wholesalers, distributors and logistics companies. In particular, we believe that we must continue to respond quickly to users' needs for broad functionality. While we attempt to upgrade our software every one to two years, we cannot guaranty that our software will continue to enjoy market acceptance. To the extent we are unable to develop and introduce products in a timely manner, we believe that participants in the Chinese supply chain will obtain products from our competitors promptly.



## **Table of Contents**

and our sales will correspondingly suffer. In addition, we strive to achieve compatibility between our products and retailing systems platforms that we believe are or will become popular and widely adopted. We invest substantial resources in development efforts aimed at achieving this compatibility. If we fail to anticipate or respond adequately to technology or market developments, we could incur a loss of competitiveness or revenue.

*We are substantially dependent upon our key personnel, particularly Adam Yan, our Chairman and Chief Executive Officer.*

Our performance is substantially dependent on the performance of our executive officers and key employees. In particular, the services of:

Adam Yan, our Chairman and Chief Executive Officer,

Qicheng Yang, our Chief Technology Officer,

Hongjun Zou, our Chief Operating Officer,

Johnson Li, our Vice President,

Kefu Zhou, our Chief Architecture Officer, and

Ping Yu, our Chief Financial Officer

would be difficult to replace. We do not have in place key person life insurance policies on any of our employees. The loss of the services of any of our executive officers or other key employees could substantially impair our ability to successfully implement our existing supply chain management software and develop new programs and enhancements.

*As a software-oriented business, our ability to operate profitably is directly related to our ability to develop and protect our proprietary technology.*

We rely on a combination of trademark, trade secret, nondisclosure and copyright law to protect our supply chain management software, which may afford only limited protection. Although the Chinese government has issued us 16 copyrights on our software, we cannot guaranty that competitors will be unable to develop technologies that are similar or superior to our technology. Despite our efforts to protect our proprietary rights, unauthorized parties, including customers, may attempt to reverse engineer or copy aspects of our software products or to obtain and use information that we regard proprietary. Although we are currently unaware of any unauthorized use of our technology, in the future, we cannot guaranty that others will not use our technology without proper authorization.

We develop our software products on third-party middleware software programs that are licensed by our customers from third parties, generally on a non-exclusive basis. We currently utilize six major suppliers of these middleware programs. Considering the fact that we believe that there are a number of widely available middleware programs available, we do not currently anticipate that our customers will experience difficulties obtaining these programs. The termination of any such licenses, or the failure of the third-party licensors to adequately maintain or update their products, could result in delay in our ability to ship certain of our products while we seek to implement technology offered by alternative sources. Nonetheless, while it may be necessary or desirable in the future to obtain other licenses, there can be no assurance that they will be able to do so on commercially reasonable terms or at all.

## **Table of Contents**

In the future, we may receive notices claiming that we are infringing the proprietary rights of third parties. While we believe that we do not infringe and have not infringed upon the rights of others, we cannot guaranty that we will not become the subject of infringement claims or legal proceedings by third parties with respect to our current programs or future software developments. In addition, we may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any such claims could be time consuming, result in costly litigation, cause product shipment delays or force us to enter into royalty or license agreements rather than dispute the merits of such claims, thereby impairing our financial performance by requiring us to pay additional royalties and/or license fees to third parties. We have not been the subject of an intellectual property claim since our formation.

***Our supply chain management software may contain integration challenges, design defects or software errors that could be difficult to detect and correct.***

Implementation of our software may involve a significant amount of systems developed by third parties. Although we have not experienced a material number of defects associated with our software to date, despite extensive testing, we may, from time to time, discover defects or errors in our software only after use by a customer. We may also experience delays in shipment of our software during the period required to correct such errors. In addition, we may, from time to time, experience difficulties relating to the integration of our software products with other hardware or software in the customer's environment that are unrelated to defects in our software products. Such defects, errors or difficulties may cause future delays in product introductions and shipments, result in increased costs and diversion of development resources, require design modifications or impair customer satisfaction with our software. Since our software are used by our customers to perform mission-critical functions, design defects, software errors, misuse of our products, incorrect data from external sources or other potential problems within or out of our control that may arise from the use of our products could result in financial or other damages to our customers. To date, however, we have not had significant difficulties integrating our software into our customers' existing systems. We do not maintain product liability insurance. Although our license agreements with customers contain provisions designed to limit our exposure to potential claims as well as any liabilities arising from such claims, such provisions may not effectively protect us against such claims and the liability and costs associated therewith. To the extent we are found liable in a product liability case, we could be required to pay substantial amount of damages to an injured customer, thereby impairing our financial condition.

***We may not pay dividends.***

We have not previously paid any cash dividends nor do we anticipate paying any dividends on our ordinary shares. Although we achieved profitability for the first time in 2004, we cannot assure you that our operations will continue to result in sufficient revenues to enable us to operate at profitable levels or to generate positive cash flows. Furthermore, there is no assurance our Board of Directors will declare dividends even if profitable. Dividend policy is subject to the discretion of our Board of Directors and will depend on, among other things, our earnings, financial condition, capital requirements and other factors. Under Cayman law, we may only pay dividends from profits or credit from the share premium account (the amount paid over par value, which is \$0.0756), and we must be solvent before and after the dividend payment. If we determine to pay dividends on any of our ordinary shares in the future, as a holding company, we will be dependent on receipt of funds from our operating subsidiary.

## **Table of Contents**

### ***A slowdown in the Chinese economy may slow down our growth and profitability.***

The Chinese economy has grown at an approximately 9 percent rate for more than 25 years, making it the fastest growing major economy in recorded history. Much of this growth has occurred in our customers' industries. For example:

in the last decade, the number of supermarkets in China increased from zero to more than 60,000;

retail sales in China increased 10.2% in 2004;

industrial growth in China increased 16.7% in 2004;

enterprise software revenues for all industry participants generated from Chinese wholesale and retail customers increased 32.5% from \$22.52 million in 2002 to \$27.16 million in 2003; and

enterprise software revenues for all industry participants generated from Chinese manufacturing customers increased 15.9% from \$140.3 million in 2002 to \$162.5 million in 2003.

We cannot assure you that growth of the Chinese economy will be steady or that any slowdown will not have a negative effect on our business. Several years ago, the Chinese economy experienced deflation, which may recur in the foreseeable future. More recently, the Chinese government announced its intention to use macroeconomic tools and regulations to slow the rate of growth of the Chinese economy, the results of which are difficult to predict. Adverse changes in the Chinese economy will likely impact the financial performance of the retailing, distribution, logistics and manufacturing industries in China. Consequently, under such circumstances, our customers may opt to delay discretionary expenditures like those for our software, which, in turn, could result in a material reduction in our sales.

### ***We do not have business interruption, litigation or natural disaster insurance.***

The insurance industry in China is still at an early state of development. In particular PRC insurance companies offer limited business products. As a result, we do not have any business liability or disruption insurance coverage for our operations in China. Any business interruption, litigation or natural disaster may result in our business incurring substantial costs and the diversion of resources.

### ***We may become a passive foreign investment company, which could result in adverse U.S. tax consequences to U.S. investors.***

Based upon the nature of our business activities, we may be classified as a passive foreign investment company ( PFIC ) by the U.S. Internal Revenue Service ( IRS ) for U.S. federal income tax purposes. Such characterization could result in adverse U.S. tax consequences to you if you are a U.S. investor. For example, if we are a PFIC, a U.S. investor will become subject to burdensome reporting requirements. The determination of whether or not we are a PFIC is made on an annual basis and will depend on the composition of our income and assets from time to time. Specifically, we will be classified as a PFIC for U.S. tax purposes if either:

75% or more of our gross income in a taxable year is passive income; or

the average percentage of our assets by value in a taxable year which produce or are held for the production of passive income (which includes cash) is at least 50%.

## **Table of Contents**

The calculation of the value of our assets is based, in part, on the then market value of our ordinary shares, which is subject to change. In addition, the composition of our income and assets will be affected by how, and how quickly, we spend the cash we raise in our contemplated initial public offering, if any. We cannot assure you that we will not be a PFIC for any taxable year.

***Any recurrence of severe acute respiratory syndrome, or SARS, pandemic avian influenza or another widespread public health problem, could adversely affect the Chinese economy as a whole and our ability to profitably develop and install our software products.***

A renewed outbreak of SARS, pandemic avian influenza or another widespread public health problem in China, where all of our revenues are derived, and in Beijing, where our operations are headquartered, could have a negative effect on our operations. Our operations may be affected by a number of health-related factors, including the foregoing:

quarantines or closures of some of our offices which would severely disrupt our operations;

the sickness or death of our key officers and employees; and

a general slowdown in the Chinese economy.

The possible quarantine of our offices or the sickness or death of our key officers and employees would restrict our ability to develop and implement our software products, thereby negatively impacting our sales. Any of the foregoing events or other unforeseen consequences of public health problems could adversely affect our markets or our ability to operate profitably. A slowdown of the Chinese economy as a whole could reduce the level of discretionary expenditures by Chinese business in the retailing, distribution, logistics and manufacturing industries, thereby resulting in a material reduction in the demand for our products.

***Recent PRC regulations relating to acquisitions of PRC companies by foreign entities may create regulatory uncertainties that could limit our PRC subsidiary's ability to distribute dividends and/or pursue any acquisition strategy that we may implement in the future.***

The PRC State Administration of Foreign Exchange (SAFE) issued a public notice in January 2005 concerning foreign exchange regulations on mergers and acquisitions in China. The public notice states that if an offshore company intends to acquire a PRC company, such acquisition will be subject to strict examination by the relevant foreign exchange authorities. The public notice also states that the approval of the relevant foreign exchange authorities is required for any sale or transfer by the PRC residents of a PRC company's assets or equity interest to foreign entities, such as us, for equity interests or assets of the foreign entities.

In April 2005, SAFE issued another public notice clarifying the January notice. In accordance with the April notice, if an acquisition of a PRC company by an offshore company controlled by PRC residents had been confirmed by a Foreign Investment Enterprise Certificate prior to the issuance of the January notice, each of the PRC residents is required to submit a registration form to the local SAFE branch to register his or her respective ownership interests in the offshore company. The PRC resident must also amend such registration form if there is a material event affecting the offshore company, such as, among other things, a change to share capital, a transfer of shares, or if such company is involved in a

## Table of Contents

merger and an acquisition or a spin-off transaction or uses its assets in China to guarantee offshore obligations. SAFE indicated that these registration provisions applied retroactively to offshore restructurings, like ours, that were completed prior to the initial public notice of the new requirements in January 2005. However, SAFE did not impose any time limit within which PRC residents must complete the mandated registration. The April notice also provided that failure to comply with the registration procedures set forth therein may result in the imposition of restrictions on the PRC company's foreign exchange activities and its ability to distribute profits to its offshore parent company.

On October 21, 2005, SAFE issued a new public notice concerning PRC residents' investments through offshore investment vehicles. This notice took effect on November 1, 2005 and replaces prior SAFE notices on this topic. According to the November 2005 notice:

any PRC resident that created an off-shore holding company structure prior to the effective date of the November notice must submit a registration form to a local SAFE branch to register his or her ownership interest in the offshore company on or before May 31, 2006;

any PRC resident that purchases shares in a public offering of a foreign company would also be required to register such shares and notify SAFE of any change of their ownership interest; and

following the completion of an off-shore financing, any PRC shareholder may transfer proceeds from the financing into China for use within China.

To the extent a PRC investor desires to purchase our ordinary shares in the secondary market, such resident must obtain SAFE and other relevant government approval prior to such investment. Upon the sale of our ordinary shares in the secondary market, a PRC resident must promptly notify SAFE of a material change in ownership. As (a) we do not anticipate a significant number of PRC residents participating in our secondary market and (b) SAFE regulations generally focus upon the initial foreign exchange transaction by which a PRC resident will purchase our ordinary shares, we do not anticipate that SAFE regulations will impact the resale of our ordinary shares in any significant manner.

As a result of the newness of these SAFE notices, lack of implementing rules and uncertainty concerning the reconciliation of these SAFE notices with other approval requirements, it remains unclear how these SAFE notices, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. We are committed to complying, and to ensuring that our shareholders who are subject to these notices comply, with the relevant rules.

### ***e-Future Beijing is subject to restrictions on paying dividends and making other payments to us.***

We are a holding company incorporated in the Cayman Islands and do not have any assets or conduct any business operations other than our investment in e-Future Beijing, our subsidiary. As a result of our holding company structure, we rely entirely on the dividends payments from e-Future Beijing. However, PRC regulations currently permit payment of dividends only out of accumulated profits, as determined in accordance with PRC accounting standards and regulations. e-Future Beijing may also be required to set aside a portion of their after-tax profits according to PRC accounting standards and regulations to fund certain reserve funds. The PRC government also imposes controls on the conversion of RMB into foreign currencies and the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency. Furthermore, if e-Future Beijing incurs debt on its own in the future, the instruments governing the debt



## **Table of Contents**

may restrict its ability to pay dividends or make other payments. If we or our subsidiary are unable to receive all of the revenues from our operations through these arrangements, we may be unable to pay dividends on our ordinary shares.

### ***Governmental control of currency conversion may affect the value of your investment.***

The PRC government imposes controls on the convertibility of the Renminbi into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in Renminbi. Under our current corporate structure, our income is derived from dividend payments from our PRC subsidiary. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiary to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from the PRC State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate government authorities is required where Renminbi is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of bank loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders.

### ***Fluctuation in the value of the Renminbi may have a material adverse effect on your investment.***

The value of the Renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an appreciation of the Renminbi against the U.S. dollar. While the international reaction to the Renminbi revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the Renminbi against the U.S. dollar. We rely entirely on dividends and other fees paid to us by our subsidiary in China. Any significant revaluation of Renminbi may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our ordinary shares in U.S. dollars. For example, an appreciation of Renminbi against the U.S. dollar would make any new Renminbi denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into Renminbi for such purposes. An appreciation of Renminbi against the U.S. dollar would also result in foreign currency translation losses for financial reporting purposes when we translate our U.S. dollar denominated financial assets into Renminbi, as the Renminbi is our reporting currency.

### ***Changes in China's political and economic policies could harm our business.***

The economy of China has historically been a planned economy subject to governmental plans and quotas and has, in certain aspects, been transitioning to a more market-oriented economy. Although we believe that the economic reform and the macroeconomic measures adopted by the Chinese government have had a positive effect on the economic development of China, we cannot predict the future direction of these economic reforms or the effects these measures may have on our business,

## **Table of Contents**

financial position or results of operations. In addition, the Chinese economy differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development ( OECD ). These differences include:

economic structure;

level of government involvement in the economy;

level of development;

level of capital reinvestment;

control of foreign exchange;

Methods of allocating resources; and

balance of payments position.

As a result of these differences, our business may not develop in the same way or at the same rate as might be expected if the Chinese economy were similar to those of the OECD member countries.

***If PRC law were to phase out the preferential tax benefits currently being extended to foreign invested enterprises and new or high-technology enterprises located in a high technology zone, we would have to pay more taxes, which could have a material and adverse effect on our financial condition and results of operations.***

Under PRC laws and regulations, a foreign invested enterprise may enjoy preferential tax benefits if it is registered in a high-technology zone and also qualifies as new or high-technology enterprise . As a foreign invested enterprise as well as a certified new or high-technology enterprise located in a high-technology zone in Beijing, we are entitled to a three-year exemption from enterprise income tax beginning from our first year of operation, a 7.5% enterprise income tax rate for another three years followed by a 15% tax rate so long as we continue to qualify as a new or high-technology enterprise. Furthermore, we may apply for a refund of the 5% business tax levied on our total revenues derived from our technology consulting services. If the PRC law were to phase out preferential tax benefits currently granted to new or high-technology enterprises and technology consulting services, we would be subject to the standard statutory tax rate, which currently is 33%, and we would be unable to obtain business tax refunds for our provision of technology consulting services.

***China's legal system embodies uncertainties that could adversely affect our ability to engage in the development and integration of the supply chain management software.***

Since 1979, the Chinese government has promulgated many new laws and regulations covering general economic matters. Despite this activity to develop a legal system, China's system of laws is not yet complete. Even where adequate law exists in China, enforcement of existing laws or contracts based on existing law may be uncertain or sporadic, and it may be difficult to obtain swift and equitable enforcement or to obtain enforcement of a judgment by a court of another jurisdiction. The relative inexperience of China's judiciary, in many cases, creates additional uncertainty as to the outcome of any litigation. In addition, interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. Noting that our business is substantially dependent upon laws

## **Table of Contents**

protecting intellectual property rights, any ambiguity in the interpretation or implementation of such laws may negatively impact our business, its financial condition and results of operation. Our activities in China will also be subject to administration review and approval by various national and local agencies of China's government. Because of the changes occurring in China's legal and regulatory structure, we may not be able to secure the requisite governmental approval for our activities. Although we have obtained all required governmental approval to operate our business as currently conducted, to the extent we are unable to obtain or maintain required governmental approvals, the Chinese government may, in its sole discretion, prohibit us from conducting our business.

***Shareholder rights under Cayman Islands law may differ materially from shareholder rights in the United States, which could adversely affect the ability of us and our shareholders to protect our and their interests.***

Our corporate affairs are governed by our amended and restated memorandum and articles of association, by the Companies Law (2004 Revision) and the common law of the Cayman Islands. The rights of shareholders to take action against the directors, actions by minority shareholders, and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law in the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as from English common law, the decisions of whose courts are of persuasive authority but are not binding on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law in this area may not be as clearly established as they would be under statutes or judicial precedent in existence in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and some states, such as Delaware, have more fully developed and judicially interpreted bodies of corporate laws. Moreover, our company could be involved in a corporate combination in which dissenting shareholders would have no rights comparable to appraisal rights which would otherwise ordinarily be available to dissenting shareholders of United States corporations. Also, our Cayman Islands counsel is not aware of a significant number of reported class actions or derivative actions having been brought in Cayman Islands courts. Such actions are ordinarily available in respect of United States corporations in U.S. courts. Finally, Cayman Islands companies may not have standing to initiate shareholder derivative action before the federal courts of the United States. As a result, our public shareholders may face different considerations in protecting their interests in actions against the management, directors or our controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States, and our ability to protect our interests may be limited if we are harmed in a manner that would otherwise enable us to sue in a United States federal court.

***As we are a Cayman Islands company and most of our assets are outside the United States, it will be extremely difficult to acquire jurisdiction and enforce liabilities against us and our officers, directors and assets based in China.***

We are a Cayman Islands exempt company, and our corporate affairs are governed by our Memorandum and Articles of Association and by the Cayman Islands Companies Law (2004 Revision) and other applicable Cayman Islands laws. Certain of our directors and officers reside outside of the United States. In addition, the Company's assets will be located outside the United States. As a result, it may be difficult or impossible to effect service of process within the United States upon our directors or officers and our subsidiaries, or enforce against any of them court judgments obtained in United States courts, including judgments relating to United States federal securities laws. In addition, there is uncertainty as to whether the courts of the Cayman Islands and of other offshore jurisdictions would

## **Table of Contents**

recognize or enforce judgments of United States courts obtained against us predicated upon the civil liability provisions of the securities laws of the United States or any state thereof, or be competent to hear original actions brought in the Cayman Islands or other offshore jurisdictions predicated upon the securities laws of the United States or any state thereof. Furthermore, because the majority of our assets are located in China, it would also be extremely difficult to access those assets to satisfy an award entered against us in United States court.

*There can be no guarantee that China will comply with the membership requirements of the World Trade Organization.*

Due in part to the relaxation of trade barriers following World Trade Organization accession in January 2002, we believe China will become one of the world's largest markets by the middle of the twenty-first century. As a result, we believe the Chinese market presents a significant opportunity for both domestic and foreign companies. With the Chinese accession to the World Trade Organization, Chinese industries are gearing up to face the new regimes that are required by World Trade Organization regulation. The Chinese government has begun to reduce its average tariff on imported goods. We believe that a tariff reduction on imported goods combined with increasing consumer demand in China may lead to increased demand for our logistics programs. China has also agreed that foreign companies will be allowed to import most products into any part of China. Current trading rights and distribution restrictions are to be phased out over a three-year period. In the sensitive area of intellectual property rights, China has agreed to implement the trade-related intellectual property agreement of the Uruguay Round. As our business is dependent upon the protection of our intellectual property in China and throughout the world, China's decision to implement intellectual property protection standards that coordinate with other major economies is of critical importance to our business and its ability to generate profits. However, there can be no assurances that China will implement any or all of the requirements of its membership in the World Trade Organization in a timely manner, if at all.

## **Item 4. Information on the Company**

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

*e-Future (Beijing) Tornado Information Technology Inc.*

e-Future (Beijing) Tornado Information Technology Inc. (e-Future Beijing) was established as a domestic Chinese company in April 2000 with total share capital of RMB 500,000, of which Hainan Future Computer Company Limited (Hainan Future) contributed RMB 400,000 (80%) and Dafu Zou contributed RMB 100,000 (20%). In July 2000, Mr. Zou transferred his shares to Johnson Li, our Vice President for RMB 100,000. In July 2000, e-Future Beijing was reorganized and its capital was increased to RMB 5,000,000. In connection with the recapitalization, Hainan Future increased its investment in e-Future Beijing to RMB 4,000,000, and Mr. Li increased his investment to RMB 1,000,000. Since its inception in January 2000, e-Future Beijing has developed and integrated software for China's supply chain front market.

## **Table of Contents**

### *e-Future Information Technology Inc.*

We were established as an offshore company incorporated in the Cayman Islands on November 2, 2000. At the time of our formation, Adam Yan, our Chairman and Chief Executive Officer, purchased 20,000 ordinary shares for \$0.01 per share, which represented the par value of the shares at the time. On April 25, 2001, we issued 4,016,610 Series A preferred shares in a private placement of preferred securities to two venture capital firms for a price of \$0.6224 per share. Such price resulted from an arm's length negotiation with such investors. In addition, on that date, we also issued an aggregate of 6,945,000 ordinary shares to our executive officers at a price equal to \$0.01 per share, which represented the par value of the shares at the time. The price and amount of the ordinary shares that we issued to our executive officers resulted from an arm's length negotiation with our venture investors. The securities and share prices referenced in this paragraph do not reflect our 1-for-7.560678 reverse stock split effected as of June 16, 2005.

### *Our Holding Company Structure*

In March 2001, Hainan Future and Mr. Li transferred all shares in e-Future Beijing to us for an aggregate of RMB 5,000,000. Pursuant to an approval from the Beijing Municipal Government, e-Future Beijing became a wholly foreign owned enterprise with an operating period of 20 years. We were created by e-Future Beijing and its shareholders as a holding company in an effort to maintain intellectual property within China while creating a corporate structure that could more easily access foreign capital. e-Future Beijing has previously and will continue to conduct all of our software development operations.

### *Hainan Future Computer Company Limited*

Hainan Future was established as a domestic Chinese company in April 1997 with registered capital of RMB 1,500,000. At the time of its formation, Hainan Future was owned by Mr. Yan (75%) and Qicheng Yang, our Chief Technology Officer (25%). Hainan Future developed a software program with particular use in the Chinese supply chain management industry. In an effort to create a company that would qualify for preferential tax treatments associated with businesses in the high-technology industry, Hainan Future agreed to sell its software program and all related rights to e-Future Beijing in 2000 for RMB 5,160,000. In connection with this transaction, Hainan Future agreed to provide e-Future technical support and development services related to the program for one year. On May 24, 2001, the PRC National Copyright Bureau issued e-Future Beijing a certificate approving the transfer of the software and granting e-Future Beijing the sole right to exploit the copyright. e-Future Beijing named the acquired software e-Future ONE POS-ERP.

Following the sale of its software to e-Future Beijing in 2000, Hainan Future's operations were limited to the completion of existing contracts and the collection of existing accounts receivable. Consequently, its operations reduced dramatically. In May 2005, Mr. Yan transferred all of his shares in Hainan Future to Xuejun Zhang for ¥225,000 and Mr. Yang transferred all of his shares in Hainan Future to Ling Zhang for ¥75,000. Xuejun Zhang serves as the manager of our administration department. Ling Zhang serves as an employee in our accounting and finance department. While not executive officers, these individuals are senior employees who actively participate in our day-to-day operations. Noting the limited number of employees in our company, they may possess the potential to influence our executive officers, and, thereby, our business and its operations.

While these transactions were not among independent parties and, arguably, not at arm's length as a result of the employer-employee relationship between the parties, the parties to the transaction

**Table of Contents**

actively negotiated the purchase price of the shares sold. At the time of the transaction, Hainan Future was essentially dormant. The aggregate consideration paid by Messrs. Zhang of ¥300,000 was equal to the book value of Hainan Future's assets at the time of the transaction as determined by the then shareholders of Hainan Future in good faith. The parties to the transactions did not consider alternative payment structures.

As of December 31, 2001, we had advanced ¥3,195,956 to Hainan Future. The balance arose as the result of payments to suppliers on behalf of Hainan Future, cash advances to Hainan Future, Hainan Future's collection of cash receipts from our customers, and the sale of an investment in a company to Hainan Future, less the collection of cash receipts from Hainan Future's customers, less Hainan Future's payments to suppliers on our behalf, less the cost of software purchased from Hainan Future and less the purchase of two real estate parcels from Hainan Future. The value of the real estate parcels and the services we provided to Hainan Future was determined in good faith by our executive officers and our Board of Directors. Hainan Future had no operations or employees from December 31, 2001. As a result, we made payments to, provided services to and collected cash receipts from Hainan Future's customers during the years ended December 31, 2003, 2004 and 2005. Those transactions along with the resulting balances receivable from Hainan Future were as follows:

	For the Years Ended December 31,			U.S. Dollars
	2003	2004	2005	For the Year Ended December 31, 2005 (Unaudited)
Payments of (refunds from) Hainan suppliers	¥ 23,500	¥ 155,307	¥ (146,699)	\$ (18,178)
Services provided to Hainan	1,000,000			
Offset receivable from Hainan against payable to Hainan			(2,526,595)	(313,077)
Collection of cash receipts from Hainan's customers	(744,800)	(1,500,700)		
<b>Balance at End of Period</b>	<b>¥ 4,018,687</b>	<b>¥ 2,673,294</b>	<b>¥</b>	<b>\$</b>

We owed Mr. Li and Hainan Future ¥1,000,000 and ¥4,000,000, respectively, for the acquisition of the Company's equity interest in e-Future Beijing. The balances due were unsecured, had no fixed terms of repayment and were considered due on demand. On August 12, 2005, we paid Hainan Future ¥575,722 towards the amount due to Hainan Future. On September 25, 2005, Hainan Future acquired Mr. Li's receivable from our company on terms negotiated by Mr. Li and shareholders of Hainan Future. The value of the receivable was based upon the book value of the receivable as reflected on the financial records of Hainan Future, which were maintained in good faith by the shareholders of Hainan Future. On November 18, 2005, we entered into an agreement with Hainan Future whereby ¥1,897,683 of the payable to Hainan Future was forgiven by Hainan Future and the remaining balance payable to Hainan Future of ¥2,526,595 was offset against the receivable from Hainan Future of the same amount. This transaction was approved by our Board of Directors and the Board of Directors of Hainan Future. We recognized this forgiveness of debt from this related party as a contribution to capital.

## **Table of Contents**

### **B. Business Overview**

#### *General*

We are a leading provider of integrated software and professional services for manufacturers, distributors, wholesalers, logistics companies and retailers in China's supply chain front market. At the present time, our customers are centered in the retail, automotive, general household appliance and consumer goods industries. Our software products, however, can optimize the operations of businesses in a wide variety of industries. We expect to broaden our scope of customers over time.

Our solutions are specifically designed to optimize demand processes from finished goods to customer checkout, and to address supply chain management, business processes, decision support, inventory optimization, collaborative planning and forecasting requirements. Our software solutions business is enhanced and supported by our consulting services and ongoing maintenance on existing software installations.

#### *Market Background*

In the past, China's supply chain infrastructure served to restrain economic development and limit the performance of local and foreign companies. Compared with western countries, China has traditionally been hampered by poor infrastructure, a disorganized distribution system, local protectionism, difficulties with cash flow and accounts receivable, and an antiquated legal system at national, regional and local levels. As the Chinese economy matures, with the assistance of enterprise software systems, we believe that these disparities will decrease. At the present time, however, we believe that the following statistics accurately reflect the infancy of the Chinese supply chain industry:

In 2000, logistics and transportation costs represented approximately 20% of the Chinese gross domestic product (GDP) compared with 10% in the United States and 14% in Japan. Interestingly, by September 2001, China's total logistics and transportation costs reduced to 16.7% of China's GDP.

The working capital turnover ratio in China ranges from 1.2 for manufacturing state-owned enterprises to 2.3 for commercial state-owned enterprises. In the United States, the average is between 15 and 20.

An average of 90% of a Chinese manufacturer's time is spent on logistics, with just 10% on manufacturing.

Many commodities in China cost 40% to 50% more to transport than they would in the United States.

## Table of Contents

Transportation and warehousing costs in China equal 30% to 40% of the total cost of goods sold.

Logistics inefficiency and lag time in receiving market information resulted in more than U.S. \$480 billion worth of goods being stockpiled by year-end 2000, which was equivalent to 45% of China's GDP.

In recent years, the Chinese government has committed significant effort to modernize China's logistics and transportation infrastructure. In particular, China's accession to the World Trade Organization in 2001 emphasized the liberalization and modernization of China's economic system. Under China's WTO agreement, the country will progressively remove the restrictions that prevent foreign companies from participating in the logistics and transportation sectors. We also expect China's WTO status to stimulate China's growth by opening its economy to competition and encouraging collaboration between local and foreign companies.

Participants in China's supply chain are currently facing intensifying competition, fluctuating demand, evolving retail channels and increasing globalization. Sales are pressured, margins are compressed through intensified competition and most companies are trying to achieve improved results with fewer people. As a result, small and large Chinese companies are increasingly seeking technology solutions to better manage their increasingly complex businesses, improve their operating efficiencies and financial performance, and strengthen their relationships with customers and suppliers. Despite the fact that Chinese businesses traditionally have low technology adoption rates, we believe that China's rapid economic development will require Chinese companies to look to source ready-made solutions for supply chain management.

### *China's Economic Development*

China's population of approximately 1.3 billion people is expected to grow by roughly 15 million people per year. The country's gross national product has grown at a rate of approximately 9 percent for more than 25 years, making it the fastest growth rate for a major economy in recorded history. In the same 25 year period, China has moved more than 300 million people out of poverty and quadrupled the average Chinese person's income. The tremendous potential of this market is noted by the fact that 400 of the world's largest 500 companies are investing in China.

These development factors have produced a burgeoning consumer goods market, as the spending power and aspirations of consumers rise. In response, industries are consolidating and modern retailers are penetrating second-tier and even some third-tier Chinese cities. We believe that the need to modernize China's supply chain infrastructure is increasing at a dramatic rate. The appearance of modern retailers in China is also generating demand for more efficient and reliable systems and services.

### *e-Future Solutions*

Upon the formation of e-Future Beijing in 2000, we began to develop our software products. Prior to the creation of our holding company structure in March 2001, we developed and released our first two software products:

*e-Future ONE SCM/CRM*, a visual supply chain management and customer relationship management solution, which was released on December 19, 2000; and



**Table of Contents**

*e-Future ESCM/e-Market Place*, an e-supply chain management and marketplace solution, which was released on December 19, 2000.

We released a third program, e-Future ONE POS-ERP, a multi-format retail enterprise resources planning tool that we purchased from Hainan Future Computer Company Limited on July 31, 2000. In order to smoothly operate the Company and to apply for preferential tax treatments so as to solve the Company's problem of lacking software, on February 20, 2000, e-Future Beijing executed an agreement with Hainan Future, in which e-Future Beijing purchased from Hainan Future the copyright and the relevant intangible assets of one set of computer software (POS-ERP), which was independently developed by Hainan Future and the registration number is 2000SR1016, at a total price of RMB 5,160,000 in which one-year of customized development and technical support were included. As provided in this Agreement, e-Future Beijing was entitled to sell and develop new products based on the software at its own discretion. The PRC National Copyright Bureau issued a Certificate on May 24, 2001 proving the filing of the aforementioned transfer of the computer software, according to this certificate, as of April 11, 2001, e-Future Beijing would have the right to use, the licensing right and the right to get paid for the computer software within the time limit regulated by law. Through e-Future Beijing we developed our remaining software products following the creation of our holding company structure.

Our solutions integrate industry know-how with predictive information technologies, and the best practices of leading Chinese companies to help our clients create, manage and fulfill customer demand. Our solutions can be deployed individually to meet specific needs, or as part of a scalable and fully integrated solution. Our primary software solutions consist of three independently deployable groups of software products: Foundation Solutions, Collaborative Solutions, and Intelligent Solutions.

*Foundation Solutions:*

<b>Type of Customer</b>	<b>e-Future ONE Solution</b>
Manufacturer	e-Future ONE Visual DRP (Visual Distribution Resources Planning Solution)  Released June 25, 2002.
Distributor	e-Future ONE DMS (Distributor Management System Solution)  Released September 25, 2002.
Retailer	e-Future ONE POS-ERP (Multi-Format Retail Enterprise Resources Planning Solution)  Released January 31, 2000. e-Future ONE eWalkman R2005 (Mobile POS-ERP solution)  Released December 25, 2005
Logistics/Distributor	e-Future ONE LRP (Logistics Resources Planning Solution)  Released January 5, 2003.

**Table of Contents**

*Collaborative Solutions:*

<b>Type of Customer</b>	<b>e-Future ONE Solution</b>
Manufacturer	e-Future ONE CRM/VMI/CPFR Solution  Released November 8, 2001.
Retailer	e-Future ONE SCM/CRM (Visual Supply Chain Management and Customer Relationship Management Solutions)  Released December 19, 2000.
Third Party ASP Operator	e-Future ONE ESCM/e-Market Place (e-Supply Chain Management and e-Marketplace Solutions)  Released December 19, 2000.

*Intelligent Solutions:*

<b>Type of Customer</b>	<b>e-Future ONE Solution</b>
Retailer	e-Future ONE BI/CM/Cleve (Business Intelligent, Category Management and Market Analysis Solution)  Released October 5, 2001.

Our software solutions include:

*e-Future ONE Visual-DRP* is a web-based product designed to meet the distribution and network management needs of manufacturers. Based on IBM Websphere middleware, this program employs a 3-layer structure and combines advanced management models with up-to-date information technology methods to establish independent distribution channels with operations expanding to nationwide retail terminals. Customers who would benefit from this solution include large manufacturers of clothing, household appliances, automobiles, and tobacco.

*e-Future ONE DMS* is a mini-enterprise resource planning application utilized by wholesalers and distributors, especially in the consumer goods industry, the essential functions of this program permit wholesalers and distributors to integrate their core business processes, such as procurement management, inventory management, sales order management and financial management. We offer several versions of this software to support different segments of wholesalers and distributors in terms of size, complexity of operation and information technology literacy.

*e-Future ONE POS-ERP* is a software solution designed to meet the demands of retailers for goods flow, order flow, information flow and cash flow management, including merchandise operations management, merchandise planning and optimization, integrated store operations, financial management and logistics management from headquarters to regional headquarters to regional distribution centers to multi-format chain stores. This program is suitable for the operation of many retail formats, such as department stores, malls, supermarkets, hypermarkets, convenience stores, grocery stores, and specialty stores.

## Table of Contents

*e-Future ONE LRP* is an application utilized by distributors or logistics companies to enable such companies to improve warehouse management, transportation management, and logistics management. The program can organize labor concentrations and warehouse organization. The program can integrate with other enterprise systems, material handling equipment and mobile technology.

*e-Future ONE SCM* is a product designed for synergistic distribution designed to promote collaborative business between retailers and their suppliers. Developed with IBM Websphere application software, this program gives support to upstream enterprises to participate in retailing enterprises vendor managed inventory processes and provides online analyses via the Internet. It enables retailers and suppliers to share consistent and accurate information such as promotion, sales and inventory data. Retailers and suppliers use this information to identify sales forecast exceptions, prevent out-of-stocks and reduce inventories. It also can help suppliers to verify their bills and confirm replenishment orders.

*e-Future ONE CPFR/VMI* is a program that provides customers with collaborative planning, forecasting and replenishment features. This solution collects, manages and analyzes supply and demand chain data to enable rapid response to changes in market conditions. It employs industry standards to accelerate the execution of the order flow and improve the accuracy of planning.

*e-Future ONE CRM* is a system tool mining and analyzing customer data for retailing operations. It helps retailers to identify, acquire, activate, serve and retain the most profitable customers. It can also help retailers find, promote and expand potential customers.

*e-Future ONE BI* is a program designed for intelligent distribution. This solution turns data about retail customers, merchandise and operations into knowledge that provides greater insight into performance and empowers retailers to make more informed decisions, gain a competitive advantage, strengthen customer and vendor loyalty, and improve profitability.

*e-Future ONE eWalkman* is an all-in-one portable payment system which can place a full screen of easily viewed information at both the operator and customer locations. Using wireless connectivity, mobile POS allows retailers to bring the store to the customer and greatly decrease check-out times, helping retailers decrease operating costs and boost their competitive position by getting closer to their customers at every point of interaction, while increasing inventory turnover and employee productivity.

### *Research and Development*

*SCM/ECR/VMI Collaborative Products.* We recently developed an enhanced version of our SCM program to include a process by which our customers may synchronize planning, execution, tracking and evaluation of the Chinese supply chain through the use of real-time visibility of suppliers, distribution hubs and retailers in a given network. We completed a pilot test on the program, and we tested the program at more than 1,800 suppliers of the Beijing Yansha Friendship Group, a Beijing-based retailer. We summarized our test and incorporated improvements in a final product released in April 2006.

We have currently developed an enhanced version of our ECR programs to coordinate product push and consumer price concepts. It enables retailers and suppliers to coordinate commodity supply and

**Table of Contents**

serve processes. We have completed a pilot test of this program and we tested the program at three key accounts at Proctor & Gamble China. We incorporated improvements and released a final product in August 2006.

In July 2006, we have completed developing an enhanced VMI (vendor managed inventory) product that enables manufacturers and suppliers to coordinate their customers' inventory in real-time through the use of SKU (stock keeping units) management.

*POS-ERP Product.* We developed a next-generation retail information system that employs a three layer web-based structure with state-of-the-art information technology to assist our retail customers with operations expanding nationally or world-wide. Our program includes advanced modules such as merchandise planning, revenue management and space and category management. We recently started pilot development on this project.

*LRP/SMS/CRM/SCM Products.* We are developing an enhanced logistics resources planning (LRP) solution, a short messaging service (SMS) application for use without customer relationship management (CRM) and a supply chain management (SCM) solution for public institutions. We established a mobile solutions lab in May 2006 to pursue further development.

To date, we have provided our products and services to businesses located throughout China, as indicated below:

**Table of Contents**

*Software Upgrades*

Depending upon the customer and the type of software program, we develop software upgrades on approximately 1-2 year cycles. Smaller customers or projects are updated on a two year cycle; medium sized customers and projects are updated on an 18 month cycle; and larger customers and projects are updated on a yearly cycle. We do not offer these upgrades as part of our initial license arrangement. Rather, customers must pay for each upgrade that they opt to install on their systems. Each upgrade is delivered through the download of service packs.

*Maintenance Services*

Following the installation of our software solutions, clients will typically require ongoing maintenance support to ensure the efficient operation of their system. These services are designed to assist our customer with integration issues and to answer questions that may arise. These services include:

database operation maintenance, space management, data migration and database tune-ups;

system servicing, device management, system updating and version control;

application servicing, debugging, real-time servicing, and application of interfaces with other business systems;

24 hour call center services; and

training in ongoing system operation.

**Table of Contents**

Following a one-year regular maintenance program that is an element of our initial software installation, our customers may purchase three levels of annual continued maintenance services. As noted below, under our Regular and Silver plans, we generally provide these maintenance services over the telephone during regular business hours. For our customers who elect to purchase our Gold plan at a higher cost, we will provide these services at the customer's location and on a real-time basis, if appropriate. Each level of maintenance offers customers different options to meet their particular needs.

	<b>Regular Maintenance</b>	<b>Silver Maintenance</b>	<b>Gold Maintenance</b>
Hotline Service	Standard	Standard	Standard
Program Debugging	Standard	Standard	Standard
Remote Servicing	Standard	Standard	Standard
Call Center Service	Standard	Standard	Standard
Inspection Service	Yearly	Quarterly	Monthly
Emergency Response	24-36 Hours	12-18 Hours	4-8 Hours
System Upgrades	2 Years	Yearly	Semi-Annually
Fieldwork Service	No	No	Yes

While on-site with our Gold plan customers, it is common for us to identify problems and issues that we believe the customer should consider in connection with the use of our software. Items that we may discuss with our customers include increasing the size of data storage or the configuration of hardware. We report these items identified as a part of our maintenance by giving written recommendations for actions the customer should consider. These services are simply a report of our suggestions and not an extensive evaluation that would be done under our consulting arrangements. If our customer deems additional services to be necessary, we will enter into a separate consulting agreement with the customer. These maintenance services are unrelated to the development and installation of program upgrades that we develop from time to time.

In 2006, we derived RMB 6,607,337 in gross revenues from the provision of our consulting and maintenance services. Of this amount, RMB 3,964,402 or 60% represented gross revenues for consulting services and RMB 2,642,935 or 40% represented gross revenues for maintenance services.

*Consulting Services*

Our consulting services group consists of business consultants, systems analysts and technical personnel with extensive retail, manufacturing, and wholesale industry experience. The consulting services group assists our customers in all phases of systems implementation that exceed the limited services we provide under our maintenance arrangements, including systems planning and design, customer-specific configuration of application modules, and on-site implementation or conversion from existing systems. We also offer a variety of post-implementation consulting services designed to maximize our customers' return on software investment, which include enhanced utilization reviews and business process optimization.

## **Table of Contents**

These services include the design and planning of business systems focused on:

profit enhancement;

supply chain management enhancements;

information technology planning;

system back-ups; or

network security.

To date, our consulting services have been utilized solely in connection with our ongoing relationships with our software licensees. We expect, however, to offer stand-alone consulting services unrelated to our software products in the future. For example, we expect to enter into consulting arrangements pursuant to which we will be engaged to optimize business processes of customers that may utilize software developed by our competitors.

### *Benefits of our Solutions*

*Our software offers a broad set of solutions for the Chinese supply chain.* Our software solutions offer our customers a broad and functional set of demand-driven solutions designed to optimize their operations. Integration costs often represent a significant expenditure for our customers. We offer integration tools and services that reduce the overall effort necessary to deploy our solutions. We also believe that our solution suite encourages customers to adopt our solutions as an internal standard for business applications, allowing them to simplify their technology partner relationships while reducing the overhead of managing multiple versions of products from disparate providers.

*Our software offers enhanced decision making and responsiveness to consumer demands.* Our solutions help customers better understand and fulfill consumer demands while improving operational efficiency. Our products enable vast amounts of consumer, sales and inventory data to be rapidly collected, organized, distributed and analyzed. Our customers can explore what if merchandising plans, track and analyze performance, business results and trends, monitor strategic plans, quickly implement operational strategies based upon sophisticated fact-based optimization techniques and adjust to changes in consumer purchasing patterns.

*Our software is highly scalable.* We have designed our software to be demand-driven with the goal of reducing our customers' risk of making large investments in software that fails to expand with the customers' businesses.

*Our software offers improved inventory management.* Our solutions enable customers to continuously monitor and reduce inventory levels, achieve higher gross margins, improve their inventory turnover rates and more effectively manage their order and distribution processes. We provide our clients with tools for vendor analysis, stock status monitoring, sales capture and analysis, merchandise allocation and replenishment, purchase order management and distribution center management.

## **Table of Contents**

*We focus our business on the entire Chinese supply chain market that ranges from distribution to logistics to retail operations. Our e-Future ONE product series is a one-stop solution to address a litany of operational and strategic complexities that market participants must master in order to effectively and efficiently operate in the Chinese economy.*

Our solutions integrate industry know-how with predictive information technologies, consulting services and the best practices of leading Chinese companies to help our clients create, manage and fulfill customer demand. Our solutions can be deployed individually to meet specific needs, or as part of a scalable and fully-integrated solution. The primary software solutions consist of three independently deployable groups of products: Foundation Solutions, Collaborative Solutions, and Intelligent Solutions.

### *Our Strategy*

Our goal is to help our customers execute their business strategies by providing them with overall, one-stop software solutions and service to enhance their effectiveness, improve customer relationships, prevent out-of-stock scenarios and reduce total cost in the Chinese supply chain. In pursuing this goal, we intend to maintain and expand our status as a leading provider of fully scalable software solutions. Key elements of our strategy include:

*Increase our market share.* We believe that as the Chinese economy continues to develop, Chinese companies will compete with international businesses at an increasing rate. Consequently, Chinese businesses will need to streamline their operations in order to maximize their competitive position. In order to increase our overall market share, we will focus on increasing the amount of business we do with the following customers:

**Manufacturers.** While we currently license our software solutions to some of the largest companies in China, we intend to focus a large part of our marketing efforts in this sector.

**Distributors.** We currently work with distributors in more than 140 different cities in China. Through our continued growth and development, we expect to license our software solutions to distributors in more than 200 cities within the next several years

*Increasingly emphasize sales to small and medium-sized businesses.* As the Chinese retail, logistics and distribution industries are in their infancy, only larger businesses were initially in a position to recognize and effectively implement our software solutions into their business operations. Over the last few years, however, as the marketplace continued to mature and competition among retailers, logistics companies and distributors has heightened, we have recognized that an increasing segment of Chinese small and medium-sized businesses in these industries have begun to utilize our software solutions. We believe that the small and medium-sized businesses in our marketplace offer our company a significant opportunity because:

these businesses have not previously adopted any supply chain management software solutions and our competition may not possess the ability to effectively market to these businesses;

these businesses are more likely to purchase our less expensive software solutions on a more frequent basis, and we expect revenues from these more frequent purchases to stabilize our cash flow which may be less predictable if based solely upon the license of our more expensive (and less licensed) software solutions; and



## **Table of Contents**

we expect to receive more timely payment for our software solutions from these businesses as they do not generally possess the economic power of larger businesses that may force us to be more flexible on payment terms.

**National Chain Retailers.** We currently license our products to national chain retailers throughout more than 80 Chinese cities. We expect to license additional products to additional customers in more than 150 cities within the next several years. We are now allocating a significant portion of the proceeds of our initial public offering to the expansion of our sales team such that our sales efforts will extend to up to 50 major Chinese cities and up to 300 regional cities throughout China.

*Provide services that generate high customer satisfaction levels.* Chinese companies in our market are strongly influenced by formal and informal references. We believe that we have the opportunity to expand market share by providing high levels of customer satisfaction with our current customers, thereby fostering strong customer references to support sales activities.

*Provide tangible, measurable return on investment.* By leveraging our success with our existing clients and a renewed focus on small-to-medium size businesses in China, we believe that we are uniquely positioned to become the preferred application and technology architecture provider for software solutions to the Chinese supply chain. We believe that our strong performance and reputation can be leveraged to develop a leading technology and best in business standard.

*Anticipate a rise in the need for Chinese supply chain management services.* We anticipate that an expanding market and increasing customer demand will position the Chinese supply chain as a competitive differentiator. Since the Chinese government and industry now recognize the impact of China's supply chain performance gap, *status quo* performance will no longer be acceptable to consumers. As we continue to firmly establish our company in the supply chain management arena, we stand to benefit as demand for our services increases.

We utilize a significant portion of the proceeds of our first public offering to enhance our existing software while also developing new ECR, VMI and retailing payment systems.

### *Customers*

We provide software and service to all participants in China's supply chain front end market. These clients include manufacturers, distributors, wholesalers, logistics companies and retailers throughout China.

Currently, our software solutions are utilized:

in all provinces in China other than Taiwan and Macau;

in more than 200 cities;

by more than 680 clients, including over 400 retailers, over 270 distributors, and several manufacturers;

by more than 35 companies listed on public markets in Shanghai, Shenzhen, Hong Kong, the United States and Singapore;

by several foreign-owned enterprises;

by more than 9,700 stores;

by over 30% the top 100 retailers and 15 of the top 50 largest retailers in China;

at more than 1,800 distribution nodes; and

at more than 50,000 retailing points-of-sale.

Our manufacturing customers include:

Procter & Gamble China, China's largest consumer goods manufacturer;

Haier Group, China's largest household appliance manufacturer;

Johnson & Johnson China, the world's most comprehensive and broadly based manufacturer of health care products; and

Kimberly-Clark China, a global manufacturer of health and hygiene products.

**Table of Contents**

Our retail customers include:

B & Q China, a leading home improvement retail brand from Europe;

Gucci China, one of the most recognized luxury fashion brands;

JUSCO China, the Chinese arm of Aeon Co., LTD, a top retailer in Japan and a part of a retail conglomerate of over 150 member companies in Japan and overseas whose business model is based upon shopping center operations;

Limen (China) Group, a franchisee of Disney China's Mickey's Space chain stores;

Tian Jing Tians Group, a multinational group listed on the American Stock Exchange;

Tian Jing Homeway, one of the largest Chinese home improvement stores which was acquired by Home Depot in 2006;

Suning Appliance, China's second largest specialty retailer of consumer electronics, personal computers, entertainment software and appliances;

Parkson China Group, the Chinese arm of the largest department store in Malaysia and a company listed on the main board of The Stock Exchange of Hong Kong Limited;

Beijing Wangfujing Department Store (Group) Inc., China's first, large, state-owned department store;

Beijing SOGO, a famous Beijing department store;

The Orient Home Group, one of the largest Chinese home improvement stores;

Shenzhen Tongluowan Group, the owner of the largest shopping malls in many Chinese cities;

Shijiazhuang Belren Group, the first, large department store and hypermarket chain in the Hebei province of China;

Jinan Yinzuo Group, the first, large department store and hypermarket china in the Shandong province of China;  
Changsha Youyi Apolo Group, the first, large department store and hypermarket chain in the Hunan province of China;

Changcun Zuozhan Group, the first, large department store in the Jilin province of China;

Guangzou Youyi Group, the first, large department store in the Guangdong province of China;

Hongkong Lane Crawford group, a well-known department store chain in China;

China Duty-Free Store, the largest duty-free store in China;

Wuhan Wushang Group Co., Ltd., the first, large department store and hypermarket chain in middle China;

Wuhan Zhongbai Group, Co., Ltd., a large supermarket and hypermarket chain in middle China; and

Chongqing Department Store, Inc., the first, large department store and supermarket chain in western China.

**Table of Contents**

Our distribution and logistics customers include:

Beijing Yishangmeijie Group, China's largest consumer product distributor;

Yoshinoya D&C Co., Ltd., a Japanese fast food chain; and

Changan Minsheng Logistics Inc., the outsourcing service for Changan-Ford Automobile Co., Ford Motor Company's Chinese joint venture.

*Our Strengths*

Our strengths include:

*Ability to leverage current engagements.* Since our inception, we have developed an impressive litany of clients. By providing our solutions on a cost efficient basis and following through with outstanding client support, we have the ability to generate additional projects from our existing client base.

*Ability to leverage our knowledge of Chinese business culture.* Many of our competitors are based outside of China. As our operating subsidiary is based in Beijing, we are in a unique position to emphasize Chinese culture and business knowledge to obtain new customers. We believe that many Chinese businesses would prefer to hire a Chinese company to assist in their business operations if a Chinese company exists with the ability to fulfill their needs on a timely and cost-efficient basis.

## **Table of Contents**

*Ability to leverage our marketing activities with other businesses.* Our ability and willingness to co-market with larger organizations allows us to obtain access to business opportunities that may not otherwise be available to companies in our size. From time to time, we have entered into joint marketing arrangements with other computer and software companies. Pursuant to these arrangements, we are able to offer our solutions as part of a multi-faceted supply chain management arrangement with larger and more prestigious companies.

As of the date of this end year reporting, we have entered into the following agreements with larger organizations to obtain business opportunities:

In 2004, we entered into a Memorandum of Understanding with IBM China Company Limited whereby we agreed to collaborate with IBM China on the development of a business proved retail solution proof of concept. Upon the development of a proof of concept, we will negotiate with IBM China to determine an acceptable agreement relating to such development; and

In 2005, we entered into an ISV Advantage Agreement with IBM Technology Engineering (Shanghai) Co., Ltd. pursuant to which IBM agreed to provide us with technical assistance related to our developments based upon IBM middleware. In connection with this relationship, IBM Technology Engineering agreed to Market our business affiliation into IBM.

In 2007, we entered into a Value Added Systems Integrator ( VASI ) Agreement with JDS Software Group, Inc. (Nasdaq: JDAS) pursuant to which we will aim to integrate people, process and technology to provide local retailers with proven, robust solutions at an affordable price.

*Experienced, Successful Executive Management Team.* Our executive management team has significant experience and success in the supply chain management industry. They will be able to draw on their knowledge of the industry, their sales and marketing experience and their relationships in the industry.

*Ability to leverage China's cost structure.* As one of the leading Chinese companies in the field, we believe that we possess an inherent advantage over foreign participants in our industry. Specifically, as a Chinese company, we can operate our business on a much more cost effective basis. These costs savings are reflected in lower costs to our customers for comparable work.

### *Competition in the Supply Chain Management Software Industry*

We encounter competitive products from a variety of vendors. We believe that while our markets are still subject to intense competition, the number of significant competitors for business in China is relatively limited. We believe the principal competitive factors in our markets are:

cultural differences;

feature and functionality;

product reputation;

quality of reference accounts;

vendor viability;

**Table of Contents**

retail and demand chain industry expertise;

total solution cost;

technology platform; and

quality of customer support.

In 2006, total revenues for software and maintenance for the Chinese enterprise application software market were approximately \$50,000,000. During that year, we generated approximately \$8,104,726 in comparable revenues. As such, while we effectively compete in our market, our competitors occupy a substantial position.

A few of our existing competitors, as well as a number of potential new competitors, have significantly greater financial, technical, marketing and other resources than we do, which could provide them with a significant competitive advantage over us. In addition, we could face competition from large, multi-industry technology companies that have historically not offered an enterprise solution set to the Chinese supply chain market. Further, the enterprise software market is consolidating and this may result in larger, new competitors with greater financial, technical and marketing resources than we possess. Such a consolidation trend could negatively impact our business. This consolidation trend is evidenced by SAP AG's announcement on February 28, 2005 of a cash tender offer to purchase all of Retek, Inc.'s outstanding shares, which was followed on March 8, 2005 by a competing cash tender offer from Oracle Corporation to purchase all of Retek, Inc.'s outstanding shares. Pursuant to its tender offer, Oracle acquired Retek in April 2005. It is difficult to estimate what effect this acquisitions will have on our competitive environment. We cannot guarantee that we will be able to compete successfully against our current or future competitors in the supply chain management software industry, or that competition will not have a material adverse effect on our business, operating results and financial condition.

*Competition in the Software Consulting Industry*

To date, our consulting services have been rendered solely in connection with the implementation of our software products. Consequently, we have not experienced a significant amount of competition for these services. We expect, however, to offer stand-alone consulting services unrelated to our software products in the future. Our competitors in the supply chain management software industry are also our primary competitors in the software consulting industry. Many of our competitors possess significantly greater financial, technical, marketing and other resources than we do. Our larger competitors, particularly SAP AG and Retek/Oracle may be in a financial position to acquire smaller software consulting companies in China. Such consolidated entities may possess significant competitive advantages over us. We cannot guaranty that we will be able to compete successfully against our current or future competitors in the software consulting industry.

*Proprietary Rights*

Our success and competitive position is dependent in part upon our ability to develop and maintain the proprietary aspect of our technology. The reverse engineering, unauthorized copying, or other misappropriation of our technology could enable third parties to benefit from our technology without paying for it. We rely on a combination of trademark, trade secret, copyright law and contractual restrictions to protect the proprietary aspects of our technology. We seek to protect the source code to our

## **Table of Contents**

software, documentation and other written materials under trade secret and copyright laws. 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.

We license our software products under signed license agreements that impose restrictions on the licensee's ability to utilize the software and do not permit the re-sale, sublicense or other transfer of the software. Finally, we seek to avoid disclosure of our intellectual property by requiring employees and independent consultants to execute confidentiality agreements with us and by restricting access to our source code.

Although we develop our software products, each is based upon middleware developed by third parties, including IBM and Oracle. We integrate this technology, licensed by our customers from third parties in our software products. If our customers are unable to continue to license any of this third party software, or if the third party licensors do not adequately maintain or update their products, we would face delays in the releases of our software until equivalent technology can be identified, licensed or developed, and integrated into our software products. These delays, if they occur, could harm our business, operating results and financial condition.

There has been a substantial amount of litigation in the software and Internet industries regarding intellectual property rights. It is possible that in the future third parties may claim that our current or potential future software solutions infringe their intellectual property. We expect that software product developers and providers of e-commerce products will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlap. In addition, we may find it necessary to initiate claims or litigation against third parties for infringement of our proprietary rights or to protect our trade secrets. Although we may disclaim certain intellectual property representations to our customers, these disclaimers may not be sufficient to fully protect us against such claims. We may be more vulnerable to patent claims since we do not have any issued patents that we can assert defensively against a patent infringement claim. Any claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or license agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all, which could have a material adverse effect on our business, operating results and financial condition.

Our standard software license agreements contain an infringement indemnity clause under which we agree to indemnify and hold harmless our customers and business partners against liability and damages arising from claims of various copyright or other intellectual property infringement by our products. We have never lost an infringement claim and our costs to defend such lawsuits have been insignificant. Although it is possible that in the future third parties may claim that our current or potential future software solutions or we infringe on their intellectual property, we do not currently expect a significant impact on our business, operating results, or financial condition.

### *China's Intellectual Property Rights Enforcement System*

In 1998, China established the State Intellectual Property Office ( SIPO ) to coordinate China's intellectual property enforcement efforts. SIPO is responsible for granting and enforcing patents, as well as coordinating intellectual property rights related to copyrights and trademarks. Protection of intellectual property in China follows a two-track system. The first track is administrative in nature, whereby a holder of intellectual property rights files a complaint at a local administrative office. Determining which



## **Table of Contents**

intellectual property agency can be confusing, as jurisdiction of intellectual property matters is diffused throughout a number of government agencies and offices, which each typically responsible for the protection afforded by one statute or one specific area of intellectual property-related law. The second track is a judicial track, whereby complaints are filed through the Chinese court system. Since 1993, China has maintained various intellectual property tribunals. The total volume of intellectual property related litigation, however, remains small.

Although there are differences in intellectual property rights between the United States and China, of most significance to our company is the inexperience of China in connection with the development and protection of intellectual property rights. Similar to the United States, China has chosen to protect software under copyright law rather than trade secrets, patent or contract law. As such, we will attempt to protect our most significant asset (software) pursuant to Chinese laws that have only recently been adopted. Unlike the United States, which has lengthy case law related to the interpretation and applicability of intellectual property law, China is currently in the process of developing such interpretations.

### *Regulation on Software Products*

On October 27, 2000, the Ministry of Information Industry issued the Administrative Measures on Software Products, or the Software Measures, to strengthen the regulation of software products and to encourage the development of the Chinese software industry. Under the Software Measures, a software developer must have all software products imported into or sold in China tested by a testing organization approved by the Ministry of Information Industry. The software products must be registered with the Ministry of Information Industry or with its provincial branch. The sale of unregistered software products in China is forbidden. Software products can be registered for five years, and the registration is renewable upon expiration.

### *Regulation of Intellectual Property Rights*

China has adopted legislation governing intellectual property rights, including trademarks and copyrights. China is a signatory to the main international conventions on intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the WTO in December 2001.

*Copyright.* China adopted its first copyright law in 1990. The National People's Congress amended the Copyright Law in 2001 to widen the scope of works and rights that are eligible for copyright protection. The amended Copyright Law extends copyright protection software products, among others. In addition, there is a voluntary registration system administered by the China Copyright Protection Center. Unlike patent and trademark registration, copyrighted works do not require registration for protection. Protection is granted to individuals from countries belonging to the copyright international conventions or bilateral agreements of which China is a member.

*Trademark.* The Chinese Trademark Law, adopted in 1982 and revised in 1993 and 2001, protects registered trademarks. The Trademark Office under the Chinese State Administration for Industry and Commerce handles trademark registrations and grants a term of ten years to registered trademarks. Trademark license agreements must be filed with the Trademark Office for record. China has a first-to-register system that requires no evidence of prior use or ownership. We have registered a number of our product names with the Trademark Office.

**Table of Contents***Sales Organization Compensation*

We employ a sales staff designed to effectively market our suite of software solutions throughout China. Our ability to continue to grow our business is directly tied to the performance of our sales force. We structure our sales force compensation on a commission basis. Theoretically, each of our salespersons can earn more than each of our executive officers, and in recent years, several have achieved such distinction.

*Relationship with Hainan Future Computer Company Limited*

As noted herein, we created our holding company structure in 2001 when the two shareholders of e-Future Beijing, Hainan Future and Johnson Li, our Vice President, transferred all shares of e-Future Beijing to us for ¥5,000,000. At the time, Hainan Future had two shareholders, Adam Yan, our Chief Executive Officer, and Qicheng Yang, our Chief Technology Officer. In May 2005, Mr. Yan and Mr. Yang transferred their shares in Hainan Future to Xuejun Zhang and Ling Zhang for RMB 225,000 and RMB 75,000, respectively. Xuejun Zhang currently serves as the director of our administration department. Ling Zhang serves as an employee in our accounting and finance department. Although they are not executive officers, these individuals are senior employees who actively participate in our day-to-day operations. Noting our limited number of employees, they may have the potential to influence our executive officers and, thereby, our business and its operations.

As of December 31, 2001, we had advanced ¥3,195,956 to Hainan Future. The balance arose as the result of payments to suppliers on behalf of Hainan Future, cash advances to Hainan Future, Hainan Future's collection of cash receipts from our customers, and the sale of an investment in a company to Hainan Future, less the collection of cash receipts from Hainan Future's customers, less Hainan Future's payments to suppliers on our behalf, less the cost of software purchased from Hainan Future and less the purchase of two real estate parcels from Hainan Future. Hainan Future had no operations or employees from December 31, 2001. As a result, we made payments to, provided services to and collected cash receipts from Hainan Future's customers during the years ended December 31, 2003, 2004 and 2005. Those transactions along with the resulting balances receivable from Hainan Future were as follows:

	For the Years Ended December 31,			U.S. Dollars
	2003	2004	2005	For the Year Ended December 31, 2005 (Unaudited)
Payments of (refunds from) Hainan suppliers	¥ 23,500	¥ 155,307	¥ (146,699)	\$ (18,178)
Services provided to Hainan	1,000,000			
Offset receivable from Hainan against payable to Hainan			(2,526,595)	(313,077)
Collection of cash receipts from Hainan's customers	(744,800)	(1,500,700)		
<b>Balance at End of Period</b>	<b>¥ 4,018,687</b>	<b>¥ 2,673,294</b>	<b>¥</b>	<b>\$</b>

We owed Mr. Li and Hainan Future ¥1,000,000 and ¥4,000,000, respectively, for the acquisition of the Company's equity interest in e-Future Beijing. The balances due were unsecured, had no fixed terms of repayment and were considered due on demand. On August 12, 2005, we paid Hainan Future ¥575,722 towards the amount due to Hainan Future. On September 25, 2005, Hainan Future acquired Mr.

**Table of Contents**

Li's receivable from our company. On November 18, 2005, we entered into an agreement with Hainan Future whereby ¥1,897,683 of the payable to Hainan Future was forgiven by Hainan Future and the remaining balance payable to Hainan Future of ¥2,526,595 was offset against the receivable from Hainan Future of the same amount. This transaction was approved by our Board of Directors and the Board of Directors of Hainan Future. We will recognize this forgiveness of debt as a contribution to capital.

**C. Organizational structure**

As of the date of this Annual Report, our ownership structure is as follows:

**D. Property, plants and equipment***Facilities*

We currently operate four facilities throughout China. Our headquarters are located in Beijing. Our research and development operations are generally located in Shanghai. We also maintain customer support and programming operations in Wuhan and Guangzhou.

Office	Address	Rental Term	Space
	#10 Building BUT Software Park No. 1 Disheng North Street, BDA		556 sq. meters
Beijing	Yizhang District Floor 19 Shentong Information Plaza 55 West Road of Huaihai Street	Expires December 31, 2007	556 sq. meters
Shanghai	Xu Jiahu District Floors 2 and 3 Office Building of Machine Bureau Fujiapo, Wuchang District	Expires March 19, 2008	452 sq. meters
Wuhan	Wuhan, Hubei Province	Expires September 18, 2007	886 sq. meters

## **Table of Contents**

Our new headquarters facility is located in a high-technology park developed on the outskirts of Beijing. This development has resulted from the Chinese government's decision to centralize high-technology companies in a currently under-utilized area of Beijing. Our new facility will offer benefits in the form of reduced rents and access to technologically advanced facilities. We believe that these facilities are more than adequate to meet our needs.

### **Item 4A. Unresolved Staff Comments**

Not applicable.

### **Item 5. Operating and Financial Review and Prospects**

*The following discussion and analysis should be read in conjunction with our audited historical consolidated financial statements and our unaudited pro forma condensed consolidated financial statements, together with the respective notes thereto, included elsewhere in this prospectus. Our audited historical consolidated financial statements have been prepared in accordance with U.S. GAAP. Our unaudited pro forma financial information has been derived from our audited historical consolidated financial statements.*

#### *Overview*

We believe that we are one of the leading businesses engaged in developing and selling enterprise resource planning software and providing one-stop solutions for distribution, retail and logistics businesses focused on the supply chain front market for manufacturers, retailers, distributors and third-party logistics companies in China. In addition, we provide related system integration services. System integration services involve system design and system implementation through the application of the software as well as ongoing technical supporting services.

Our business started in 2000 when we purchased our e-Future ONE POS-ERP software from Hainan Future Computer Company Limited ( Hainan Future ). Following its formation in 1997, Hainan Future developed this software program that possessed particular use in the Chinese supply chain management industry. In an effort to create a new company that would qualify for preferential tax treatments associated with businesses in the high-technology industry, we agreed to purchase this program and all related rights from Hainan Future in 2000 for RMB 5,160,000. In connection with this transaction, Hainan Future agreed to provide us with technical support and development services related to the program for one year. On May 24, 2001, the PRC National Copyright Bureau issued e-Future (Beijing) Tornado Information Technology Inc., our wholly-owned subsidiary ( e-Future Beijing ) a certificate approving the transfer of the software and granting e-Future Beijing the sole right to exploit the copyright.

Since the acquisition of this program, we have continued to develop our core software to meet the needs of a wide range of customers, and today we have expanded to the small business market which is growing. We expect our revenues to continue to be cyclical during each year with a greater amount of revenues recognized in the last half of the year. This can cause a need for future borrowing from financial institutions. In the past, we have been able to borrow funds at reasonable interest rates and expect that we will be able to do so in the future. However, there is a possibility that funds may not be available and that unavailability could cause us significant difficulty in funding operations in the future.

Should there be a significant decline in the business climate in China, we would not be able to sustain our operations, and we would have to reduce operations and cut expenses to be able to continue in

## Table of Contents

business. This could have a negative impact upon our financial position and results of operations. Such an event would probably have a significant effect on our ability to collect our trade receivables and would cause us to recognize an increase in bad debt allowance related to such receivables. We currently do not anticipate such a decline based on current trends in China.

Customers who license our software generally purchase maintenance contracts, typically covering renewable annual periods. In addition, customers may purchase consulting services, which are customarily billed at a fixed daily rate plus out-of-pocket expenses. Contract development services, including new product development services, are typically performed for a fixed fee. Our revenue growth has resulted from a combination of increased market penetration and expanding product offerings. Our investments in research and development and alliances have helped us bring new software solutions to market. Our investments have produced a suite of decision support solutions. To support our growth during these periods, we have also continued to invest in internal infrastructure by hiring employees throughout various departments of the organization. It is possible that in the future we may have difficulty in hiring qualified employees to fulfill our needs, but at the present time, it appears that there is an abundance of qualified individuals available to support our needs.

### *Critical Accounting Policies and Estimates*

#### *Revenue Recognition*

We recognize revenues based on the following principles:

We generate revenue from the sale of software, related hardware, maintenance and support contracts, and professional consulting, training and contract development services. At this time, we generally license our products to customers on a perpetual basis and we recognize revenue upon delivery of the products. Under certain of our license agreements, we will provide technical advisory services after the delivery of our products to help our customers exploit the full value and functionality of our products. Revenue from the sale of software licenses and technical advisory services under these agreements will be recognized as the services are performed over the contract period.

We recognize revenue when it is realized and earned. We consider revenue realized or realizable and earned when:

we have persuasive evidence of an arrangement;

delivery has occurred;

the sales price is fixed or determinable; and

collectibility is reasonably assured.

We do not consider delivery to occur until products have been shipped or services have been provided to the client, risk of loss has transferred to the client and client acceptance has been obtained, client acceptance provisions have lapsed, or we have objective evidence that the criteria specified in client acceptance provisions have been satisfied. We do not consider the sales price to be fixed or determinable until all contingencies related to the sale have been resolved. We have not encountered significant difficulty in the past with our customers accepting our products and services. Our products and services

**Table of Contents**

have fulfilled the needs of our customers. Should other products or services be introduced in the market that compete with our products and services, our future customers may choose those products and services instead of ours and affect our ability to generate revenues. We are confident that our constant development of our software products will maintain us as a leader in our market.

For software sales, we recognize revenues in accordance with the provisions of Statement of Position No. 97-2, Software Revenue Recognition, and related interpretations. Revenue from perpetual (one-time charge) licensed software is recognized at the inception of the license term. Revenue from term (monthly license charge) arrangements is recognized on a subscription basis over the period that the customer is using the license. Revenue from maintenance for the first year and initial training are included in the purchase price of the software. Initial training is provided at the time of installation and is recognized as income as part of the price of the software since it is minimal in value. Maintenance is valued based on a fee schedule we use for providing our regular level of maintenance on a stand alone basis. Maintenance revenue is included in the income statement under services and is recognized over the term of the agreement. We will recognize revenue upon the completion of the project and the inception of the license term. Revenues applicable to multiple-element fee arrangements are bifurcated among elements such as software, hardware, and post-contact service using vendor-specific objective evidence of fair value. Such evidence consists primarily of pricing of multiple elements sold as separate elements in the contract.

We generally recognize revenue from hardware sales when the product is shipped to the customer and when there are no unfulfilled company obligations that affect the customer's final acceptance of the arrangement.

We provide services for system integration which involve the design and development of complex information technology systems to the customer's specifications. We provide these services on a fixed-price contract and the contract terms generally are short. We recognize revenue when delivery and acceptance is determined by a completion report signed by our customer.

Since our sales are based on customer acceptance of our software and services, we have experienced success in demonstrating the value of our products in the past, and our customers have accepted our software and services, we do not anticipate difficulty in gaining acceptance of our products in the future. However, it is impossible to know how future customers might react if other products are introduced that compete with our products and services. Accordingly, our estimate of acceptance of our software and services has a reasonably high likelihood of change.

We have not entered into contracts with customers unless collection of the contract amount is reasonably assured. We re-evaluate the customer's ability and intent to pay at the date of completion and acceptance of our products and base this assessment on a number of factors including deposits collected prior to completion of installation of our products, the customer's acceptance of our products and services and their commitment at that date to pay the remaining balance under the contract. Our assessment resulted in the conclusion that collection of the amounts due under the sales arrangements was reasonably assured at the time of the contracts and at the dates the contracts were completed, although, subsequent to completion and revenue recognition, there were significant bad debts associated with uncollectible accounts receivable. The bad debts, as explained below, were caused by reasons other than the probability of collection at the date of contract completion.

## **Table of Contents**

### *Allowance for Doubtful Accounts*

From the date a contract for our products is signed through the date of customer acceptance, we generally require our customers to deposit up to 60% of the contract price. We also generally grant credit to customers allowing them to pay 20% to 30% of the contract price 30 to 60 days after acceptance and 5% to 10% of the contract price up to one year after acceptance. We have not been able to consistently enforce the credit terms provided to all of our customers. Although we thoroughly evaluate a customer's credit standing at the date we enter into a contract, there have been situations where the creditworthiness of customers has declined before we have collected the entire contract price, which has resulted in the write off of bad debts. We recognize that the passage of time and changes in customers' financial condition have caused deterioration of the collectibility of past due accounts receivable.

During 2003 and 2004, bad debts increased mainly due to changes in the financial condition of customers prior to the due dates of the receivables, which caused us not to be able to consistently enforce the credit terms for collection of accounts receivable during and after those periods. During this time period our management team made little effort related to collection of accounts receivable because sales were increasing dramatically and cash flows were good. Our compensation policies contributed to our lack of effort related to collections as employees were motivated to pay more attention to new orders. In addition, there are a large number of national holidays in China during the first half of the year. Since most of our customers are in the retail trade, our customers typically hold on to cash longer during the first half of the year and use the cash for internal purposes rather than timely paying vendors under credit terms granted. This cycle tends to increase the aging of accounts receivable during the first half of the year. During the first half of 2005, our efforts were focused on our products, on generating new sales and on obtaining financing, which resulted in less effort directed towards collecting accounts receivable. As a result, the aging of our accounts receivable increased significantly during the six months ended June 30, 2005. We have realized that a stronger effort was needed on collection activities and our lack of our focus on collections caused collectibility of past due receivables to come into question and resulted in significant bad debts during that period.

Since September 2004, we have been focusing our sales efforts more on small to medium-sized customers rather than on larger, key customers, in order to broaden coverage nationally and to decrease fluctuations in cash flows from customers. These changes have improved collection of accounts receivable because we typically do not grant smaller customers long credit terms like we have granted to larger customers. In 2006, we have seen an improved collection of accounts receivable and less bad debts.

We have developed standardized, turnkey products and standardization of the implementation process for small to medium sized customers which is intended to decrease cost and save time for us and for the customers during implementation of our software products. A significant portion of our bad debts have been from our larger, key customers. Our management has modified our method of serving our larger customers to use a three-month implementation cycle for determining and fulfilling the customer's needs. We believe this effort will shorten the time required to complete contracts with these customer, obtain their acceptance of our products and to enable us to collect payments from these key customers more consistently.

We have provided additional training for our sales personnel and our implementation team to help them focus on the relationship between the need to identifying customers' software requirements while meeting our cash flow requirements and collecting accounts receivable under the credit terms provided to the customers. Beginning in 2006, we have provided our key sales and implementation personnel with a compensation bonus plan that is based upon cash collections from their respective customers.

## **Table of Contents**

These measures have been implemented so we will be able to consistently enforce the credit terms provided to our customers. However, there is no assurance that these efforts will be successful. If we are unable to enforce our credit terms in the future or if other identified changes to our sales and collection efforts are not successful, our cash flows from operating activities and our cash balance would decrease and the results of our operations would decline.

We have provided for doubtful accounts based on the aging of accounts receivable, with higher allowance percentages for older receivables. The factors used to compute our estimate of bad debts is based on historical experience and has been modified based upon general economic conditions. The estimate of the allowance is reasonably likely to change in the future. Since the allowance for doubtful accounts is based on matters that are highly uncertain, the allowance is highly sensitive to changes in the economy in China, our clients' acceptance of and satisfaction with our software and services, and the terms granted to clients to pay for the products and services. Each of these factors could have a material effect upon the estimated allowance for doubtful accounts, although we are not aware of the specific sensitivity of the allowance to any of these factors. As an example, if the aging of accounts receivable increases to be over one year, the allowance for doubtful accounts would likely increase by 70% to 100% of accounts receivable and there would be significant write offs of accounts receivable older than one year. The actual collectibility of our accounts receivable, however could differ from our current estimates, and that difference could adversely affect our financial position, results of operation or liquidity in the future.

### *Stock-Based Compensation*

Through December 31, 2005, we have accounted for stock options issued to directors, officers and employees under Accounting Principles Board Opinion No. 25 and related interpretations ( APB 25 ). Since January 1, 2006, we have accounted for stock options at their fair value in accordance with SFAS 123R. We account for options and warrants issued to non-employees at their fair value in accordance with SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ). We did not recognize any compensation cost during the years ended December 31, 2004, 2005 or 2006 from stock-based compensation. We may use stock based compensation more extensively in the future to reward our employees and encourage loyalty to help our company grow. This could increase expenses related to stock based compensation in the future.

### *Property and Equipment*

We depreciate property and equipment on a straight-line basis over their estimated useful lives, which range from ten years for motor vehicles and five years for purchased software and communication and office equipment to three years for leasehold improvements. These estimated lives have been reasonably accurate in the past and have been based on historical experience and the estimated useful lives of similar assets by other software companies. These estimates are reasonably likely to change in the future since they are based upon matters that are highly uncertain such as the general economy, potential changes in technology and estimated cash flows from the use of these assets. Should any of these changes in the estimated lives of property and equipment occur, their remaining carrying value of ¥1,014,581 at December 31, 2006 could be depreciated completely in one year.

### *Intangible Assets*

We charge all of our development costs to research and development until we have established technological feasibility. We acknowledge technological feasibility of our software when a detailed



## **Table of Contents**

program design has been completed, or upon the completion of a working model. Upon reaching technological feasibility, we capitalize additional software costs until the software is available for general release to customers. Although we have not established a budget or time table for software development, we anticipate the need to continue the development of our software products in the future and the cost could be significant. We believe that, as in the past, the costs of development will result in new products that will increase revenue and therefore justify costs. There is, however, a reasonable possibility that we may be unable to realize the carrying value of our software, and the amount not so realized may adversely affect our financial position, results of operation or liquidity in the future.

We amortize the cost of intangible assets over the shorter of four years or the estimated period of realization of revenue from the related software. The estimated life of our software is based upon historical usefulness of similar software products and the rate of change in technology in general. Our estimate of the useful lives of our software has been reasonably accurate in the past, but it is reasonably likely to change in the future due to the highly uncertain nature of this estimate. Should economic conditions change or technological advances occur rapidly, our estimate of the useful lives of our software products could decline quickly, which would result in recognition of increased amortization. We currently estimate that the carrying value of our internally generated software as of December 31, 2006 will be amortized at the rate of ¥2,599,319 during 2007, decreasing to ¥566,737 during 2010. Should economic or technological changes occur in the near future, amortization of our internally generated software could increase to as high as approximately ¥7,000,000 in one year.

### *Cost of Revenue*

Cost of our revenues includes wages, materials, handling charges, and other expenses associated with the development of software, sale of hardware, and technical support services. We charge the allowance for doubtful accounts as part of the cost of software sold. We expect cost of revenue to grow as our revenues grow. As noted above, development costs will increase in the future, and we expect revenues to increase at the same time. It is possible that we could incur development costs with little revenue recognition, but based upon our past history, we expect our revenues to grow.

### *Valuation of Long-Lived Assets*

We review the carrying values of our long-lived assets for impairment whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, we project undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, we reduce the carrying value of the long-lived asset, by the estimated excess of the carrying value over the projected discounted cash flows. In the past, we have not had to make significant adjustments to the carrying values of our long-lived assets, and we do not anticipate a need to do so in the future. However, circumstances could cause us to have to reduce the value of our capitalized software at a more rapid rate than we have in the past if our revenues were to significantly decline. Estimated cash flows from the use of the long-lived assets are highly uncertain and therefore the estimation of the need to impair these assets is reasonably likely to change in the future. Should the economy or acceptance of our software change in the future, it is likely that our estimate of the future cash flows from the use of these assets will change by a material amount. The amount of possible change is discussed above under *Property and Equipment* and *Intangible Assets*.

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

The following table presents the results of our operations for the periods indicated. Our historical reporting results are not necessarily indicative of the results to be expected for any future period.

	Chinese Yuan (Renminbi)			U.S. Dollars
	For the Years Ended December 31,			For the Year
	2004	2005	2006	Ended
				December 31,
				2006
				(Unaudited)
<b>Revenues</b>				
Software sales	¥ 25,130,089	¥ 25,177,810	¥ 29,832,720	\$ 3,822,698
Hardware sales	5,141,041	10,241,749	11,403,473	1,461,216
Service fee income	4,432,167	3,824,442	6,607,337	846,649
<b>Total Revenues</b>	<b>34,703,297</b>	<b>39,244,001</b>	<b>47,843,530</b>	<b>6,130,563</b>
<b>Cost of Revenues</b>				
Cost of software	10,097,528	7,815,315	7,665,866	982,287
Cost of hardware	4,097,518	8,681,619	10,548,649	1,351,680
Cost of service fee income	1,033,167	901,973	1,887,676	241,883
Amortization of software costs	1,966,420	2,305,835	2,727,198	349,457
<b>Total Cost of Revenue</b>	<b>17,194,633</b>	<b>19,704,742</b>	<b>22,829,389</b>	<b>2,925,307</b>
<b>Gross Profit</b>	<b>17,508,664</b>	<b>19,539,259</b>	<b>25,014,141</b>	<b>3,205,256</b>
<b>Expenses</b>				
Research and development	1,419,937	93,814	527,219	67,557
General and administrative	6,104,657	7,811,742	7,298,980	935,275
Selling and distribution expenses	4,786,308	5,790,675	9,210,975	1,180,274
<b>Total Expenses</b>	<b>12,310,902</b>	<b>13,696,231</b>	<b>17,037,174</b>	<b>2,183,106</b>
<b>Income (loss) from operations</b>	<b>5,197,762</b>	<b>5,843,028</b>	<b>7,976,967</b>	<b>1,022,150</b>
<b>Interest income</b>	<b>16,108</b>	<b>110,268</b>	<b>141,230</b>	<b>18,097</b>
<b>Interest expense</b>	<b>(688,680)</b>	<b>(483,033)</b>	<b>(13,471)</b>	<b>(1,726)</b>
<b>Net income (loss)</b>	<b>¥ 4,525,190</b>	<b>¥ 5,470,263</b>	<b>¥ 8,104,726</b>	<b>\$ 1,038,521</b>
<b>Earnings (loss) per ordinary share</b>				
Basic	¥ 4.91	¥ 4.43	¥ 4.80	\$ 0.61
Diluted	¥ 2.90	¥ 3.50	¥ 4.43	\$ 0.57

---

**Table of Contents**

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

*Revenue*

**Total revenue.** Total revenue is comprised of software sales, hardware sales and service fee revenue. Total revenue increased 21.9% from RMB 39,244,001 in 2005 to RMB 47,843,530 in 2006.

**Software sales.** Our software sales increased 18.5% from RMB 25,177,810 in 2005 to RMB 29,832,720 in 2006. This increase is primarily attributable to our decision to focus our marketing efforts upon small and medium-sized businesses in our marketplace. The number of small and medium-sized businesses in China has grown dramatically, and we expect to see this trend continue in future fiscal periods. In addition, we also believe that as such businesses mature, their need for our products and services will correspondingly increase. These customers are essential to the growth and development of our company. We expect to witness more intensive competition in the Chinese retail market in the near future.

**Hardware sales.** Our hardware sales increased 11.3% from RMB 10,241,749 in 2005 to RMB 11,403,473 in 2006. In recent years, we decided to de-emphasize hardware sales in an increasingly competitive hardware sales market. The margins that we are able to achieve from hardware sales have diminished significantly. As a relatively young company, we don't believe that we are in a business position to leverage a low margin, high volume sales sector. Consequently, while we will continue to sell computer hardware in connection with our software sales, we have not and do not expect to emphasize hardware sales as part of our marketing and sales strategies. Nonetheless, there may be occasions where we may profitably include hardware in projects that we complete for clients that possess superior credit. This occurred in 2006. In 2006, several customers required the purchase of new hardware for integration into their software products. As a result, we experienced an increase in hardware sales when compared to 2005. Over time, however, we expect to experience reduced hardware sales as we focus our efforts on higher margin areas of our business. We expect that, in the short-term, we may fail to capture additional revenues for hardware sales, but our management believes that the long-term health of our company is substantially dependent upon the licensing of our software products. As a result of our decision to de-emphasize hardware sales, we have altered our revenue structure in an effort to enhance our software sales and service fees.

**Service fee income.** Our service fee income increased 72.8% from RMB 3,824,442 in 2005 to RMB 6,607,337 in 2006. This increase is primarily attributable to the following factors:

A. We generated service fee income from Software as a Service ( SaaS ) in 2006. SaaS refers to an innovative practice in which a software developer leases programs to customers and provides maintenance, daily technical operation, and support for the software. SaaS is a model of software delivery rather than a market segment; software can be delivered using this method to any market segment including home consumers, small businesses, as well as medium and large businesses. We will focus on using this method to deliver our software to small and medium-sized businesses in China, especially in specialty stores, in future fiscal periods;

B. The free service periods for many contracts previously signed began to expire during 2006, and further services are charged by annual basis, resulting in increased service fee income; and

C. The increase in software sales provided additional opportunity for our company to generate service fees associated with such software.

## **Table of Contents**

As we continue to refine our business model, we expect to continue to experience increased service fees.

### *Cost of revenues*

**Cost of software.** Cost of software consists of wages, materials, handling charges and other expenses associated with the development of our software. Cost of software essentially remained flat from RMB 7,815,315 in 2005 to RMB 7,665,866 in 2006. This modest decrease resulted directly from our decision to continue our focus on marketing upon small and medium-sized businesses. Initially, these customers tend to purchase our less sophisticated software products. As such, these projects require fewer integration services to reach completion. Over time, however, we believe that as our customer base grows, our cost of license and related maintenance revenue will increase as we hire personnel for our customer support organization. As a percentage of software sales, cost of software was 31% for 2005 and 26% for 2006. This decrease was primarily attributable to the fact that in 2006, we sold more mature software products that require less customization. We expect that as we continue to develop and license newer products, cost of software as a percentage of software sales will likely increase.

**Cost of hardware.** Cost of hardware consists primarily of fees for third party hardware products that are utilized in connection with our software products. Cost of hardware increased by 21.5% from RMB 8,681,619 in 2005 to RMB 10,548,649 in 2006. This increase resulted directly from the increase in hardware sales we experienced in 2006. As a percentage of hardware sales, cost of hardware was 84.8% in 2005 and 93% in 2006. This increase was primarily attributable to the competitive market in hardware sales. In 2006, we were unable to maintain the margin on hardware sales that we experienced in prior periods. We expect this trend to continue in future fiscal periods. As noted above, however, the cost of hardware provides us with a relatively small profit margin. In order to emphasize our profitability, we will continue to de-emphasize hardware sales as an element of our business operations in future periods.

**Cost of service fee income.** Cost of service fee income includes salaries and related expenses of our consulting organization and an allocation of our facilities and depreciation expenses. Cost of services increased 109.3% from RMB 901,973 for 2005 to RMB 1,887,676 for 2006. The increase resulted directly from the dramatic increase in our service fee income and the increased size in our labor force necessary to fulfill our service obligations.

**Amortization of Software Costs.** Intangible assets represent the cost of computer software we acquired and developed. These costs are amortized over the useful life of the software. Costs included are mostly salary and employee benefits for those involved in the development of the software. Amortization expense increased 18.3% from RMB 2,305,835 in 2005 to RMB 2,727,198 in 2006. The increase is due to the increase of software products being amortized at December 31, 2006. Because we are continually developing our products, we expect amortization to continue increasing in future years based upon our success in developing new products for our customers.

### *Operating expenses*

**Research and development.** Research and development expenses, which are expensed as incurred, consist primarily of salaries and related costs of our engineering organization; consultants; and an allocation of our facilities and depreciation expenses. We believe that our success depends on continued enhancement of our current products and our ability to develop new technologically advanced products that meet the increasingly sophisticated requirements of our customers. Research and development expenses increased 462.0% from RMB 93,814 in 2005 to RMB 527,219 in 2006. The

## Table of Contents

increase in these expenses was primarily attributable to the fact that in 2006 we focused our attention on the development of new software products to meet the evolving complexities of our customers' businesses. We did not focus upon research and development in 2005. Rather, we opted to gain market acceptance of our software products that were developed in previous fiscal periods. Research and development represented 0.2% of total revenue for 2005 and 1.1% of total revenue for 2006.

General and administrative. General and administrative expenses consist primarily of costs from our finance and human resources organizations; third party legal and other professional services fees; and an allocation of our facilities costs and depreciation expenses. General and administrative expenses decreased 6.6% from RMB 7,811,742 in 2005 to RMB 7,298,980 in 2006. The decrease in general and administrative expenses is attributable to the strict cost control strategies including the relocation of our office from downtown Beijing to the Beijing Economic-Technological Development Area (BDA) which is located in nearby Yizhuang.

General and administrative expenses were 19.9% of total revenue for 2005 and 16% of total revenue for 2006. This decrease in general and administrative expenses as a percentage of revenue was attributable to the increase of overall revenues and the decrease in general and administrative expenses noted above. We expect that as a public company we will likely experience an increase in general and administrative expenses as a percentage of total revenues in future fiscal periods. These expenses include additional legal and accounting fees and public relations costs.

Selling and distribution expenses. Selling and distribution expenses consist primarily of salaries and related costs of our sales and marketing organization: sales bonuses; costs of our marketing programs, including public relations, advertising, trade shows, and collateral sales bonuses; and an allocation of our facilities and depreciation expenses. Selling and distribution expenses increased 59.1% from RMB 5,790,675 in 2005 to RMB 9,210,975 in 2006. The increase in selling and distribution expenses was due to additional labor costs associated with the expansion of our sales force. During this time period we added 26 employees to our sales department. We anticipate that sales and marketing expenses will increase to support our intended expansion of our sales and marketing organization. Selling and distribution expenses were 14.8% of total revenue for 2005 and 19% of total revenue for 2006. This increase in selling and distribution expenses as a percentage of revenue was attributable to the fact that the costs associated with our larger sales department were not immediately offset by increased sales that we could recognize in 2006.

### *Other*

Interest Income. Our interest income represents the interest accrued as a result of bank deposits. Our interest income increased 28.1% from RMB110,268 in 2005 to RMB141,230 in 2006. The increase is primarily due to interest earned on the proceeds of our initial public offering in 2006.

Interest Expense. Our interest expense represents the interest incurred as a result of short-term loans taken during the course of our operations. Our interest expense decreased 97.2% dramatically from RMB 483,033 in 2005 to RMB 13,471 in 2006. This decrease generally resulted from the decrease in outstanding short-term loans.

**Table of Contents**

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

**Revenue**

**Total revenue.** Total revenue is comprised of software sales, hardware sales and service fee revenue. Total revenue increased 13.1% from RMB 34,703,297 in 2004 to RMB 39,244,001 in 2005.

**Software sales.** Software sales generally remained flat from RMB 25,130,089 in 2004 to RMB 25,177,810 in 2005. While we expect our software sales to increase significantly over time, we believe that our software sales in 2005 were flat as a result of several factors:

In 2005, we experienced several situations where large, rapidly growing retail operations opted to acquire existing stores instead of developing new stores. These acquired operations did not immediately require our software solutions. We believe, however, that our software products will be attractive to these retailing operations as they continue to integrate their acquired stores.

In 2005, we emphasized sales to small and medium-sized businesses in our marketplace. As noted in the chart below, while the number of licenses we issued for our software products increased dramatically from 2004 to 2005, these customers opted to purchase less expensive software solutions. As a result, the increase in the number of software licenses issued was offset by smaller license fees. Over time, we believe that these customers will be essential to the growth and development of our company. We expect to witness more intensive competition in the Chinese retail market in the near future. We believe that much of this growth will be in small and medium-sized businesses. By establishing a significant presence in this market, we believe that we should be able to capitalize upon this growth.

In 2005, a significant number of contracts for the year were executed in the latter half of the year. As these projects take several months to complete, we were unable to recognize the revenue associated with these projects in 2005. However, we expect to recognize this revenue in 2006. The chart below indicates our software sales in 2005 and 2004. It does not include revenues we generated from the sale of software developed by third parties.

	RMB	RMB		2005	2004	
	2005	2004		2005	2004	
<b>Software Program</b>	<b>Sales</b>	<b>Sales</b>	<b>% Increase</b>	<b>Licenses</b>	<b>Licenses</b>	<b>% Increase</b>
ONE Visual-DRP	361,046	581,026	(37.9)%	3	4	(25.0)%
ONE DMS	1,988,339	2,219,470	(10.4)%	69	62	11.3%
ONE POS-ERP	18,828,832	18,697,075	0.7%	113	37	205.4%
ONE LRP	0	814,957	(100.0)%	1	1	(100.0)%
ONE SCM	1,041,927	145,299	617.1%	2	2	N/A
ONE CPFRR/VMI	1,100,765	105,573	942.7%	12	2	500.0%
ONE CRM	0	1,225,928	(100.0)%	4	4	(100.0)%
ONE BI	97,285	581,197	(83.3)%	1	1	0.0%

**Hardware sales.** Hardware sales increased 99.2% from RMB 5,141,041 in 2004 to RMB 10,241,749 in 2005. In recent years, we decided to de-emphasize hardware sales in an increasingly competitive hardware sales market. The margins that we are able to achieve from hardware sales have diminished significantly. As a relatively young company, we don't believe that we are in a business position to leverage a low margin, high volume sales sector. Consequently, while we will continue to sell computer hardware in connection with our software sales, we have not and do not expect to emphasize hardware sales as part of our marketing and sales strategies. Nonetheless, there may be occasions where

---

**Table of Contents**

we may profitably include hardware in projects that we complete for clients that possess superior credit. This occurred in 2005. In 2005, several existing customers required the purchase of new hardware for integration into their existing software products. As a result, we experienced a significant increase in hardware sales when compared to 2004. Over time, however, we expect to experience reduced hardware sales as we focus our efforts on higher margin areas of our business. We expect that, in the short-term, we may fail to capture additional revenues for hardware sales, but our management believes that the long-term health of our company is substantially dependent upon the licensing of our software products. As a result of our decision to de-emphasize hardware sales, we have altered our revenue structure in an effort to enhance our software sales and service fees. In the near term, we expect that this decision may decrease our revenue growth by 5-10%. We do not expect our strategy to materially impact our staffing requirements, marketing efforts or relations with our suppliers.

**Service fee income.** Service fee income decreased 13.7% from RMB 4,432,167 in 2004 to RMB 3,824,442 in 2005. This decrease is attributable to the fact that, in 2005, we focused our sales efforts on small and medium-sized businesses. These businesses initially tend to implement our more basic software solutions, and these software solutions may not require our customers to utilize our services for implementation. As we continue to provide more complex software solutions to all of our customers and our small and medium-sized businesses continue to grow, we expect that many of our clients will opt to utilize our services to coordinate our software solutions with existing computer systems. We expect to see increased service fees as revenues for our more complex software solutions continue to develop.

*Cost of revenues*

**Cost of software.** Cost of software consists of wages, materials, handling charges and other expenses associated with the development of our software. Cost of software decreased by 22.6% from RMB 10,097,528 in 2004 to RMB 7,815,315 in 2005 during this time period. This decrease resulted directly from our decision in 2005 to focus upon small and medium-sized businesses. Initially, these customers tend to purchase our less sophisticated software products. As such, these projects require fewer integration services to reach completion. Over time, however, we believe that as our customer base grows, our cost of license and related maintenance revenue will increase as we hire personnel for our customer support organization. As a percentage of software sales, cost of software was 40.2% for 2004 and 31.0% for 2005. This decrease is primarily attributable to our decision to focus our marketing efforts on small to medium-sized businesses. As noted above, the software programs initially purchased by such customers do not typically require intensive integration services, thereby reducing our cost of software without a corresponding decrease in software sales. As we continue to market small in medium-sized businesses in the near future, we expect this trend to continue into future fiscal periods.

**Cost of hardware.** Cost of hardware consists primarily of fees for third party hardware products that are utilized in connection with our software products. Cost of hardware increased by 111.9% from RMB 4,097,518 in 2004 to RMB 8,681,619 in 2005. This increase is primarily attributable to the unexpected increase in our hardware sales during the period. As a percentage of hardware sales, cost of hardware was 79.7% in 2004 and 84.8% in 2005. This increase was primarily attributable to the fact that in 2005 we opted to emphasize sales to small and medium-sized businesses in 2005, and many of these businesses were existing customers. As these smaller customers initially license our less sophisticated software, we were unable to add additional hardware mark-ups related the license of our more complex and expensive software programs. In addition, as many of these customers were existing clients, we were less likely to negotiate additional hardware mark-ups. As noted above, however, the cost of hardware provides us with a relatively small profit margin. In order to emphasize our profitability, we have decided to de-emphasize hardware sales as an element of our business operations in the future.

## **Table of Contents**

**Cost of service fee income.** Cost of service fee income includes salaries and related expenses of our consulting organization and an allocation of our facilities and depreciation expenses. Cost of services decreased 12.7% from RMB 1,033,167 for 2004 to RMB 901,973 for 2005. The decrease resulted directly from our decision to market to small and medium-sized businesses. As these customers initially purchase less sophisticated software programs, the consulting services required to maintain these products require less labor. As such, our cost to provide such services was less in 2005. As a percentage of service fee income, cost of service fee income remained consistent from 23.3% for 2004 and 23.6% for 2005.

**Amortization of Software Costs.** Intangible assets represent the cost of computer software we acquired and developed. These costs are amortized over the useful life of the software. Costs included are mostly salary and employee benefits for those involved in the development of the software. Amortization expense increased 17.3% from RMB 1,966,420 in 2004 to RMB 2,305,835 in 2005. The increase is due to the increase of software products being amortized at December 31, 2005. Because we are continually developing our products, we expect amortization to continue increasing in future years based upon our success in developing new products for our customers.

### *Operating expenses*

**Research and development.** Research and development expenses, which are expensed as incurred, consist primarily of salaries and related costs of our engineering organization; consultants; and an allocation of our facilities and depreciation expenses. We believe that our success depends on continued enhancement of our current products and our ability to develop new technologically advanced products that meet the increasingly sophisticated requirements of our customers. Research and development expenses decreased 93.4% from RMB 1,419,937 in 2004 to RMB 93,814 in 2005. The decrease in these expenses was primarily attributable to the fact that in 2005 we focused our attention on the marketing of existing products rather than upon the development of new software products. In future periods, however, we must continually develop our software products. As such, we expect research and development expenses to continue to increase in absolute dollars in future periods as we continue to improve our software products to meet the evolving complexities of our customers' businesses. Research and development represented 4.1% of total revenue for 2004 and 0.2% of total revenue for 2005. This decrease in research and development expenses as a percentage of revenue was attributable to our decision to emphasize the marketing of existing products in 2005 with the long-term goal of developing new software products in future periods.

**General and administrative.** General and administrative expenses consist primarily of costs from our finance and human resources organizations; third party legal and other professional services fees; and an allocation of our facilities costs and depreciation expenses. General and administrative expenses increased 28.0% from RMB 6,104,657 in 2004 to RMB 7,811,742 in 2005. The increase in absolute general and administrative expenses is attributable to the growth of our administrative organizations in support of our overall growth. Specifically, we:

made several improvements to our headquarters facility in Beijing;

increased the size of our facility in Wuhan; and

incurred additional legal and other professional service fees associated with our contemplated public offering.



## **Table of Contents**

General and administrative expenses were 17.6% of total revenue for 2004 and 19.9% of total revenue for 2005. This increase in general and administrative expenses as a percentage of revenue was attributable to the flatness of overall revenues being offset by the increase in general and administrative expenses noted above. We expect that becoming an independent public company may create a short-term increase in general and administrative expenses as a percentage of total revenues. These expenses include additional legal and accounting fees and public relations costs. Many of these costs are expected to be non-recurring as they relate primarily to the establishment of additional functions in connection with becoming a publicly-traded company.

**Selling and distribution expenses.** Selling and distribution expenses consist primarily of salaries and related costs of our sales and marketing organization; sales commissions; costs of our marketing programs, including public relations, advertising, trade shows, and collateral sales materials; and an allocation of our facilities and depreciation expenses. Selling and distribution expenses increased 21.0% from RMB 4,786,308 in 2004 to RMB 5,790,675 in 2005. The increase in selling and distribution expenses was due to additional labor costs associated with the expansion of our sales force. During this time period we added 17 employees to our sales department. We anticipate that sales and marketing expenses will increase in absolute dollars to support our intended expansion of our sales and marketing organization. Selling and distribution expenses were 13.8% of total revenue for 2004 and 14.8% of total revenue for 2005. This slight increase in selling and distribution expenses as a percentage of revenue was attributable to the fact that the costs associated with our larger sales department were not immediately offset by increased sales that we could recognize in 2005.

### *Other*

**Interest Income.** Our interest income represents the interest accrued as a result of bank deposits. Our interest income increased 584.6% from RMB 16,108 in 2004 to 110,268 in 2005. The increase is primarily due to the fact that our cash balances in 2005 were greater than 2004. We expect that our interest income will dramatically increase in the near future as we will earn interest in the proceeds of the initial public offering pending application thereof.

**Interest Expense.** Our interest expense represents the interest incurred as a result of short-term loans taken during the course of our operations. Our interest expense decreased 29.9% from RMB 688,680 in 2004 to RMB 483,033 in 2005. This decrease generally resulted from a reduction in outstanding short-term loans.

### *Liquidity and Capital Resources*

#### *Cash Flows and Working Capital*

To date, we have primarily financed our operations through funds raised in our initial public offering, debt financings, a private placement of Series A convertible preferred shares and cash flow from operations. Working capital needs are expected to continue to increase as we continue to develop and market our software products and implement mergers and acquisitions. Anticipated increases in net working capital are expected to be met from our cash flow from operations and the net proceeds of our public offering.

Our operations provided cash of RMB 12,648,838 for the year ended December 31, 2006 and RMB 7,826,015 for the year ended December 31, 2005. This increase was primarily the result of an increase in net income and an increase in the balance of advances from customers. We used cash in investing activity of RMB 545,001 in 2004, RMB 4,855,435 in 2005 and RMB 3,555,937 in 2006. Our net cash used in investing activity has primarily been used to develop our software suite.

## **Table of Contents**

During 2006, we received cash in financing activities of RMB 47,128,495. This amount was the result of the receipt of proceeds from our initial public offering. During 2005, the Company provided cash in financing activities of RMB 1,420,335. This amount was related to proceeds that we received from a short term loan. During 2004, the Company used cash in financing activities of RMB 4,758,817. This amount was generally related to the repayment of an outstanding debt of RMB 4,800,000 that we incurred in 2003.

We believe that our current cash and cash equivalents, cash flow from operations and the net cash proceeds from our public offering of \$6,800,000 will be sufficient to meet our anticipated cash needs, including working capital, capital expenditures and various contractual obligations, for at least the next 30 months. 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 our cash requirements, we may seek to sell debt securities or additional equity or to obtain a credit facility. The sale of convertible debt securities or additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financial covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

### *Indebtedness*

On February 6, 2005, we entered into a loan agreement with Beijing Haidan District Yuyuantan Rural Credit Cooperative (the Lender). Pursuant to this agreement, the Lender has agreed to lend up to RMB 2,800,000 at an interest rate of 5.58% per annum. In 2005, we borrowed the full loan amount of RMB 2,800,000. We were obligated to repay interest on this loan on a quarterly basis, and we repaid all outstanding principal on January 18, 2006. As we are not a government-owned business, our lender required us to obtain a guaranty of our indebtedness from a third-party. As the Chinese banking industry is relatively new and has not traditionally loaned funds to private businesses, banks have developed a system whereby private loans require third-party guarantors. We believe this requirement to be common among Chinese banks. On February 6, 2005, we entered into a guaranty agreement with Beijing Hejia Software Technology Co., Ltd., an unrelated third party (the Guarantor), and the Lender. Prior to the execution of the guaranty, we had no prior business interactions with the Guarantor. Pursuant to this agreement, the Guarantor agreed to accept joint and several liability for our obligations under the Loan Agreement. In addition, the guaranty covered interest and the cost of collection. The guaranty shall terminate on the date that is two years following the expiration of the Loan Agreement. To the extent we reach an agreement with the Lender to extend the term of the Loan Agreement, the Guarantor has agreed to extend the guaranty until a date that is two years following the expiration of the extended loan arrangement. In consideration of the Guarantor's willingness to serve as our guarantor, we loaned the Guarantor an aggregate of RMB 800,000. Such loan shall be repaid no later than the expiration of the guaranty and accrues interest at the rate of 5.58% per annum. We believe that the Guarantor was willing to accept a fee in the form of borrowed funds because the Guarantor is not government-owned. As such, in order to directly obtain a bank loan, the Guarantor would be required to obtain a third-party guarantor. The process of obtaining such a guarantor requires the Guarantor to pay a fee to its own third-party guarantor. With the exception of this loan arrangement, we will not pay the Guarantor, directly or indirectly, any additional fee. Our note receivable from the Guarantor was collected during January 2006.

## **Table of Contents**

To the extent that guarantors are unavailable or unwilling to guaranty our future obligations, it is unlikely that a bank will be willing to enter into a debt financing arrangement with our company. As noted herein, we tend to recognize revenue in the latter half of a fiscal year, and we have traditionally utilized debt financing to provide funds necessary for operation in the first half of a given year. Although we have not experienced difficulty obtaining third-party guaranty arrangements in the past and we do not expect to experience any such difficulty in the future, to the extent that we are unable to obtain and utilize third-party guarantees and bank debt financing arrangements, our business, operations and prospects may suffer.

In addition, on March 3, 2005, we borrowed an additional RMB 350,000 from the Lender. We repaid this amount on May 3, 2005.

As of December 31, 2005, we did not have any outstanding loan capital issued or agreed to be issued, bank overdrafts, loans, debt securities or similar indebtedness, liens, liabilities under acceptance (other than normal trade bills) or acceptance credits, debentures, mortgages, charges, finance leases or hire purchase commitments, guarantees or other material contingent liabilities. In addition, there has not been any material change in our indebtedness, commitments and contingent liabilities since December 31, 2005.

### *Holding Company Structure*

We are a holding company with no operations of our own. All of our operations are conducted through e-Future Beijing, our Chinese subsidiary. As a result, our ability to pay dividends and to finance any debt that we may incur is dependent upon dividends and other distributions paid by e-Future Beijing. If e-Future Beijing incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends to us. In addition, Chinese legal restrictions permit payment of dividends to us by e-Future Beijing only out of its net income, if any, determined in accordance with Chinese accounting standards and regulations. Under Chinese law, e-Future Beijing may also be required to set aside a portion (at least 10%) of its after tax net income, if any, each year for certain reserve funds until the amount of the reserve reaches 50% of e-Future Beijing registered capital. According to Chinese law, however, e-Future Beijing is required to withdraw reserve funds only in fiscal years following the elimination of its accumulated deficit in which it paid income tax. Noting our accumulated deficit and the tax deferrals associated with our business, we have not funded these reserves in the past and do not expect to do so in the near future. Consequently, we do not believe that these fund reserves had or will have a material impact upon our liquidity. Although these statutory reserves can be used, among other ways, to increase the registered capital and eliminate future losses in excess of retained earnings, the reserve funds are not distributable as cash dividends except in the event of a solvent liquidation of e-Future Beijing. This reserve fund is not distributable as a cash dividend.

### *Off-Balance Sheet Arrangements*

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, we have not entered into any derivative contracts that are indexed to our own shares and classified as shareholders' equity, or that are not reflected in our financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. Moreover, we do not have any variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

## **Table of Contents**

### *Quantitative and Qualitative Disclosures About Market Risk*

#### *Interest Rate Risk*

Our exposure to market risk for changes in interest rates relates primarily to the interest income generated by our cash deposits in banks. We have not used derivative financial instruments in our investment portfolio. Interest-earning instruments and floating rate debt carry a degree of interest rate risk. We have not been exposed, nor do we anticipate being exposed, to material risks due to changes in interest rates. Our future interest income may fluctuate in line with changes in interest rates. However, the risk associated with fluctuating interest rates is principally confined to our cash deposits in banks, and, therefore, our exposure to interest rate risk is minimal and immaterial.

#### *Foreign Exchange Risk*

Virtually all of our revenues and costs are denominated in Renminbi and substantially all of our assets and liabilities are denominated in Renminbi. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be impacted by fluctuations in the exchange rate between U.S. dollars and Renminbi. If the Renminbi depreciates against the U.S. dollar, the value of our Renminbi revenues and assets as expressed in U.S. dollars in our financial statements will decline. See Risk Factors Fluctuation of the Renminbi could materially affect our financial condition and results of operations.

#### *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 0.46%, (0.77)%, and 1.16% in 2001, 2002 and 2003, respectively. However, in connection with a 3.9% increase in 2004, the Chinese government announced measures to restrict lending and investment in China in order to reduce inflationary pressures in China's economy. In the first eight months of 2005, the change in the Consumer Price Index in China was 6.18%. The Chinese government may introduce further measures intended to reduce the inflation rate in China. We cannot assure you that these measures will not have a significant impact on our business. Any such measures may not be successful or immediately effective in reducing or slowing the increase in China's inflation rate. Sustained or increased inflation in China may have an impact on China's economy and our customers, which may adversely affect our business and financial results.

#### *Taxation*

Under the current law of the Cayman Islands, we are not subject to tax on income or capital gain. However, our revenues are primarily derived from our Chinese subsidiary, e-Future Beijing. Chinese foreign invested enterprises are generally subject to a 30.0% federal (state) enterprise income tax, and a 3.0% local enterprise income tax. However, e-Future Beijing has been certified by the Chinese government as a High Technology Enterprise. This certification entitled e-Future Beijing to be exempt from federal enterprise tax from 2000 through 2002, to pay a federal enterprise tax of 7.5% from 2003 through 2005, to pay a federal enterprise tax thereafter of 15% and to be exempt from local income taxes, all for so long as e-Future Beijing maintains its High Technology Enterprise certification and for so long as it remains located in a State Standard High Enterprise Zone. In addition, e-Future Beijing is allowed a deduction for operating loss carry forwards for up to five years because it has foreign invested capital.

**Table of Contents**

If our activities constitute a permanent establishment in China, the income we earn in China would also be subject to a 30.0% state enterprise income tax and 3.0% local enterprise 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 receipt from profit, interest, rentals, royalties and other income earned in China. Dividends from our wholly owned subsidiary, e-Future Beijing, to our company are exempt from Chinese withholding tax.

Our software and system integration services revenues are also subject to a value-added tax at the rate of 17.0%.

*Contractual Obligations and Commercial Commitments*

The following table sets forth our contractual obligations as of December 31, 2006:

	Total	Payments Due By Period			More than 5 Years
		Less than 1 Year	1-3 Years	3-5 Years	
Facility lease commitments	\$ 128,336	\$ 108,758	\$ 19,578		
Other contractual commitments	\$	\$			
Total contractual obligations	\$ 128,336	\$ 108,758	\$ 19,578		

*Recently Issued Accounting Standards*

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* (SFAS 155). SFAS 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and related interpretations. SFAS 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies which interest-only strips and principal-only strips are not subject to recognition as liabilities. SFAS 155 eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for the Company for all financial instruments acquired or issued beginning January 1, 2007. The impact of adoption of this statement on the Company's consolidated financial statements, if any, has not yet been determined.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140* (SFAS 156). SFAS 156 amends SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and related interpretations. SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to use either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for the Company as of January 1, 2007. The impact of adoption of this statement on the Company's consolidated financial statements, if any, has not yet been determined.

**Table of Contents**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS 157 is not expected to have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) ( SFAS 158 ). Under SFAS 158, companies must recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. The effective date of the recognition and disclosure provisions for calendar-year public companies is for calendar years ending after December 15, 2006. The Company is currently evaluating the impact of this new standard but it is not expected to have a significant effect on the consolidated financial statements for the year ending December 31, 2006.

**Item 6. Directors, Senior Management and Employees****A. Directors and senior management**

The following table sets forth our executive officers and directors, their ages and the positions held by them as of June 27, 2007:

Name	Age	Position
Adam Yan (1)(8)	38	Chairman, Chief Executive Officer, Director and Founder
Qicheng Yang (1)	41	Chief Technology Officer and Founder
Hongjun Zou (1)	39	Chief Operating Officer and Founder
Johnson Li (1)	40	Vice President and Founder
Zhou Kefu (1)	52	Chief Architecture Officer
Ping Yu (1)(7)	37	Chief Financial Officer and Director
Ming Zhu (2)(9)	48	Director
Dong Cheng, Ph.D. (1)(3)(4)(5)(9)	39	Director
Wenhua Tong (1)(3)(4)(5)(7)	36	Director
Dennis O. Laing (6)(8)	61	Director
Chaoyong Wang (1)(3)(4)(5)(8)	42	Director

(1) The individual's business address is c/o e-Future Information Technology Inc., No. 10 Building, BUT Software Park, No. 1 Disheng North Street, BDA, Yizhuang District, Beijing, People's Republic of China 100176.

(2) Mr. Zhu's business address is c/o RMCC International, Inc. 6724 Patterson Avenue, Richmond, Virginia 23226.

(3) Member of audit committee.

(4) Member of compensation committee.

(5) Member of corporate governance committee.

(6) Mr. Laing's business address is 4860 Cox Road, Suite 200, Glen Allen, Virginia 23060.

(7) Class II director whose term expires in 2007.

(8) Class III director whose term expires in 2008.

(9) Class I director whose term expires in 2009.

---

**Table of Contents**

*Adam Yan.* Mr. Yan is our Chairman, Chief Executive Officer and our principal accounting officer. He founded e-Future in 1997. From 1997 to 1999 and 2002 to 2004, Mr. Yan also served as our Chief Accounting Officer. From 1991 to 1997, Mr. Yan served as the general manager of the Bangda Information Industry Center of the Haikou Financial Bureau in the Hainan province of China. Mr. Yan received a bachelor's degree in computer science and a master's degree in machine vision engineering from Chongqing University in China. From 1991 to 1994, Mr. Yan also served as the chief accounting software designer for Haikou Accounting Firm in the Hainan province of China. In his role as chief accounting software designer, Mr. Yan served as the development team leader responsible for writing the software in accordance with the accounting policies of the Chinese government, developing system architecture, and developing team organization. He has also studied accounting and finance at the Central University of Finance and Economics. While Mr. Yan has experience in developing accounting software and he has served as our principal accounting officer since our formation, he has not been responsible for preparing or supervising financial reporting and has no experience in preparing reports required by the SEC for foreign private issuers. While we believe that Mr. Yan possesses the skills necessary to prepare and/or supervise the preparation of our financial reporting and required SEC reporting, we expected to hire an experienced chief financial officer following the completion of our contemplated public offering. At the end of 2006, Ms. Yu Ping has been nominated as our CFO.

*Qicheng Yang.* Mr. Yang has served as our Chief Technology Officer since 1997. From 1995 to 1997, Mr. Yang served as the Chief Technology Officer of Hainan Fujie Industrial Inc., an information technology company delivering software and system integration services in the Hainan province of China. From 1993 to 1995, he served as a manager in the system network department of Hainan Zhouli Sci-Tech Industrial Inc., an information technology company delivering software and system integration services in the Hainan province of China. From 1990 to 1993, Mr. Yang taught computer courses at Huazhong University of Science and Technology. He received a bachelor's degree in automatic control and a master's degree in automatic control from Huazhong University of Science and Technology in China.

*Hongjun Zou.* Mr. Zou has served as our Chief Operating Officer since 1997. From 1993 to 1997, Mr. Zou served as Chief Technology Officer of Hainan Fujie Industrial Company, an information technology company providing multi-media development platform software to various industries in China. Mr. Zou received a bachelor's degree in computer science from Chongqing University in China.

*Johnson Li.* Mr. Li has served as our Vice President since 1997. From 1994 to 1997, Mr. Li served as a manager of the project implementation department of Hainan Fujie Industrial Inc., an information technology company delivering software and system integration services in the Hainan province of China. Mr. Li received a bachelor's degree in computer science from China People's Police Officer University in China.

*Zhou Kefu.* Mr. Kefu has served as our Chief Architecture Officer since 2002. From 1995 to 2002, Mr. Kefu served as Senior Programmer and Analyst at the information System division of Wal-Mart Stores, Inc. in Bentonville, Arkansas. From 1992 to 1994, he served as a programmer for International Business Machines in Charlotte, North Carolina. Mr. Kefu received a bachelor's degree in electronics from Xi'an JiaoTong University and a master's degree in computer science from The University of North Carolina, Charlotte.

*Ping Yu.* Ms. Ping Yu is our Company's Chief Financial Officer and is a United States-educated Certified Public Accountant. She received a bachelor's degree from Hubei University and a master's degree in Business Administration from Rutgers University. From 1993 to 2001, Ms. Yu served various positions in different corporations, including service as a Senior Accountant of Longchamp Sales Corp.

## **Table of Contents**

(August 1993 - June 1996), a Senior Analyst of Citic Industrial Bank (July 1996 - September 1999), and Chief Officer of the Accounting Department of Walkalone Real Estate Co. (October 1999 - April 2001). In 2001, Ms. Yu she received her master's degree and began work as an auditor for Golf & Wroblewski in New York (September 2002 - February 2004). In 2004, on returning to China, Ms. Yu served as manager of the internal auditing section of Dongfeng Nissan (February 2004 - June 2005), where she was responsible for internal control and risk management tasks. Before being employed by e-Future, Ms. Yu served as a specialist in Beijing Smartdot Technologies, Inc. (July 2005 - December 2006), providing consultation to companies listed in the United States on meeting the requirements of the Sarbanes-Oxley Act as well as helping companies implement the COSO-Enterprise Risk Management-Integrated framework.

*Ming Zhu.* Mr. Zhu has served as a director since 2005. Since 1994, Mr. Zhu has been an international business consultant with RMCC International, Inc., a Richmond, Virginia based import/export consulting firm. Mr. Zhu received a bachelor's degree in English from Beijing Second Foreign Language Institute and a master's degree in tourism and business from Virginia Commonwealth University.

*Dong Cheng, Ph.D.* Dr. Cheng has served as a director since 2005. Since 2002, Dr. Cheng has served as a Full Professor at the Business School at Renmin University of China (Renmin University). From 1995 to 2002, Dr. Cheng served as an Associate Professor at Renmin University, and from 1993 to 1995, Dr. Cheng served as an Assistant Professor at Renmin University. Dr. Cheng has written numerous articles on the development of Chinese business practices. Dr. Cheng received a bachelor's degree and a master's degree in computer software from Xi'an Jiao Tong University in China. He also received a doctorate degree in Business Administration from Renmin University and was a doctorate candidate in Computer Science from Peking University in Beijing, China.

*Wenhua Tong.* Mr. Tong has served as a director since 2005. Since April 2005, Mr. Tong has been employed as the Manager of Channel and Alliance for the Asia Pacific Retail Store Solutions Division of IBM China Company Ltd. From 2003 to 2005, he served as the General Manager for the Greater China Group Retail Store Solutions Division of IBM China Company Ltd. (the Solutions Division). From 2002 until 2003, Mr. Tong served as the manager of the Solutions Division. During 2001, Mr. Tong served as the Solution Manager for the Distribution Industry Solution Unit of IBM China Company Ltd. (DISU) and completed an assignment as an e-business solution specialist in Vancouver, Canada for IBM Canada. From 2000 to 2001, Mr. Tong served as a Client Manager of DISU. During 1999, Mr. Tong served as a Client Team Leader for North China for DISU. Mr. Tong has received numerous awards from IBM throughout his career. Mr. Tong received a bachelor's degree in engineering (automatic control) and a bachelor's degree in economics (industrial foreign trade) from Beijing Polytechnic University.

*Dennis O. Laing.* Mr. Dennis O. Laing has practiced law in Richmond, Virginia for over 30 years. Mr. Laing's law practice centers upon business and corporate law with special interest in energy, healthcare and technology sectors. Mr. Laing received a bachelor's degree in government from the University of Virginia and a law degree from the University of Richmond. Mr. Laing was initially appointed to the Board of Directors to fill a vacancy left by the resignation of Mr. L. McCarthy Downs III upon the termination of appointment rights held by Anderson & Strudwick Incorporated received in connection with its service as underwriter in our initial public offering. Mr. Laing currently serves as a Class III director; however both he and the Board wish for Laing to be elected as a Class II director.



**Table of Contents**

*Chaoyong Wang.* Mr. Wang has been a director since 2005. In 1999, Mr. Wang founded ChinaEquity Investment Co., Ltd., a China-based independent venture capital firm which focuses on the technology, media and telecommunications sectors in China ( ChinaEquity ). Mr. Wang currently serves as the Chairman and Chief Executive Officer of ChinaEquity. Prior to founding ChinaEquity, Mr. Wang spent 12 years in the investment banking and financial services industry with Chase, Standard & Poors, Morgan Stanley and China Development Bank. Mr. Wang currently serves as a director of Rising Tech Corp. Ltd., Longshine Information Technology Co. Ltd., Futong Science & Tech Co. Ltd. and Infront Asia Limited, all of which are privately-held businesses. He also serves as an independent director of Beijing Beida Jade Bird Universal Sci-Tech Co. Ltd., a privately-held business. He also serves as an advisor to the Global Environment Funds, co-sponsored by the World Bank and the Chinese State Economic and Trading Commission and an advisor to the Economic Commission of the Beijing Municipal Government. Mr. Wang received a bachelor's degree from Huazhong University of Science and a master's degree in business administration from Rutgers University. Mr. Wang has also attended the Senior Executive Program of Harvard University and Tsinghua University.

**B. Compensation***Executive Compensation*

The following table shows, as of December 31, 2006, the estimated annual compensation paid by us to our executive officers for the years ended December 31, 2004, 2005, and 2006.

**Summary Compensation Table**

Name	Year	Salary	Bonus	Annual Compensation		
				Options	Other Annual Compensation	All Other Compensation
Adam Yan Chairman and Chief Executive Officer	2006	\$ 23,922				
	2005	\$ 23,922				
	2004	\$ 16,487				
Qicheng Yang Chief Technology Officer	2006	\$ 24,577				
	2005	\$ 24,577				
	2004	\$ 18,628				
Hongjun Zou Chief Operating Officer	2006	\$ 23,565				
	2005	\$ 23,565				
	2004	\$ 16,130				
Johnson Li Vice President	2006	\$ 21,008				
	2005	\$ 21,008				
	2004	\$ 15,059				
Kefu Zhou Chief Architecture Officer	2006	\$ 22,096				
	2005	\$ 22,096			\$ 2,974(1)	
	2004	\$ 18,379			\$ 2,974(1)	

(1) Represents a housing subsidy.

**C. Board practices**

See information provided in response to Item 6.A. above.

## **Table of Contents**

### *Board of Directors and Board Committees*

Our board of directors consists of seven members. We expect that all current directors will continue to serve after our contemplated public offering. There are no family relationships between any of our executive officers and directors.

The directors will be divided into three classes, as nearly equal in number as the then total number of directors permits. Class I directors shall face re-election at our annual general meeting of shareholders in 2009 and every three years thereafter. Class II directors shall face re-election at our annual general meeting of shareholders in 2007 and every three years thereafter. Class III directors shall face re-election at our annual general meeting of shareholders in 2008 and every three years thereafter.

If the number of directors changes, any increase or decrease will be apportioned among the classes so as to maintain the number of directors in each class as nearly as possible. Any additional directors of a class elected to fill a vacancy resulting from an increase in such class will hold office for a term that coincides with the remaining term of that class. Decreases in the number of directors will not shorten the term of any incumbent director. These board provisions could make it more difficult for third parties to gain control of our company by making it difficult to replace members of the Board of Directors.

A director may vote in respect of any contract or transaction in which he is interested, provided, however that the nature of the interest of any director in any such contract or transaction shall be disclosed by him at or prior to its consideration and any vote on that matter. A general notice or disclosure to the directors or otherwise contained in the minutes of a meeting or a written resolution of the directors or any committee thereof that a director is a shareholder of any specified firm or company and is to be regarded as interested in any transaction with such firm or company shall be sufficient disclosure and after such general notice it shall not be necessary to give special notice relating to any particular transaction.

There are no membership qualifications for directors. Further, there are no share ownership qualifications for directors unless so fixed by us in a general meeting.

Currently, three committees have been established under the board: the audit committee, the compensation committee and the nominating committee. The audit committee is responsible for overseeing the accounting and financial reporting processes of our company and audits of the financial statements of our company, including the appointment, compensation and oversight of the work of our independent auditors. The compensation committee of the board of directors reviews and makes recommendations to the board regarding our compensation policies for our officers and all forms of compensation, and also administers our incentive compensation plans and equity-based plans (but our board retains the authority to interpret those plans). The corporate governance committee of the board of directors is responsible for the assessment of the performance of the board, considering and making recommendations to the board with respect to the nominations or elections of directors and other governance issues.

There are no other arrangements or understandings pursuant to which our directors are selected or nominated.

**Table of Contents****D. Employees**

As of December 31, 2006, we had 331 employees, all of whom were based in China. Of the total, five were in management, 118 were in technical support, 110 were in research and development, 89 were engaged in sales and marketing, and 14 were in financial affairs and administration. We believe that our relations with our employees are good. We have never had a work stoppage, and our employees are not subject to a collective bargaining agreement.

**E. Share ownership**

The following table sets forth information with respect to beneficial ownership of our ordinary shares as of June 22, 2006, for each person known by us to beneficially own 5% or more of our ordinary shares, and all of our executive officers and directors individually and as a group. Beneficial ownership is determined in accordance with the rules of the SEC and includes voting or investment power with respect to the securities. Except as indicated below, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them. The number of our ordinary shares outstanding used in calculating the percentage for each listed person includes our ordinary shares underlying options held by such persons that are exercisable within 60 days of June 22, 2006, but excludes ordinary shares underlying options held by any other person. Percentage of beneficial ownership is based on 2,633,500 shares outstanding as of June 22, 2006. Our major shareholders do not possess voting rights that differ from our other shareholders.

	<b>Amount of Beneficial Ownership (1)</b>	<b>Percentage Ownership (2)</b>
Adam Yan (3)	387,275	14.7%
Qicheng Yang (4)	115,709	4.4%
Hongjun Zou (5)	216,622	8.2%
Johnson Li (6)	188,455	7.1%
Zhou Kefu (7)	13,886	*
Yu Ping (6)	2,000	*
Dennis O. Laing		*
Ming Zhu		*
Dong Cheng, Ph.D. (8)	2,500	*
Wenhua Tong		*
Chaoyong Wang (8)	2,500	*
All directors and executive officers as a group (11 people) (9)	928,947	34.8%
C Tech Fund	306,028	11.6%

\* Less than 1%.

- (1) Beneficial ownership is determined in accordance with the rules of the SEC and includes voting or investment power with respect to the ordinary shares.
- (2) The number of our ordinary shares outstanding used in calculating the percentage for each listed person includes the ordinary shares underlying options held by such person.
- (3) Includes currently exercisable options to purchase 3,847 ordinary shares.
- (4) Includes currently exercisable options to purchase 3,577 ordinary shares.
- (5) Includes currently exercisable options to purchase 3,379 ordinary shares.
- (6) Includes currently exercisable options to purchase 13,180 ordinary shares.
- (7) Includes currently exercisable options to purchase 8,735 ordinary shares.
- (8) Represents currently exercisable options to purchase ordinary shares.
- (9) Includes currently exercisable options to purchase 39,718 ordinary shares.

## **Table of Contents**

### **Stock Option Plan and Grants**

We did not grant any stock options in 2006.

### **Item 7. Major Shareholder and Related Party Transactions**

#### **A. Major shareholders**

See information provided in response to item 6.E. above. All shareholders possess identical voting rights.

#### **B. Related party transactions**

##### *Finder's Fee*

Upon the closing of our initial public offering, our underwriter paid a 1% finder's fee to RMCC International, Inc., a company located in Richmond, Virginia (RMCC). Our underwriter compensated RMCC for introducing us to the underwriter. RMCC did not participate in the structure or pricing of our initial public offering. Mr. Zhu, one of our directors, serves as the Executive Vice President of RMCC. RMCC is not registered as a broker-dealer with the National Association of Securities Dealers, Inc. Upon the satisfying of the minimum offering size of our initial public offering, our underwriter paid RMCC \$60,000 for its services.

##### *Amounts Due from Shareholders*

In 2001, we loaned \$15,666 to Qicheng Yang, our Chief Technology Officer, and \$7,541 to Johnson Li, our Vice President, for the purchase of personal property. These debts were unsecured, interest-free and had no fixed terms of repayment. As of December 31, 2005, these loans have since been repaid.

In connection with the creation of our holding company structure in 2001, we issued ordinary shares to certain individuals and loaned \$69,500 to these individuals to satisfy required capital requirements. These debts were unsecured, interest-free and had no fixed terms of repayment. These loans have since been repaid in full.

##### *Amounts Due to and from Related Parties*

As noted herein, we created our holding company structure in 2001 when the two shareholders of e-Future Beijing, Hainan Future and Johnson Li, our Vice President, transferred all shares of e-Future Beijing to us for RMB 5,000,000. At the time, Hainan Future had two shareholders, Adam Yan, our Chief Executive Officer, and Qicheng Yang, our Chief Technology Officer. In May 2005, Mr. Yan and Mr. Yang transferred their shares in Hainan Future to Xuejun Zhang and Ling Zhang for ¥225,000 and ¥75,000, respectively. Xuejun Zhang currently serves as the director of our administration department. Ling Zhang serves as an employee in our accounting and finance department. Although they are not executive officers, these individuals are senior employees who actively participate in our day-to-day operations. Noting our limited number of employees, they may have the potential to influence our executive officers and, thereby, our business and its operations.

**Table of Contents**

As of December 31, 2001, we had advanced ¥3,195,956 to Hainan Future. The balance arose as the result of payments to suppliers on behalf of Hainan Future, cash advances to Hainan Future, Hainan Future's collection of cash receipts from our customers, and the sale of an investment in a company to Hainan Future, less the collection of cash receipts from Hainan Future's customers, less Hainan Future's payments to suppliers on our behalf, less the cost of software purchased from Hainan Future and less the purchase of two real estate parcels from Hainan Future. Hainan Future had no operations or employees from December 31, 2001. As a result, we made payments to, provided services to and collected cash receipts from Hainan Future's customers during the years ended December 31, 2003, 2004 and 2005. Those transactions along with the resulting balances receivable from Hainan Future were as follows:

	For the Years Ended December 31,			U.S. Dollars For the Year
	2003	2004	2005	Ended December 31, 2005 (Unaudited)
Payments of (refunds from) Hainan suppliers	¥ 23,500	¥ 155,307	¥ (146,699)	\$ (18,178)
Services provided to Hainan	1,000,000			
Offset receivable from Hainan against payable to Hainan			(2,526,595)	(313,077)
Collection of cash receipts from Hainan's customers	(744,800)	(1,500,700)		
<b>Balance at End of Period</b>	<b>¥ 4,018,687</b>	<b>¥ 2,673,294</b>	<b>¥</b>	<b>\$</b>

We owed Mr. Li and Hainan Future ¥1,000,000 and ¥4,000,000, respectively, for the acquisition of the Company's equity interest in e-Future Beijing. The balances due were unsecured, had no fixed terms of repayment and were considered due on demand. On August 12, 2005, we paid Hainan Future ¥575,722 towards the amount due to Hainan Future. On September 25, 2005, Hainan Future acquired Mr. Li's receivable from our company. On November 18, 2005, we entered into an agreement with Hainan Future whereby ¥1,897,683 of the payable to Hainan Future was forgiven by Hainan Future and the remaining balance payable to Hainan Future of ¥2,526,595 was offset against the receivable from Hainan Future of the same amount. This transaction was approved by our Board of Directors and the Board of Directors of Hainan Future. We recognized this forgiveness of debt as a contribution to capital.

*Future Related Party Transactions*

In the future, the Corporate Governance Committee of our Board of Directors must approve all related party transactions. All material related party transactions will be made or entered into on terms that are no less favorable to use than can be obtained from unaffiliated third parties. Related party transactions that we have previously entered into were not approved by independent directors, as we had no independent directors at that time.

**Table of Contents****C. Interests of experts and counsel**

Not applicable.

**Item 8. Financial Information**

See information provided in response to Item 18 below.

**Item 9. The Offer and Listing****A. Offer and listing details**

The following chart shows the price history of our ordinary shares following the completion of our initial public offering in 2006.

	<b>High</b>	<b>Low</b>
2006 (November 9 <sup>th</sup> – December 31)	\$ 48.64	\$ 10.52
November 2006	\$ 48.64	\$ 10.52
December 2006	\$ 43.24	\$ 30.16
2007 (through June 27 <sup>th</sup> )	\$ 37.26	\$ 14.70
January 2007	\$ 37.26	\$ 31.21
February 2007	\$ 36.09	\$ 26.27
March 2007	\$ 27.95	\$ 18.68
April 2007	\$ 22.90	\$ 17.37
May 2007	\$ 19.71	\$ 15.60
June 2007 (through June 27 <sup>th</sup> )	\$ 24.25	\$ 14.70

**B. Plan of distribution**

Not applicable.

**C. Markets**

Our ordinary shares are listed on the Nasdaq Capital Market under the symbol EFUT.

**D. Selling shareholders**

Not applicable.

**E. Dilution**

Not applicable.





**Table of Contents**

**F. Expenses of the issue**

Not applicable.

**Item 10. Additional Information**

**A. Share capital**

Not applicable.

**B. Memorandum and articles of association**

The information required by this item is incorporated by reference to the material headed "Description of Share Capital" in our Registration Statement on Form F-1, File No. 333-126007, as filed with the SEC.

**C. Material contracts**

Not Applicable.

**D. Exchange controls**

*Foreign Currency Exchange.*

Pursuant to the Foreign Currency Administration Rules promulgated in 1996 and amended in 1997 and various regulations issued by State Administration of Foreign Exchange, or the SAFE, and other relevant PRC government authorities, RMB is freely convertible only to the extent of current account items, such as trade related receipts and payments, interests and dividends. Capital account items, such as direct equity investments, loans and repatriation of investment, require prior approval from the SAFE or its provincial branch for conversion of RMB into a foreign currency, such as U.S. dollars, and remittance of the foreign currency outside the PRC. Payments for transactions that take place within the PRC must be made in RMB. Unless otherwise approved, PRC companies must repatriate foreign currency payments received from abroad. Foreign-invested enterprises may retain foreign exchange in accounts with designated foreign exchange banks subject to a cap set by SAFE or its local counterpart. Unless otherwise approved, domestic enterprises must convert all of their foreign currency receipts into RMB.

*Dividend Distribution.*

The principal regulations governing dividend distributions by wholly foreign-owned enterprises and Sino-foreign equity joint ventures include:

Wholly Foreign-Owned Enterprise Law (1986), as amended;

Wholly Foreign-Owned Enterprise Law Implementing Rules (1990), as amended;

Sino-foreign Equity Joint Venture Enterprise Law (1979), as amended; and

Sino-foreign Equity Joint Venture Enterprise Law Implementing Rules (1983), as amended.



## **Table of Contents**

Under these regulations, wholly foreign-owned enterprises and Sino-foreign equity joint ventures in the PRC may pay dividends only out of their accumulated profits, if any, as determined in accordance with PRC accounting standards and regulations. Additionally, these foreign-invested enterprises are required to set aside certain amounts of their accumulated profits each year, if any, to fund certain reserve funds. These reserves are not distributable as cash dividends.

### *Regulation of foreign exchange in certain onshore and offshore transactions.*

Under recent notices issued by SAFE, PRC residents are required to register with and receive approvals from SAFE in connection with offshore investment activities. SAFE has stated that the purpose of these notices is to ensure the proper balance of foreign exchange and the standardization of cross-border flow of funds.

In January 2005, SAFE issued a notice stating that SAFE approval is required for any sale or transfer by PRC residents of a PRC company's assets or equity interests to foreign entities in exchange for the equity interests or assets of the foreign entities. The notice also states that, when registering with the foreign exchange authorities, a PRC company acquired by an offshore company must clarify whether the offshore company is controlled or owned by PRC residents and whether there is any share or asset link between or among the parties to the acquisition transaction.

In April 2005, SAFE issued another notice further explaining and expanding upon the January notice. The April notice clarified that, where a PRC company is acquired by an offshore company in which PRC residents directly or indirectly hold shares, such PRC residents must (i) register with the local SAFE branch regarding their respective ownership interests in the offshore company, even if the transaction occurred prior to the January notice, and (ii) file amendments to such registration concerning any material events of the offshore company, such as changes in share capital and share transfers. The April notice also expanded the statutory definition of the term "foreign acquisition," making the notices applicable to any transaction that results in PRC residents directly or indirectly holding shares in the offshore company that has an ownership interest in a PRC company. The April notice also provided that failure to comply with the registration procedures set forth therein may result in the imposition of restrictions on the PRC company's foreign exchange activities and its ability to distribute profits to its offshore parent company.

On October 21, 2005, SAFE issued a new public notice concerning PRC residents' investments through offshore investment vehicles. This notice took effect on November 1, 2005 and replaces prior SAFE notices on this topic. According to the November 2005 notice:

any PRC resident that created an off-shore holding company structure prior to the effective date of the November notice must submit a registration form to a local SAFE branch to register his or her ownership interest in the offshore company on or before May 31, 2006;

any PRC resident that purchases shares in a public offering of a foreign company would also be required to register such shares and notify SAFE of any change of their ownership interest; and

following the completion of an off-shore financing, any PRC shareholder may transfer proceeds from the financing into China for use within China.

In accordance with the April 2005 notice, on September 25, 2005, our PRC shareholders previously filed appropriate registration materials with their local SAFE offices. We have received verbal

## **Table of Contents**

confirmation from our local SAFE office that our September 25, 2005 filings meet the requirements of the October 21, 2005 notice. We are unaware of SAFE's written approval of any PRC resident's registration materials, including those of our shareholders. The failure or inability of our PRC resident shareholders to obtain registration that is recognized by the Chinese government may subject us to fines and legal sanctions, restrict our cross-border investment activities, or limit our PRC subsidiary's ability to distribute dividends to our company.

As a Cayman Islands company and, therefore, a foreign entity, if we purchase the assets or equity interest of a PRC company owned by PRC residents, such PRC residents will be subject to the registration procedures described in the notices. Moreover, PRC residents who are beneficial holders of our shares are required to register with SAFE in connection with their investment in us.

As a result of the lack of implementing rules and other uncertainties concerning how the SAFE notices will be interpreted or implemented, we cannot predict how they will affect our business operations or future strategy. For example, our present or prospective PRC subsidiaries' ability to conduct foreign exchange activities, such as remittance of dividends and foreign currency denominated borrowings, may be subject to compliance with SAFE registration requirements by such PRC residents, over whom we have no control. Although each of our shareholders has made the requisite filings, we have no control over the outcome of such registration procedures. Such uncertainties may adversely affect our business and prospects.

### **B. Taxation**

#### *Cayman Islands Taxation*

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes likely to be material to our company levied by the Government of the Cayman Islands except for stamp duties which may be applicable on instruments executed in, or after execution brought within the jurisdiction of the Cayman Islands. The Cayman Islands are not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

Pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, we have obtained an undertaking from the Governor-in-Council:

that no law which is enacted in the Cayman Islands imposing any tax to be levied on profits or income or gains or appreciation shall apply to us or our operations; and

that the aforesaid tax or any tax in the nature of estate duty or inheritance tax shall not be payable on the shares, debentures or other of our obligations.

The undertaking for us is for a period of twenty years from December 19, 2000.

#### *United States Federal Income Taxation*

The following is a summary of material United States federal income tax consequences under present law relating to the purchase, ownership, and disposition of the ordinary shares. This description does not provide a complete analysis of all potential tax consequences. The information provided below is based on the Internal Revenue Code of 1986, as amended, or the Code, Treasury Regulations, proposed Treasury Regulations, Internal Revenue Service, or the IRS, published rulings and court decisions, all as

**Table of Contents**

of the date hereof. These authorities may change, possibly on a retroactive basis, or the IRS might interpret the existing authorities differently. In either case, the tax consequences of purchasing, owning or disposing of ordinary shares could differ from those described below. We do not intend to obtain a ruling from the IRS with respect to the tax consequences of acquiring or holding the ordinary shares.

This description is general in nature and does not discuss all aspects of U.S. federal income taxation that may be relevant to a particular investor in light of the investor's particular circumstances, or to certain types of investors subject to special treatment under U.S. federal income tax laws, such as:

banks or financial institutions,

life insurance companies,

tax-exempt organizations,

dealers in securities or foreign currencies,

traders in securities that elect to apply a mark-to-market method of accounting,

persons holding ordinary shares as part of a position in a straddle or as part of a hedging, conversion or integrated transaction for U.S. federal income tax purposes,

persons subject to the alternative minimum tax provisions of the Code, and

persons that have a functional currency other than the U.S. dollar.

This description generally applies to purchasers of the ordinary shares as capital assets. This description does not consider the effect of any foreign, state, local or other tax laws that may be applicable to particular investors.

Investors considering the purchase of ordinary shares should consult their own tax advisors regarding the application of the U.S. federal income tax laws to their particular situations and the consequences of U.S. federal estate or gift tax laws, foreign, state, or local laws, and tax treaties.

*U.S. Holders*

As used herein, the term "U.S. Holder" means a beneficial owner of ordinary shares that is:

a citizen or resident of the U.S. or someone treated as a U.S. citizen or resident for U.S. federal income tax purposes;

a corporation or other entity taxable as a corporation for U.S. federal income tax purposes organized in or under the laws of the U.S. or any political subdivision thereof;

## Edgar Filing: eFuture Information Technology Inc. - Form 20-F

an estate the income of which is subject to U.S. federal income taxation regardless of its source; or

a trust, if such trust validly elects to be treated as a U.S. person for U.S. federal income tax purposes, or if (a) a court within the U.S. can exercise primary supervision over its administration and (b) one or more U.S. persons have the authority to control all of the substantial decisions of such trust.

---

**Table of Contents**

If a partnership (including for this purpose any entity treated as a partnership for U.S. tax purposes) is a beneficial owner of the ordinary shares, the U.S. tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. A holder of the ordinary shares that is a partnership and partners in such partnership should consult their individual tax advisors about the U.S. federal income tax consequences of holding and disposing of the ordinary shares.

**If you are not a U.S. Holder, this subsection does not apply to you and you should refer to **Non-U.S. Holders** below.**

*Taxation of Dividends and Other Distributions on Ordinary Shares*

Subject to the passive foreign investment company rules discussed below, all distributions to a U.S. Holder with respect to the ordinary shares, other than certain pro rata distributions of our shares, will be includible in a U.S. Holder's gross income as ordinary dividend income when received, but only to the extent that the distribution is paid out of our current or accumulated earnings and profits. For this purpose, earnings and profits will be computed under U.S. federal income tax principles. The dividends will not be eligible for the dividends-received deduction allowed to corporations. To the extent that the amount of the distribution exceeds our current and accumulated earnings and profits, it will be treated first as a tax-free return of your tax basis in the ordinary shares, and to the extent the amount of the distribution exceeds the U.S. Holder's tax basis, the excess will be taxed as capital gain. Any gain recognized by a non-corporate U.S. Holder on the sale or exchange of ordinary shares generally will be subject to a maximum tax rate of 15%, which maximum tax rate will increase under current law to 20% for dispositions occurring during taxable years beginning on or after January 1, 2009.

Dividends paid in Renminbi will be included in your income as a U.S. dollar amount based on the exchange rate in effect on the date that the U.S. Holder receives the dividend, regardless of whether the payment is in fact converted into U.S. dollars. If the U.S. Holder does not receive U.S. dollars on the date the dividend is distributed, the U.S. Holder will be required to include either gain or loss in income when the U.S. Holder later exchanges the Renminbi for U.S. dollars. The gain or loss will be equal to the difference between the U.S. dollar value of the amount that the U.S. Holder includes in income when the dividend is received and the amount that the U.S. Holder receives on the exchange of the Renminbi for U.S. dollars. The gain or loss generally will be ordinary income or loss from United States sources. If we distribute as a dividend non-cash property, the U.S. Holder will generally include in income an amount equal to the U.S. dollar equivalent of the fair market value of the property on the date that it is distributed.

Dividends will constitute foreign source income for foreign tax credit limitation purposes. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends distributed by us with respect to the ordinary shares will be passive income or, in the case of certain U.S. Holders, financial services income. In particular circumstances, a U.S. Holder that:

has held the ordinary shares for less than a specified minimum period during which it is not protected from risk of loss,

is obligated to make payments related to the dividends, or

## **Table of Contents**

holds the ordinary shares in arrangements in which the U.S. Holder's expected economic profit, after non-U.S. taxes, is insubstantial will not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on the ordinary shares.

Distributions to a U.S. Holder of shares or rights to subscribe for shares that are received as part of a pro rata distribution to all our shareholders should not be subject to U.S. federal income tax. The basis of the new shares or rights so received will be determined by allocating the U.S. Holder's tax basis in the ordinary shares between the ordinary shares and the new shares or rights received, based on their relative fair market values on the date of distribution. However, the basis of the new shares or rights will be zero if:

the fair market value of the new shares or rights is less than 15.0% of the fair market value of the old ordinary shares at the time of distribution; and

the U.S. Holder does not make an election to determine the basis of the new shares by allocation as described above.

The U.S. Holder's holding period in the new shares or rights will generally include the holding period of the old ordinary shares on which the distribution was made.

### *Taxation of Disposition of Ordinary Shares*

Subject to the passive foreign investment company rules discussed below, a U.S. Holder will recognize taxable gain or loss on any sale or exchange of ordinary shares equal to the difference between the amount realized (in U.S. dollars) for the ordinary shares and the U.S. Holder's tax basis (in U.S. dollars) in the ordinary shares. The gain or loss will be capital gain or loss. Any gain or loss that you recognize will generally be treated as United States source income or loss, except that losses will be treated as foreign source losses to the extent you received dividends that were includible in the financial services income basket during the 24-month period prior to the sale. If the ordinary shares are not stock in a passive foreign investment company with respect to a U.S. Holder in either the taxable year of the distribution or the preceding taxable year, the distribution otherwise constitutes qualified dividend income for United States federal income tax purposes, certain holding period and other requirements are met, and the distribution is received in a taxable year beginning prior to January 1, 2009, the distribution will be taxable to a non-corporate U.S. Holder at a maximum rate of 15%.

### *Passive Foreign Investment Company*

We believe that we are not a passive foreign investment company for U.S. federal income tax purposes, but we cannot be certain whether we will be treated as a passive foreign investment company for any future taxable year. If we are a passive foreign investment company in any year in which a U.S. Holder holds ordinary shares, the U.S. Holder generally will be subject to increased U.S. tax liabilities and reporting requirements on receipt of certain dividends or on a disposition of ordinary shares, in that year and all subsequent years although a shareholder election to terminate such deemed passive foreign investment company status may be made in certain circumstances. U.S. Holders should consult their own tax advisors regarding our status as a passive foreign investment company, the consequences of an investment in a passive foreign investment company, and the consequences of making a shareholder election to terminate deemed passive foreign investment company status if we no longer meet the income or asset test for passive foreign investment company status in a subsequent taxable year.



## Table of Contents

A company is considered a passive foreign investment company for any taxable year if either:

at least 75.0% of its gross income is passive income, or

at least 50.0% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income.

We will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, more than 25.0% (by value) of the stock of such corporation.

Our belief that we are not a passive foreign investment company is based on our estimate of the fair market value of our intangible assets, including goodwill, not reflected in our financial statements under U.S. GAAP. In the future, in calculating the value of these intangible assets, we will value our total assets, in part, based on our total market value determined using the average of the quarterly selling prices of the ordinary shares for the relevant year. We believe this valuation approach is reasonable. However, it is possible that the IRS will challenge the valuation of our intangible assets, which may result in our classification as a passive foreign investment company. In addition, if our actual acquisitions and capital expenditures do not match our projections, the likelihood that we are or will be classified as a passive foreign investment company may also increase.

A separate determination must be made each year as to whether we are a passive foreign investment company. As a result, our passive foreign investment company status may change.

If we are a passive foreign investment company for any taxable year during which a U.S. Holder holds ordinary shares, the U.S. Holder will be subject to special tax rules with respect to:

Any excess distribution that the U.S. Holder receives on ordinary shares, and

Any gain the U.S. Holder realizes from a sale or other disposition (including a pledge) of the ordinary shares, unless the U.S. Holder makes a mark-to-market election as discussed below.

Distributions the U.S. Holder receives in a taxable year that are greater than 125% of the average annual distributions the U.S. Holder received during the shorter of the three preceding taxable years or the U.S. Holder's holding period for the ordinary shares will be treated as an excess distribution. Under these special tax rules:

the excess distribution or gain will be allocated ratably over your holding period for the ordinary shares,

the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which we were a passive foreign investment company, will be treated as ordinary income, and

the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

## **Table of Contents**

The tax liability for amounts allocated to years prior to the year of disposition or excess distribution cannot be offset by any net operating losses, and gains (but not losses) realized on the sale of the ordinary shares cannot be treated as capital, even if the U.S. Holder holds the ordinary shares as capital assets.

A U.S. shareholder of a passive foreign investment company may avoid taxation under the excess distribution rules discussed above by making a qualified electing fund election to include the U.S. Holder's share of our income on a current basis. However, a U.S. Holder may make a qualified electing fund election only if the passive foreign investment company agrees to furnish the shareholder annually with certain tax information, and we do not presently intend to prepare or provide such information.

Alternatively, a U.S. Holder of marketable stock in a passive foreign investment company may make a mark-to-market election for stock of a passive foreign investment company to elect out of the excess distribution rules discussed above. If a U.S. Holder makes a mark-to-market election for the ordinary shares, the U.S. Holder will include in income each year an amount equal to the excess, if any, of the fair market value of the ordinary shares as of the close of your taxable year over the U.S. Holder's adjusted basis in such ordinary shares. A U.S. Holder is allowed a deduction for the excess, if any, of the adjusted basis of the ordinary shares over their fair market value as of the close of the taxable year only to the extent of any net mark-to-market gains on the ordinary shares included in the U.S. Holder's income for prior taxable years. Amounts included in a U.S. Holder's income under a mark-to-market election, as well as gain on the actual sale or other disposition of the ordinary shares, are treated as ordinary income. Ordinary loss treatment also applies to the deductible portion of any mark-to-market loss on the ordinary shares, as well as to any loss realized on the actual sale or disposition of the ordinary shares, to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included for such ordinary shares. A U.S. Holder's basis in the ordinary shares will be adjusted to reflect any such income or loss amounts. The tax rules that apply to distributions by corporations which are not passive foreign investment companies would apply to distributions by us.

The mark-to-market election is available only for stock which is regularly traded on a national securities exchange that is registered with the SEC or on NASDAQ, or an exchange or market that the U.S. Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. The mark-to-market election would be available to a U.S. Holder unless our ordinary shares are delisted from The NASDAQ Capital Market and do not subsequently become regularly traded on another qualified exchange or market.

A U.S. Holder who holds our ordinary shares in any year in which we are a passive foreign investment company would be required to file IRS Form 8621 regarding distributions received on our ordinary shares and any gain realized on the disposition of our ordinary shares.

### *Non-U.S. Holders*

A Non-U.S. Holder generally will not be subject to U.S. federal income tax on dividends paid by us with respect to our ordinary shares unless the income is effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States.

A Non-U.S. Holder generally will not be subject to U.S. federal income tax on any gain attributable to a sale or other disposition of our ordinary shares unless such gain is effectively connected with the Non-U.S. Holder's conduct of a trade or business within the United States or the Non-U.S. Holder is a natural person who is present in the United States for 183 days or more and certain other conditions exist.

## **Table of Contents**

Dividends and gains that are effectively connected with a Non-U.S. Holder's conduct of a trade or business in the United States generally will be subject to tax in the same manner as they would be if the Non-U.S. Holder were a U.S. Holder, except that the passive foreign investment company rules will not apply. Effectively connected dividends and gains received by a corporate Non-U.S. Holder may also be subject to an additional branch profits tax at a 30.0% rate or a lower tax treaty rate.

### *Information Reporting and Backup Withholding*

In general, information reporting requirements will apply to dividends in respect of our ordinary shares or the proceeds received on the sale, exchange or redemption of our ordinary shares paid within the United States (and, in certain cases, outside the United States) to U.S. Holders other than certain exempt recipients, such as corporations, and backup withholding tax may apply to such amounts if the U.S. Holder fails to provide an accurate taxpayer identification number or to report interest and dividends required to be shown on its U.S. federal income tax returns. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as credit against the U.S. Holder's U.S. federal income tax liability provided that the appropriate returns are filed.

A Non-U.S. Holder generally may eliminate the requirement for information reporting and backup withholding by providing certification of its foreign status to the payor, under penalties of perjury, on IRS Form W-8BEN.

#### **C. Dividends and paying agents**

Not applicable.

#### **D. Statement by experts**

Not applicable.

#### **E. Documents on display**

We are subject to the information requirements of the Exchange Act. In accordance with these requirements, the Company files reports and other information with the SEC. You may read and copy any materials filed with the SEC at the Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a web site at <http://www.sec.gov> that contains reports, proxy statements and other information regarding registrants that file electronically with the SEC.

#### **F. Subsidiary Information**

Not applicable.

## **Table of Contents**

### **Item 11. Quantitative and Qualitative Disclosures About Market Risk**

#### *Interest Rate Risk*

Our exposure to market risk for changes in interest rates relates primarily to the interest income generated by our cash deposits in banks and interest expense arising from our short-term bank borrowings that we incur in our ordinary course of business. We have not used derivative financial instruments in our investment portfolio. Interest-earning instruments and floating rate debt carry a degree of interest rate risk. We have not been exposed, nor do we anticipate being exposed, to material risks due to changes in interest rates. Our future interest income may fluctuate in line with changes in interest rates. However, the risk associated with fluctuating interest rates is principally confined to our cash deposits in banks, and, therefore, our exposure to interest rate risk is minimal and immaterial.

#### *Foreign Exchange Risk*

Virtually all of our revenues and costs are denominated in Renminbi and substantially all of our assets and liabilities are denominated in Renminbi. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be impacted by fluctuations in the exchange rate between U.S. dollars and Renminbi. If the Renminbi depreciates against the U.S. dollar, the value of our Renminbi revenues and assets as expressed in U.S. dollars in our financial statements will decline. See Risk Factors Fluctuation of the Renminbi could materially affect our financial condition and results of operations.

#### *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 0.46%, (0.77)%, and 1.16% in 2001, 2002 and 2003, respectively. However, in connection with a 3.9% increase in 2004, the Chinese government announced measures to restrict lending and investment in China in order to reduce inflationary pressures in China's economy. In the first eight months of 2005, the change in the Consumer Price Index in China was 6.18%. The Chinese government may introduce further measures intended to reduce the inflation rate in China. We cannot assure you that these measures will not have a significant impact on our business. Any such measures may not be successful or immediately effective in reducing or slowing the increase in China's inflation rate. Sustained or increased inflation in China may have an impact on China's economy and our customers, which may adversely affect our business and financial results.

#### *Taxation*

Under the current law of the Cayman Islands, we are not subject to tax on income or capital gain. However, our revenues are primarily derived from our Chinese subsidiary, e-Future Beijing. Chinese foreign invested enterprises are generally subject to a 30.0% federal (state) enterprise income tax, and a 3.0% local enterprise income tax. However, e-Future Beijing has been certified by the Chinese government as a High Technology Enterprise. This certification entitled e-Future Beijing to be exempt from federal enterprise tax from 2000 through 2002, to pay a federal enterprise tax of 7.5% from 2003 through 2005, to pay a federal enterprise tax thereafter of 15% and to be exempt from local income taxes, all for so long as e-Future Beijing maintains its High Technology Enterprise certification and for so long as it remains located in a State Standard High Enterprise Zone. In addition, e-Future Beijing is allowed a deduction for operating loss carry forwards for up to five years because it has foreign invested capital.

**Table of Contents**

If our activities constitute a permanent establishment in China, the income we earn in China would also be subject to a 30.0% state enterprise income tax and 3.0% local enterprise 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 receipt from profit, interest, rentals, royalties and other income earned in China. Dividends from our wholly subsidiary, e-Future Beijing, to our company are exempt from Chinese withholding tax.

Our software and system integration services revenues are also subject to a value-added tax at the rate of 17.0%.

**Item 12. Description of Securities Other than Equity Securities**

Not applicable.

**PART II**

**Item 13. Defaults, Dividend Arrearages and Delinquencies**

None.

**Item 14. Material Modifications to the Rights of Securities Holders and Use of Proceeds**

None.

**Item 15. Controls and Procedures**

*Disclosure Controls and Procedures*

We performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of December 31, 2006. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within our Company to disclose material information otherwise required to be set forth in our periodic reports. Following the evaluation described above, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective at that time.

*Management's Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006.

Based on our assessment of the system of internal control, management believes that as of December 31, 2006 our internal control over financial reporting was effective.

**Table of Contents**

**Item 15T. Controls and Procedures**

Not applicable.

**Item 16. [Reserved]**

**Item 16A. Audit Committee Financial Expert**

The Company's Board of Directors has determined that Mr. Chaoyong Wang qualifies as an audit committee financial expert in accordance with applicable Nasdaq Capital Market standards. The Company's Board of Directors also determined that each member of the Audit Committee is independent in accordance with the applicable Nasdaq Capital Market standards.

**Item 16B. Code of Ethics**

The Company has adopted a Code of Business Conduct and Ethics that applies to the Company's employees, including its principal executive officers. A copy of the Code of Business Conduct and Ethics is filed as an exhibit to this Annual Report. In addition, the Company has posted this information on its website at [www.e-future.com.cn](http://www.e-future.com.cn). The Company will provide any person a copy of its Code of Business Conduct and Ethics, without charge, upon request. Such request should be addressed to:

e-Future Information Technology Inc.  
No. 10 Building  
BUT Software Park  
No. 1 Disheng North Street  
BDA, Yizhuang District  
Beijing 100176, People's Republic of China  
Attention: Secretary

**Item 16C. Principal Accountant Fees and Services**

*Audit Fees*

During fiscal 2006, we paid Hansen, Barnett & Maxwell's fees in the aggregate amount of \$60,000 for the annual audit of our financial statements.

*Audit Related Fees*

During fiscal 2006, we paid Hansen, Barnett & Maxwell \$20,000 for audit-related services.

*Tax Fees*

During fiscal 2006, we did not pay Hansen, Barnett & Maxwell any fees for tax services.

*Pre-Approval Policies*

## Edgar Filing: eFuture Information Technology Inc. - Form 20-F

Our Audit Committee has the sole authority to approve all audit engagement fees and terms, and the Audit Committee, or as member of the audit Committee, must pre-approve any audit and non-audit service provided to the Company by the Company's independent auditor.

**Table of Contents**

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Not applicable.

**PART III**

**Item 17. Financial Statements**

Not applicable.

**Item 18. Financial Statements**

The consolidated financial statements of e-Future Information Technology Inc. are included at the end of this annual report, beginning with page F-1 and continuing through page F-22.

**Item 19 Exhibits**

- 1.1 Amended and Restated Memorandum and Articles of Association of the Registrant (1)
- 1.2 Amended and Restated Memorandum of Association of the Registrant (1)
- 1.3 Written resolutions of the Registrant amending the terms of its Memorandum of Association dated June 16, 2005 (1)
- 2.1 Specimen Certificate for Ordinary Shares (1)
- 4.1 Labor Contract by and between e-Future Beijing and Adam Yan (1)
- 4.2 Labor Contract by and between e-Future Beijing and Qicheng Yang (1)
- 4.3 Labor Contract by and between e-Future Beijing and Hongjun Zou (1)
- 4.4 Labor Contract by and between e-Future Beijing and Johnson Li (1)
- 4.5 Labor Contract by and between the e-Future Beijing and Zhou Kefu (1)
- 4.6 Summary of translation of Share Transfer Agreement of Hainan Future Computer Co., Ltd. by and between Qicheng Yang and Ling Zhang (1)
- 4.7 Summary of translation of Share Transfer Agreement of Hainan Future Computer Co., Ltd. by and between Adam Yan and Xuejun Zhang (1)
- 4.8 Summary of translation of Share Transfer Agreement of e-Future (Beijing) Tornado Information Technology, Inc. by and between Dafu Zou and Johnson Li (1)
- 4.9 Agreement to terminate Agreement and forgive debt (1)



**Table of Contents**

4.10	Memorandum of Understanding by and between IBM China Company Limited and the Registrant (1)
4.11	ISV Advantage Agreement by and between IBM Engineering Technology (Shanghai) Co., Ltd. and the Registrant (1)
4.12	Termination and Debt Forgiveness Agreement by and among e-Future (Beijing) Tornado Information Technology Inc., e-Future Information Technology Inc. and Hainan Future Computer Co., Ltd. (1)
4.13	Summary of translation of Guarantee Agreement numbered 2005 Wangbaozhi No. 002 (1)
4.14	Summary of translation of Agreement, dated February 20, 2000, by and between e-Future Beijing and Hainan Future Computer Co., Ltd. transferring ONE POS-ERP (1)
4.15	Summary of translation of Agreement by and between e-Future (Beijing) Tornado Information Technology, Inc. and Limen (China) Group (2)
8.1	Subsidiaries of the Registrant (1)
11.1	Code of Business Conduct and Ethics (3)
12.1	Section 302 Certification of Adam Yan (3)
12.2	Section 302 Certification of Yu Ping (3)
13.1	Section 906 Certification of Adam Yan (3)
13.2	Section 906 Certification of Yu Ping (3)
99.1	Schedule II Valuation and Qualifying Accounts (3)

---

(1) Incorporated by reference to the Registrant's Registration Statement on Form F-1 (File No. 333-126007).  
(2) Incorporated by reference to the Registrant's Annual Report on Form 20-F (File No. 001-33113) filed with the SEC on June 30, 2006.  
(3) Filed herewith.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the undersigned certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form F-20 and has duly caused this Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 on Form F-20 to be signed on its behalf by the undersigned, thereunto duly authorized, in the People's Republic of China, on the 28th day of June, 2007.

**E-FUTURE INFORMATION TECHNOLOGY INC.**

By: /s/ Adam Yan  
Name: Adam Yan  
Title: Chairman and Chief Executive Officer

(Principal Executive Officer and Principal  
Accounting Officer)  
Date: June 28, 2007

S-1

**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**

**INDEX TO FINANCIAL STATEMENTS**

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets as of December 31, 2005 and 2006</u>	F-3
<u>Consolidated Statements of Operations for the Years Ended December 31, 2004, 2005 and 2006</u>	F-4
<u>Consolidated Statements of Stockholders' Equity (Deficit) for the Years Ended December 31, 2004, 2005 and 2006</u>	F-5
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2004, 2005 and 2006</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

F-1

**Table of Contents**

**HANSEN, BARNETT & MAXWELL, P.C.**  
A Professional Corporation  
CERTIFIED PUBLIC ACCOUNTANTS  
5 Triad Center, Suite 750  
Salt Lake City, UT 84180-1128  
Phone: (801) 532-2200  
Fax: (801) 532-7944

**Registered with the Public Company  
Accounting Oversight Board**

www.hbmcpas.com

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and the Shareholders

e-Future Information Technology Inc.

We have audited the accompanying consolidated balance sheets of e-Future Information Technology Inc. and subsidiary as of December 31, 2005 and 2006, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2006, presented in Chinese Yuan (Renminbi). These consolidated 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of e-Future Information Technology Inc. and subsidiary as of December 31, 2005 and 2006 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, presented in Chinese Yuan (Renminbi), in conformity with accounting principles generally accepted in the United States of America.

**HANSEN, BARNETT & MAXWELL, P.C.**

Salt Lake City, Utah

March 14, 2007

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS**

	Chinese Yuan (Renminbi) December 31,		U.S. Dollars December 31,
	2005	2006	2006 (Unaudited)
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	¥ 8,834,817	¥ 61,464,737	\$ 7,875,955
Trade accounts receivable, less allowance for doubtful accounts of ¥960,682, ¥2,109,910 (\$270,359), respectively	3,788,397	4,452,959	570,592
Refundable value added tax	2,543,534	2,470,941	316,621
Deposits	511,401	44,943	5,759
Advances to employees	1,035,820	1,198,601	153,586
Advances to suppliers, less allowance for doubtful accounts of ¥145,700 and ¥0 (\$0), respectively	108,190	443,030	56,769
Other receivables	231,672	171,120	21,927
Prepaid expenses	474,112	534,755	68,522
Inventory	4,146,409	4,121,136	528,073
Loan to guarantor	800,000		
<b>Total current assets</b>	<b>22,474,352</b>	<b>74,902,222</b>	<b>9,597,804</b>
<b>Non-current assets</b>			
Deferred offering costs	2,009,360		
Property and equipment, net of accumulated depreciation of ¥4,010,980, ¥4,690,856 (\$601,076), respectively	1,157,117	1,014,581	130,006
Intangible assets - Internally generated software, net of accumulated amortization of ¥5,951,553, ¥8,678,751 (\$1,112,076), respectively	6,016,845	7,108,244	910,835
<b>Total non-current assets</b>	<b>9,183,322</b>	<b>8,122,825</b>	<b>1,040,841</b>
<b>Total assets</b>	<b>¥ 31,657,674</b>	<b>¥ 83,025,047</b>	<b>\$ 10,638,645</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>Current liabilities</b>			
Short-term loan	¥ 2,800,000	¥	\$
Trade accounts payable	1,612,044	1,230,782	157,710
Accrued expenses	3,483,799	3,941,618	505,071
Taxes payable	5,664,924	5,182,615	664,089
Advances from customers	6,004,589	8,121,043	1,040,612
<b>Total current liabilities</b>	<b>¥ 19,565,356</b>	<b>¥ 18,476,058</b>	<b>\$ 2,367,482</b>
<b>Shareholders equity (deficit)</b>			
Ordinary shares, \$0.0756 U.S. Dollars (¥0.6257) par value; 6,613,756 shares authorized; 1,500,000 and 2,633,500 shares outstanding, respectively	938,550	1,647,781	211,143
Additional paid-in capital	33,592,443	77,726,236	9,959,667
Statutory reserves	3,084,020	3,084,020	395,179
Accumulated other comprehensive loss - foreign currency translation		(491,079)	(62,926)
Accumulated deficit	(25,522,695)	(17,417,969)	(2,231,900)

Edgar Filing: eFuture Information Technology Inc. - Form 20-F

<b>Total shareholders equity</b>	12,092,318	64,548,989	8,271,163
<b>Total liabilities and shareholders equity</b>	¥ 31,657,674	¥ 83,025,047	\$ 10,638,645

See accompanying notes to the consolidated financial statements.

F-3

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Chinese Yuan (Renminbi)			U.S. Dollars
	For the Years Ended December 31,			For the
	2004	2005	2006	Year Ended
				December 31,
				2006
				(Unaudited)
<b>Revenues</b>				
Software sales	¥ 25,130,089	¥ 25,177,810	¥ 29,832,720	\$ 3,822,698
Hardware sales	5,141,041	10,241,749	11,403,473	1,461,216
Service fee income	4,432,167	3,824,442	6,607,337	846,649
<b>Total Revenues</b>	<b>34,703,297</b>	<b>39,244,001</b>	<b>47,843,530</b>	<b>6,130,563</b>
<b>Cost of revenues</b>				
Cost of software	10,097,528	7,815,315	7,665,866	982,287
Cost of hardware	4,097,518	8,681,619	10,548,649	1,351,680
Cost of service fee income	1,033,167	901,973	1,887,676	241,883
Amortization of software costs	1,966,420	2,305,835	2,727,198	349,457
<b>Total Cost of Revenue</b>	<b>17,194,633</b>	<b>19,704,742</b>	<b>22,829,389</b>	<b>2,925,307</b>
<b>Gross Profit</b>	<b>17,508,664</b>	<b>19,539,259</b>	<b>25,014,141</b>	<b>3,205,256</b>
<b>Expenses</b>				
Research and development	1,419,937	93,814	527,219	67,557
Selling and distribution	4,786,308	5,790,675	9,210,975	1,180,274
General and administrative	6,104,657	7,811,742	7,298,980	935,275
<b>Total Expenses</b>	<b>12,310,902</b>	<b>13,696,231</b>	<b>17,037,174</b>	<b>2,183,106</b>
<b>Income from operations</b>	<b>5,197,762</b>	<b>5,843,028</b>	<b>7,976,967</b>	<b>1,022,150</b>
<b>Interest income</b>	<b>16,108</b>	<b>110,268</b>	<b>141,230</b>	<b>18,097</b>
<b>Interest expense</b>	<b>(688,680)</b>	<b>(483,033)</b>	<b>(13,471)</b>	<b>(1,726)</b>
<b>Net income</b>	<b>¥ 4,525,190</b>	<b>¥ 5,470,263</b>	<b>¥ 8,104,726</b>	<b>\$ 1,038,521</b>
<b>Earnings per ordinary share</b>				
Basic	¥ 4.91	¥ 4.43	¥ 4.80	\$ 0.61
Diluted	¥ 2.90	¥ 3.50	¥ 4.43	\$ 0.57

See accompanying notes to the consolidated financial statements.





**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)**  
**FOR THE YEARS ENDED DECEMBER 31, 2004, 2005 AND 2006**

	Ordinary Shares		Additional Paid-in Capital	Chinese Yuan (Renminbi)			Accumulated Other Comprehensive Loss	Accumulated Deficit	Total
	Shares	Amount		Statutory Reserves	Subscriptions Receivable				
Balance as of December 31, 2003	921,875	¥ 576,817	¥ 889,663	¥ 1,584,702	¥ (575,722)	¥	¥ (34,018,830)	¥ (31,543,370)	
Contributed interest			346,096					346,096	
Transfer to statutory reserves				678,779			(678,779)		
Net income for the year							4,525,190	4,525,190	
Balance as of December 31, 2004	921,875	576,817	1,235,759	2,263,481	(575,722)		(30,172,419)	(26,672,084)	
Conversion of Series A preferred stock	578,125	361,733	30,222,260					30,583,993	
Contributed interest			236,742					236,742	
Forgiveness of debt by majority shareholder			1,897,682					1,897,682	
Payment of subscription receivable					575,722			575,722	
Transfer to statutory reserves				820,539			(820,539)		
Net income for the year							5,470,263	5,470,263	
Balance as of December 31, 2005	1,500,000	938,550	33,592,443	3,084,020			(25,522,695)	12,092,318	
Issuance of ordinary shares and warrants for cash, net of offering costs	1,133,500	709,231	44,133,793					44,843,024	
Net income for the year							8,104,726	8,104,726	
Foreign currency translation adjustment							(491,079) ¥	(491,079)	
Balance as of December 31, 2006	2,633,500	¥ 1,647,781	¥ 77,726,236	¥ 3,084,020	¥	¥ (491,079)	¥ (17,417,969)	¥ 64,548,989	

	Ordinary Shares		Additional Paid-in Capital	Statutory Reserves	U.S. Dollars (Unaudited)		Accumulated Other Comprehensive	Accumulated Deficit	Total
	Shares	Amount			Subscriptions Receivable				

Edgar Filing: eFuture Information Technology Inc. - Form 20-F

	Loss								
Balance as of									
December 31, 2005	1,500,000	\$	120,264	\$	4,304,461	\$	395,179	\$	
Issuance of ordinary shares and warrants for cash, net of offering costs	1,133,500		90,879		5,655,206				5,746,085
Net income for the year									1,038,521
Foreign currency translation adjustment								(62,926)	(62,926)
Balance as of									
December 31, 2006	2,633,500	\$	211,143	\$	9,959,667	\$	395,179	\$	(62,926)
									(2,231,900)
									8,271,163

See accompanying notes to the consolidated financial statements.

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Chinese Yuan (Renminbi)			U.S. Dollars For the
				Year Ended
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006 (Unaudited)
<b>Cash flows from operating activities:</b>				
Net income	¥ 4,525,190	¥ 5,470,263	¥ 8,104,726	\$ 1,038,521
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation	1,106,019	574,954	679,876	87,118
Amortization of intangible assets	1,966,420	2,305,835	2,727,198	349,457
Loss on disposition of property and equipment	8,726	8,759		
Interest on notes payable contributed by shareholders	346,096	236,742		
Change in assets and liabilities:				
Trade accounts receivable	2,296,537	126,677	(664,562)	(85,155)
Refundable value added tax	(1,788,333)	119,659	72,593	9,302
Deposits	(35,096)	5,976	466,458	59,771
Advances to employees	108,652	84,682	(162,781)	(20,858)
Advances to suppliers	3,870,044	240,220	(334,840)	(42,906)
Other receivables	451,307	54,001	60,552	7,759
Prepaid expenses		(474,112)	(66,189)	(8,481)
Inventory	2,750,908	(711,057)	25,277	3,239
Trade accounts payables	(4,128,140)	1,252,205	208,096	26,665
Accrued expenses	639,942	(1,811,714)	(101,711)	(13,033)
Taxes payable	2,303,828	358,033	(482,309)	(61,802)
Advances from customers	(8,301,726)	(15,108)	2,116,454	271,198
<b>Net cash provided by operating activities</b>	<b>6,120,374</b>	<b>7,826,015</b>	<b>12,648,838</b>	<b>1,620,795</b>
<b>Cash flows from investing activities:</b>				
Purchases of property and equipment	(79,633)	(545,155)	(537,340)	(68,854)
Payments for internally generated software	(1,810,761)	(3,081,257)	(3,818,597)	(489,307)
Loan to guarantor		(800,000)		
Collection of loan to guarantor			800,000	102,510
Amounts due to a related company		(575,722)		
Amounts due from a related company	1,345,393	146,699		
<b>Net cash used in investing activities</b>	<b>(545,001)</b>	<b>(4,855,435)</b>	<b>(3,555,937)</b>	<b>(455,651)</b>
<b>Cash flows from financing activities:</b>				
Issuance of ordinary shares for cash, net of offering costs paid		(2,009,360)	47,128,495	6,038,940
Proceeds received from loans to shareholders	41,183	53,973		
Proceeds from short-term loans		2,800,000		
Proceeds from subscription receivable		575,722		
Repayment of short-term loan	(4,800,000)		(2,800,000)	(358,786)
<b>Net cash provided by (used in) financing activities</b>	<b>(4,758,817)</b>	<b>1,420,335</b>	<b>44,328,495</b>	<b>5,680,154</b>

Edgar Filing: eFuture Information Technology Inc. - Form 20-F

<b>Effect of exchange rate changes on cash</b>			(791,476)	(101,418)
<b>Net increase in cash</b>	816,556	4,390,915	52,629,920	6,743,881
<b>Cash and cash equivalents at beginning of year</b>	3,627,346	4,443,902	8,834,817	1,132,074
 <b>Cash and cash equivalents at end of year</b>	 ¥ 4,443,902	 ¥ 8,834,817	 ¥ 61,464,737	 \$ 7,875,955
 <b>Supplemental cash flow information</b>				
Interest paid	¥ 336,603	¥ 186,412	¥ 66,593	8,533
 <b>Noncash Investing and Financing Activities:</b>				
Offset of Hainan Future Company payable	¥	¥ 2,526,595	¥	\$
Forgiveness of debt recognized as contribution	¥	¥ 1,897,682	¥	\$
Conversion of series A convertible preferred stock	¥	¥ 30,222,260	¥	\$

See accompanying notes to the consolidated financial statements.

F-6

---

**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

**NOTE 1. ORGANIZATION AND NATURE OF OPERATIONS**

**Organization** e-Future Information Technology, Inc. is a Cayman Islands Corporation. Its wholly owned subsidiary e-Future (Beijing) Tornado Information Technology, Inc. is a Beijing foreign investment enterprise in the People's Republic of China (the PRC).

**Nature of Operations** The Company is mainly engaged in developing and selling Enterprise Resource Planning (ERP) software and providing ONE-STOP solutions for distribution, retail and logistics businesses focused on the supply chain front market for manufacturers, retailers, distributors and third party logistics, and in providing the related system integration service and technical training services. Systems integration services involve system design and system implementation through the application of the software as well as ongoing technical supporting services.

**NOTE 2. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Translating Financial Statements** The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company's functional currency is the Chinese Yuan (Renminbi) and the accompanying consolidated financial statements have been expressed in Chinese Yuan. The consolidated financial statements as of and for the year ended December 31, 2006 have been translated into United States dollars solely for the convenience of the reader, are not presented in accordance with accounting principles generally accepted in the United States of America and are unaudited. Solely for this purpose, the consolidated financial statements have been translated into U.S. dollars at the rate of ¥7.8041 = US\$1.00, the approximate exchange rate prevailing on December 31, 2006. These translated U.S. dollar amounts should not be construed as representing Chinese Yuan amounts or that the Chinese Yuan amounts have been or could be converted into U.S. dollars.

**Reclassifications** Certain 2005 amounts have been reclassified to bring them into conformity with the 2006 presentation. These reclassifications had no effect on the previously reported net income.

**Consolidation** The accompanying consolidated financial statements include the accounts of e-Future Information Technology Inc. and of its wholly owned subsidiary, e-Future (Beijing) Tornado Information Technology Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

**Accounting Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In particular, the estimated allowance for doubtful accounts could change in the near term.

**Fair Values of Financial Instruments** The carrying amounts reported in the consolidated balance sheets for trade accounts receivable, other receivables, advances to suppliers, trade accounts payable, accrued liabilities and advances from customers approximate fair value because of the immediate or short-term maturity of these financial instruments.

**Cash and Cash Equivalents** Cash and cash equivalents are comprised of cash on hand, demand deposits and short-term debt investments with original maturities of no more than three months.

**Trade Accounts and Other Receivables** Provision is made against trade accounts and other receivables to the extent they are considered to be doubtful. Other receivables are from transactions with non-trade customers.

**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

**Inventory** Inventory is comprised of purchased software available for resale, other consumable materials and work in process. Inventory is stated at the lower of average cost or net realizable value. Work in process consists of costs incurred on contracts that have not been completed nor recognized as revenue.

**Valuation of Long-lived Assets** The carrying values of the Company's long-lived assets are reviewed for impairment annually or whenever events or changes in circumstances indicate that they may not be recoverable. When such an event occurs, the Company projects the undiscounted cash flows to be generated from the use of the asset and its eventual disposition over the remaining life of the asset. If projections indicate that the carrying value of the long-lived asset will not be recovered, the carrying value of the long-lived asset is reduced by the estimated excess of the carrying value over the projected discounted cash flows.

**Intangible Assets Internally Generated Computer Software Costs and Research and Development** The Company charges all development costs to research and development until technological feasibility has been established. Technological feasibility has been established when a detail program design has been completed, or the completion of a working model. After reaching technological feasibility, additional software costs are capitalized until the software is available for general release to customers. The estimated useful life of capitalized software development expenditures is the shorter of four years or the estimated period of realization of revenue from the related software.

**Revenue Recognition** The Company recognizes revenue when it is realized and earned. The Company considers revenue realized or realizable and earned when (1) it has persuasive evidence of an arrangement, (2) delivery has occurred, (3) the sales price is fixed or determinable, and (4) collectibility is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client and the client has signed a completion and acceptance report, risk of loss has transferred to the client, client acceptance provisions have lapsed, or the Company has objective evidence that the criteria specified in client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

The Company provides the following products and services: self-developed software, purchased software, purchased hardware, system design and integration, and post-contract maintenance and technical support.

**Software**

The Company sells self-developed software and software purchased from other vendors. For software sales, the Company recognizes revenues in accordance with the provisions of Statement of Position No. 97-2, *Software Revenue Recognition*, and related interpretations. Revenue from perpetual (one-time charge) licensed software is recognized at the inception of the license term. Revenue from term (monthly license charge) arrangements is recognized on a subscription basis over the period that the customer is using the license. The Company does not provide any rights of return or warranties on the Company's software.

Revenues applicable to multiple-element fee arrangements are bifurcated among the elements such as software, hardware and post-contract service using vendor-specific objective evidence of fair value. Such evidence consists of pricing of multiple elements when those same elements are sold as separate products or arrangements. Software maintenance for the first year and initial training are included in the purchase price of the software. Initial training is provided at the time of installation and is recognized as income as part of the price of the software since it is minimal in value. Maintenance is valued based on the fee schedule used by the Company for providing the regular level of maintenance service as sold to customers when renewing their maintenance contracts on a stand alone basis. Maintenance revenue is included in the statement of operations under service fee income and is recognized over the term of the agreement.

---

**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

**Hardware**

Revenue from hardware sales is generally recognized when the product is shipped to the customer and when there are no unfulfilled Company obligations that affect the customer's final acceptance of the arrangement.

**Services**

The Company provides services for system integration which involves the design and development of complex information technology systems to the customer's specifications. These services are provided on a fixed-price contract and the contract terms generally are short term. Revenue is recognized on the completed-contract method when delivery and acceptance is determined by a completion report signed by the customer.

Work in process inventory represents the cost of work performed towards providing such services that has not been completed as of the balance sheet date.

The Company offers telephone and minimal on-site support to its customers on a stand alone basis. Revenue from maintenance and technical support is recognized over the period of the agreement.

Advances from customers represent deposits received as of the balance sheet date. Advances include amounts related to projects that had yet to be completed.

Deferred revenue represents unearned amounts billed to customers related to post-contract maintenance agreements.

**Cost of Revenues** Costs associated with contracts are deferred and recognized as inventory until the services are completed, the products and software are installed and delivered to and accepted by the customer. When the criteria for revenue recognition have been met, costs incurred are recognized as cost of revenue. Cost of revenues include wages, materials, handling charges, and other expenses associated with the development of information technology systems to the customer's specifications, the cost of purchased hardware and software, and costs related to technical support services. Amortization of capitalized software costs is included in the cost of revenue.

**Advertising Costs** Advertising costs are expensed when incurred. Total advertising expense was ¥963,163, ¥905,012, and ¥280,891 (\$35,993) for the years ended December 31, 2004, 2005 and 2006, respectively.

**Income taxes** Income taxes are provided based upon the liability method of accounting pursuant to SFAS No. 109, *Accounting for Income Taxes*. Under this approach, deferred income taxes are recorded to reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. A valuation allowance is recorded against deferred tax assets if it is not likely that the asset will be realized.

In June 2006, the Financial Accounting Standards Board issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition classification, interest and penalties, accounting in interim periods, disclosure, and transition. The interpretation is effective for the fiscal years beginning after December 15, 2006. The impact of adoption of this interpretation on the Company's consolidated financial statements, if any, has not yet been determined.

**Net Earnings per Ordinary Share** Basic earnings per ordinary share is computed by dividing net income by the weighted-average number of ordinary shares outstanding. Diluted earnings per ordinary share is computed by dividing net income by the weighted-average number of ordinary shares and dilutive potential ordinary share equivalents outstanding. Potential ordinary share equivalents consist of shares issuable upon the conversion of preferred stock and the exercise of stock options and warrants.





**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

The following table is a reconciliation of the numerators and denominators used in the calculation of basic and diluted earnings per share and the weighted-average ordinary shares outstanding for the years ended December 31, 2004, 2005 and 2006:

	Chinese Yuan (Renminbi)			U.S. Dollars
				For the
				Year Ended
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006
				(Unaudited)
Net income	¥ 4,525,190	¥ 5,470,263	¥ 8,104,726	\$ 1,038,521
Basic weighted-average ordinary shares outstanding	921,875	1,235,488	1,689,434	1,689,434
Effect of dilutive securities:				
Series A convertible preferred stock	578,125	264,512		
Stock options and warrants	62,499	62,499	141,824	141,824
Diluted weighted-average ordinary shares outstanding	1,562,499	1,562,499	1,831,258	1,831,258
Basic earnings per share	¥ 4.91	¥ 4.43	¥ 4.80	\$ 0.61
Diluted earnings per share	¥ 2.90	¥ 3.50	¥ 4.43	\$ 0.57

**Stock-Based Compensation** Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement of Financial Accounting Standards 123 (Revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and is measured based on the grant date fair value of the award. SFAS 123R also requires the stock option compensation expense to be recognized over the period during which an employee is required to provide service in exchange for the award (the vesting period). Prior to the Company adopting SFAS 123R, stock-based compensation plans were accounted for under Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees* (APB 25). Under APB 25, generally no compensation expense is recorded when the terms of the award are fixed and the exercise price of the employee stock option equals or exceeds the fair value of the underlying stock on the date of grant. The Company adopted the disclosure-only provision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123).

For the years ended December 31, 2004, 2005 and 2006, the Company had no compensation expense related to stock options.

For options granted subsequent to the adoption date of SFAS 123R on January 1, 2006, the fair value of each stock option grant will be estimated on the date of grant using the Black-Scholes option pricing model. The Company had no stock option grants during the years ended December 31, 2004, 2005 or 2006. During the years ended December 31, 2004, 2005 and 2006 there were 62,499 of options outstanding that had not been exercised as of December 31, 2006.

**Recently Enacted Accounting Standards** In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* (SFAS 155). SFAS 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and related interpretations. SFAS 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies which interest-only strips and principal-only strips are not subject to recognition as liabilities. SFAS 155 eliminates the prohibition on a qualifying special-purpose entity from

holding a derivative financial instrument that

F-10

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for the Company for all financial instruments acquired or issued beginning January 1, 2007. The impact of adoption of this statement on the Company's consolidated financial statements, if any, has not yet been determined.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140* (SFAS 156). SFAS 156 amends SFAS No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and related interpretations. SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to use either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for the Company as of January 1, 2007. The impact of adoption of this statement on the Company's consolidated financial statements, if any, has not yet been determined.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS 157 is not expected to have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ( SFAS 158 ). Under SFAS 158, companies must recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. The effective date of the recognition and disclosure provisions for calendar-year public companies is for calendar years ending after December 15, 2006. The Company is currently evaluating the impact of this new standard but it is not expected to have a significant effect on the consolidated financial statements for the year ending December 31, 2006.

**Business Segments** The Company operates in one industry which includes the sale of computer software, hardware and services solely to customers in China; therefore, no business segment information has been presented.

**NOTE 3. INVENTORY**

Inventory consisted of the following at December 31, 2005 and 2006:

	Chinese Yuan (Renminbi)		U.S. Dollars
	December 31, 2005	December 31, 2006	December 31, 2006
			(Unaudited)
Purchased software	¥ 138,376	¥	\$
Work in process	3,940,196	4,038,375	517,468
Other	67,837	82,761	10,605
Total inventory	¥ 4,146,409	¥ 4,121,136	\$ 528,073

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)****NOTE 4. PROPERTY AND EQUIPMENT**

Property and equipment are stated at cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

Motor vehicles	10 Years
Leasehold improvements - shorter of	3 Years or Lease Term
Office equipment	5 Years
Communication equipment	5 Years
Software	5 Years

Maintenance and repairs are charged to expense as incurred and major improvements are capitalized. Gains or losses on sales or retirements are included in the consolidated statements of operations in the year of disposition. Depreciation expense was ¥1,106,019, ¥574,954, and ¥679,876 (\$87,118) for the years ended December 31, 2004, 2005, and 2006, respectively. Property and equipment consisted of the following at December 31, 2004 and 2005:

	Chinese Yuan (Renminbi)		U.S. Dollars
	December 31,		December 31,
	2005	2006	2006 (Unaudited)
Motor vehicles	¥ 290,000	¥ 290,000	\$ 37,160
Leasehold improvements	280,711	433,394	55,534
Office equipment	3,893,567	4,266,615	546,715
Communication equipment	157,279	161,344	20,674
Software	546,540	554,084	70,999
Total	5,168,097	5,705,437	731,082
Less: Accumulated depreciation	(4,010,980)	(4,690,856)	(601,076)
Property and equipment, net	¥ 1,157,117	¥ 1,014,581	\$ 130,006

**NOTE 5. INTERNALLY GENERATED SOFTWARE**

Intangible assets consist of the cost of computer software acquired, which is included in property and equipment, and the cost of computer software available for sale that has been internally developed by the Company. The components of intangible assets at December 31, 2005 and 2006 are as follows:

	Chinese Yuan (Renminbi)		U.S. Dollars
	December 31,		December 31,
	2005	2006	2006

Edgar Filing: eFuture Information Technology Inc. - Form 20-F

			(Unaudited)
Internally generated software	¥ 11,968,398	¥ 15,786,995	\$ 2,022,910
Less: Accumulated amortization	(5,951,553)	(8,678,751)	(1,112,076)
<b>Intangible assets, net</b>	<b>¥ 6,016,845</b>	<b>¥ 7,108,244</b>	<b>\$ 910,835</b>

All intangible assets have a useful life of and are amortized over 4.0 years. Amortization expense for the years ended December 31, 2004, 2005 and 2006 was ¥1,966,420, ¥2,305,835 and ¥2,727,198 (\$349,457), respectively. Estimated aggregate amortization expense as of December 31, 2006 for the succeeding five years ending December 31, is as follows:

F-12

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

	Chinese Yuan (Renminbi)	U.S. Dollars (Unaudited)
2007	¥ 2,599,319	\$ 333,071
2008	2,096,176	268,599
2009	1,450,407	185,852
2010	566,737	72,620
2011		
Undetermined	395,605	50,693

Research and development costs for the years ended December 31, 2004, 2005 and 2006 were ¥1,419,937, ¥93,814 and ¥527,219 (\$67,557), respectively. The Company has capitalized ¥395,605 of software costs that are not yet being amortized as the Company has yet to receive certification from the government for computer software that was recently developed. When the Company receives certification from the government these capitalized software costs will be amortized.

**NOTE 6. SHAREHOLDERS' EQUITY (DEFICIT)**

**Reverse Stock Split** On June 16, 2005, the shareholders of the Company approved a 1-for-7.560678 reverse stock split to its outstanding ordinary shares. This split also affected the potential conversion of the preferred stock. The number of ordinary shares outstanding for all periods presented has been retroactively restated to reflect the reverse stock split in the accompanying consolidated financial statements. The shareholders of the Company changed its authorized capital to 6,613,756 ordinary shares with a par value of \$0.0756 U.S. Dollars per share.

**Preferred stock** The Company's Articles of Association allows for the issuance of convertible preferred stock in the amount of 10,000,000 shares at a par value of \$0.0756 per share with the rights as described in those articles. Holders of the preferred stock have the same voting rights as holders of ordinary stock. All other material rights are to be determined by special resolution of the board of directors.

**Series A Convertible Preferred Stock** At December 31, 2004, there were 4,016,610 shares of Series A convertible preferred stock outstanding. Holders of the Series A convertible preferred stock had the same voting rights as holders of ordinary stock. Series A convertible preferred stock holders were entitled to the number of votes equal to the number of ordinary shares into which such shares of Series A convertible preferred were convertible. The conversion rate was one share of Series A preferred stock to 0.1439335 shares of ordinary stock, or 578,125 shares.

At any time starting April 20, 2006, any majority holder of Series A convertible preferred stock had the right to require the Company to redeem of the Series A convertible preferred stock at a redemption price of ¥7.61 (\$0.94) per share plus all declared but unpaid dividends. From the date of issuance in 2001, the redemption amount was ¥30,583,993. As a result, the Series A convertible preferred stock was mandatorily redeemable and was classified as a long-term liability upon adopting SFAS No. 150 during 2003. In accordance with EITF D-98, the Company recorded the carrying amount of the redeemable Series A preferred stock at its fair value when it was issued on April 20, 2001. The fair value was determined based upon its redemption value at that date and resulted in a charge to accumulated deficit of ¥9,894,407 during 2001. There were no changes in the redemption value from the date of issuance through June 16, 2005.

Holders of Series A preferred were entitled to receive non-cumulative dividends of ¥0.25 per share per annum only if declared by the Board of Directors. No dividends were declared.

Upon the close of an underwritten public offering, at a public price which represents a valuation of the share capital of the Company of at least ¥662,120,000 and with the gross proceeds to the Company of at least ¥165,530,000, the



---

**Table of Contents**

**E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

shares of Series A convertible stock would automatically be converted into shares of ordinary stock based upon the conversion price described above. In the event of liquidation, the holders of the Series A Preferred stock were entitled to a ratable liquidating distribution of up to ¥5.13 per share and any dividends declared but unpaid.

On June 16, 2005, all 4,016,610 shares of Series A preferred stock were converted into 578,125 shares of ordinary stock. The preferred shares were consolidated into ordinary shares on June 16, 2005.

**Ordinary Shares** During October 2006 the Company closed its initial public offering of 1,133,500 ordinary shares at ¥47.27 per share under the terms of the offering and realized gross proceeds of ¥53,581,679 before cash offering costs of ¥8,738,655. In addition, the Company issued the placement agents warrants to purchase 113,350 shares of common stock at ¥56.19 per share for a period of five years. The Company accounted for the warrants as an additional offering cost.

**Subscriptions Receivable** Reflected as a reduction to stockholders' deficit at December 31, 2003 and 2004 was ¥575,722 due from stockholders related to 921,875 shares of outstanding ordinary stock that were issued to the founding shareholders in November 2000 and April 2001. The shareholders made cash payments during September 2005 of ¥575,722 which paid the subscriptions receivable in full.

**Statutory Reserves** According to the Articles of Association, the Company is required to transfer a certain portion of its net profits, as determined under PRC accounting regulations, from accumulated deficit to both the surplus reserve fund and the public welfare fund. In 2004 and 2005, the Company transferred to these funds ¥678,779 and ¥820,539, respectively. The amount comprising the surplus reserve fund was ¥2,056,013 at both December 31, 2005 and 2006. The amount comprising the public welfare fund was ¥1,028,007 (\$131,726) at both December 31, 2005 and 2006.

**Stock Options** During 2002, the Company granted stock options to purchase 62,499 shares of ordinary shares to employees and directors. At December 31, 2005, and 2006, the Company had 62,499 options outstanding. These options vested over 2 years and have an exercise price of \$4.71 (¥36.76) per share. The options are exercisable through 2012.

On August 20, 2005, the Company adopted the e-Future Information Technology, Inc. Stock Option Plan (the Plan), which authorized for grant stock options equivalent to five percent of the total number of ordinary shares outstanding immediately following the initial public offering of the Company.

The Plan allows the Company to grant options as a means of providing equity incentives to key personnel, giving them a proprietary interest in the Company and its success and progress. The options pursuant to this plan shall vest over a five year period at a rate of 20% per year and shall expire after 10 years. The exercise price of each option shall be the fair market value of an ordinary share on the date of grant. The plan will expire on December 31, 2014. As of December 31, 2006 no options had been granted under the Plan.

**NOTE 7. RELATED-PARTY TRANSACTIONS**

**Amounts Due From a Related Company** At December 31, 2003, e-Future (Beijing) Tornado Information Technology, Inc. ( e-Future Beijing ) had advanced ¥4,018,687 to Hainan Future Company ( Hainan ), a company owned by the principal shareholders of the Company. The balance arose as the result of payments to suppliers on behalf of Hainan, cash advances to Hainan, Hainan's collection of cash receipts from E-Future's customers, and the sale of an investment in a company to Hainan, less the collection of cash receipts from Hainan's customers, less Hainan's payments to suppliers on behalf of E-Future, less the cost of software purchased from Hainan and less the purchase of two real estate parcels from Hainan. Hainan had no operations or employees from December 31, 2001. As a result, E-Future made payments to, provided services to and collected cash receipts from Hainan's customers during the years ended December 31, 2004 and 2005. Those transactions along with the resulting balances receivable from Hainan were as follows:





**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

	For the Years Ended	
	December 31,	
	2004	2005
Beginning balance	¥ 4,018,687	¥ 2,673,294
Payments of (refunds from) Hainan suppliers	155,307	(146,699)
Offset receivable from Hainan against payable to Hainan		(2,526,595)
Collection of cash receipts from Hainan's customers	(1,500,700)	
<b>Ending Balance</b>	<b>¥ 2,673,294</b>	<b>¥</b>

**Amounts Due to Related Parties** Represented the amounts due to Mr. Li and to Hainan Future Company, the former shareholders of e-Future Beijing, of ¥1,000,000 (\$123,913) and ¥4,000,000 (\$495,651), respectively, for the acquisition of the Company's equity interest in e-Future Beijing. The balances due were unsecured, had no fixed terms of repayment and were considered due on demand. As amounts due did not require the payment of interest, the Company calculated interest expense at its incremental borrowing rate and has recorded the interest expense and additional paid-in capital. For the years ended December 31, 2004 and 2005, the Company calculated interest expense at 6.9%.

On August 12, 2005, the Company paid Hainan ¥575,722 towards the amount due to Hainan. On September 25, 2005, Hainan acquired Mr. Li's ¥1,000,000 receivable from the Company. On November 18, 2005, the Company and Hainan entered into an agreement whereby ¥1,897,683 of the payable to Hainan was forgiven by Hainan and the remaining balance payable to Hainan of ¥2,526,595 was offset against the receivable from Hainan discussed above of that same amount. The forgiveness of debt from this related party was recognized as a contribution to capital.

**NOTE 8. INCOME TAXES**

To date, the Company has not been subject to any income taxes in the United States or the Cayman Islands. Enterprises with foreign investment and foreign enterprises doing business in the People's Republic of China (PRC) are generally subject to federal (state) enterprise income tax at a rate of 30% and a local income tax at a rate of 3%; however, due to the Company's location in a State Standard High Technology Development Zone, the Company was granted a certification of High Technology Enterprise and will be taxed at a 15% federal rate for taxable income generated after 2001 and will be exempt from local tax. In addition, e-future Beijing is located in the Beijing Zhongguanchun High Technology Development Zone. Therefore, it was exempt from 50% of the federal tax during 2003 through 2005. Since e-future Beijing has foreign invested capital, it is allowed a deduction for operating loss carry forwards for up to five years.

The Company had minimal operations in jurisdictions other than the PRC. Income (loss) before income taxes consists of:

	Chinese Yuan (Renminbi)			U.S. Dollars
				For the
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006
				(Unaudited)
PRC	¥ 4,906,218	¥ 5,707,988	¥ 8,396,431	\$ 1,075,899
Cayman Islands	(381,028)	(237,725)	(291,705)	(37,378)
Net income	¥ 4,525,190	¥ 5,470,263	¥ 8,104,726	\$ 1,038,521



**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

The provision for income taxes was as follows:

	Chinese Yuan (Renminbi)			U.S. Dollars
				For the Year
				Ended
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006
				(Unaudited)
Current tax before benefit of operating loss carry forwards	¥ 705,869	¥ 1,020,641	¥ 1,332,590	\$ 170,755
Benefit of operating loss carry forwards	(705,869)	(1,020,641)	(1,332,590)	(170,755)
Total provision for income taxes	¥	¥	¥	\$

The reconciliation of income tax (benefit) computed by applying the statutory income tax rate to pre-tax income (loss) to the actual tax (benefit) is as follows:

	Chinese Yuan (Renminbi)			U.S. Dollars
				For the
				Year Ended
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006
				(Unaudited)
Income tax computed at federal statutory tax rate (30%)	¥ 1,357,557	¥ 1,641,079	¥ 2,431,418	\$ 311,556
Non-deductible expenses	114,308	71,318	56,720	7,268
Effect of lower actual tax rates	(735,932)	(856,198)	(1,244,069)	(159,412)
Valuation allowance	(735,933)	(856,199)	(1,244,069)	(159,412)
Total income tax	¥	¥	¥	\$

The components of the deferred income tax asset were as follows:

	Chinese Yuan (Renminbi)		U.S. Dollars
	December 31,		December 31,
	2005	2006	2006
			(Unaudited)
Net operating loss carry forwards	¥ 3,099,458	¥ 1,038,193	\$ 133,032

Edgar Filing: eFuture Information Technology Inc. - Form 20-F

Bad debt allowance and write offs	342,672	515,056	65,998
Deferred revenue	83,863		
Valuation allowance	(3,525,993)	(1,553,249)	(199,030)
<b>Net Deferred Tax Asset</b>	¥	¥	\$

At December 31, 2006, the Company had operating loss carry forwards that will expire, if unused, as follows:

<b>Expire December 31:</b>	
2007	¥ 6,230,690
2008	690,598
	¥ 6,921,288

**NOTE 9. NOTES PAYABLE AND CONTINGENCIES**

**Short-Term Loan** In February 2005, the Company entered into a short-term loan for ¥2,800,000 which required a guarantor, was due in February 2006 and bore interest at 5.58 percent. The loan was paid in full during January 2006. The Company loaned the unrelated guarantor ¥800,000 under the same terms. The guarantor also paid this loan in full during January 2006.

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)**

In March 2005, the Company entered into a short-term loan for ¥350,000 which was due in May 2005 and bore interest at 0.72 percent. The loan was paid in May 2005.

**Operating Lease Agreements** The Company leases offices in Beijing and Shanghai. The amounts of commitments for non-cancelable operating leases in effect at December 31, 2006, were as follows:

	Yuan	U.S. Dollars (Unaudited)
2007	¥ 848,760	\$ 108,758
2008	152,790	19,578
<b>Total</b>	<b>¥ 1,001,550</b>	<b>\$ 128,336</b>

The Company incurred rental expense, of ¥1,848,113, ¥2,039,835 and ¥1,625,148 (\$208,243) during the years ended December 31, 2004, 2005 and 2006, respectively.

**Software Infringement Indemnity** Standard software license agreements contain an infringement indemnity clause under which the company agrees to indemnify and hold harmless customers and business partners against liability and damages arising from claims of various copyright or other intellectual property infringements by their software products. The terms constitute a form of guarantee that is subject to the provisions of Financial Accounting Standards Board Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of Others*. The estimated liability under the guarantee is zero.

**Litigation** In August 2002, the Company was sued for the termination of contracts between the Company and another party. The other party sued for costs and losses in the amount of ¥665,500 (\$82,464). The case is currently in the procedure of first instance or first trial.

In the administration of adjudication of Civil litigations in the PRC, the people's courts adopt the system whereby a case shall be finally decided after at most two trials, which are called first instance and second instance respectively. This means: (a) Judgments or orders of the first instance shall come from a local people's court, and a party may bring an appeal only once to the people's court at the next higher level; (b) Judgments or orders of the first instance of the local people's courts at various levels become legally effective if, within the prescribed period for appeal, no party makes an appeal; (c) judgments and orders of the court of the second instance, if any, shall be seen as final decisions of the case and cannot be appealed, however, any judgments and orders rendered by the Supreme People's Court as the court of the first instance shall become immediately legally effective. This case is not with the Supreme People's Court.

The Company has accrued ¥665,500 in accrued expenses. There might be additional expenses related to this claim but it is impossible for management to forecast all of the possibilities related to this case. The additional expenses that could be incurred include: additional accrued interest expense, execution (of the legally effective legal documents) expenses of the case and accepting fee of People's Court(s).

Management has considered the likely out come of this case based on past experience with similar cases and determined that the total amount of estimated costs should be accrued and expensed as a result of the claim. There could be additional costs related to the case which can not be estimated at this time.

**Concentration of suppliers** During the year ended December 31, 2006, the Company's purchases from three suppliers accounted for approximately 40%, 15% and 10% of product purchases, respectively. No concentration of suppliers existed during the years ended December 31, 2004 or 2005.



**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements**

(Information in United States Dollars, as of December 31, 2006, is Unaudited.)

**NOTE 10. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION****Condensed balance sheets**

	Chinese Yuan (Renminbi)		U.S. Dollars
	2005	2006	December 31, 2006 (Unaudited)
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	¥ 7,393	¥ 33,399,189	\$ 4,279,698
<b>Total current assets</b>	7,393	33,399,189	4,279,698
<b>Non-current assets</b>			
Investments in and amounts due from subsidiary	10,529,865	30,948,777	3,965,706
Prepaid expense		325,171	41,666
Deferred offering costs	2,009,360		
<b>Total non-current assets</b>	12,539,225	31,273,948	4,007,372
<b>Total assets</b>	¥ 12,546,618	¥ 64,673,137	\$ 8,287,070
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>Current liabilities</b>			
Accrued expenses	¥ 454,300	¥ 124,148	\$ 15,907
<b>Total current liabilities</b>	454,300	124,148	15,907
<b>Shareholders equity</b>			
Ordinary shares, \$0.0756 U.S. Dollars (¥0.6257) par value; 6,613,756 shares authorized; 1,500,000 and 2,633,500 shares outstanding, respectively	938,550	1,647,781	211,143
Additional paid-in capital	33,592,443	77,726,236	9,959,667
Statutory reserves	3,084,020	3,084,020	395,179
Accumulated other comprehensive loss, foreign currency translation		(491,079)	(62,926)
Accumulated deficit	(25,522,695)	(17,417,969)	(2,231,900)
<b>Total shareholders equity</b>	12,092,318	64,548,989	8,271,163
<b>Total liabilities and shareholders equity</b>	¥ 12,546,618	¥ 64,673,137	\$ 8,287,070

**Condensed statements of operations**



Edgar Filing: eFuture Information Technology Inc. - Form 20-F

	Chinese Yuan (Renminbi)			U.S. Dollars
				For the
				Year Ended
	For the Years Ended December 31,			December 31,
	2004	2005	2006	2006
				(Unaudited)
General and administrative expense	¥ (34,932)	¥ (983)	¥ (401,123)	\$ (51,400)
<b>Operating loss</b>	(34,932)	(983)	(401,123)	(51,400)
Equity in profit of subsidiary	4,906,218	5,707,988	8,396,431	1,075,900
Interest income			109,418	14,021
Interest expense	(346,096)	(236,742)		
<b>Net income</b>	¥ 4,525,190	¥ 5,470,263	¥ 8,104,726	\$ 1,038,521

F-18

**Table of Contents****E-FUTURE INFORMATION TECHNOLOGY INC. AND SUBSIDIARY****Notes to Consolidated Financial Statements****(Information in United States Dollars, as of December 31, 2006, is Unaudited.)****Condensed cash flow statements**

	Chinese Yuan (Renminbi)			U.S. Dollars
	For the Years Ended December 31,			For the
	2004	2005	2006	Year Ended
				December 31,
				2006
				(Unaudited)
<b>Cash flows from operating activities:</b>				
Net income (loss)	¥ 4,525,190	¥ 5,470,263	¥ 8,104,726	\$ 1,038,521
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Equity in profit of subsidiary	(4,906,218)	(5,707,988)	(8,396,431)	(1,075,900)
Interest on notes payable contributed by shareholders	346,096	236,742		
Expenses paid by subsidiary on behalf of parent	34,928	(446,035)	(11,433,110)	(1,465,013)
Changes in assets and liabilities				
Prepaid expenses			(330,717)	(42,377)
Accrued expenses		454,300	(889,691)	(114,003)
Net cash provided by (used in) operating activities	(4)	7,282	(12,945,223)	(1,658,772)
<b>Cash flows from investing activities:</b>				
Payment on amount due to related company		(575,723)		
Net cash used in investing activities		(575,723)		
<b>Cash flows from financing activities:</b>				
Issuance of shares for cash			47,128,495	6,038,940
Proceeds from subscription receivable		575,722		
Net cash used in investing activities		575,722	47,128,495	6,038,940
Effect of exchange rate changes on cash			(791,476)	(101,418)
Net (decrease) increase in cash	(4)	7,281	33,391,796	4,278,750
Cash and cash equivalents at beginning of year	116	112	7,393	948
Cash and cash equivalents at end of year	¥ 112	¥ 7,393	¥ 33,399,189	\$ 4,279,698

**Basis of presentation**

## Edgar Filing: eFuture Information Technology Inc. - Form 20-F

For the purposes of the presentation of e-Future Information Technology Inc. s (the Parent) condensed financial information, the Parent has recorded its investment in e-Future Beijing (the Subsidiary) under the equity method of accounting as prescribed in APB opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

The profit from the subsidiary is reflected on the condensed statements of operations as equity in profit of subsidiary.

Under PRC laws and regulations, there are restrictions on the subsidiary transferring certain of its net assets to the Parent either in the form of dividends, loans or advances. The amounts restricted include statutory reserves of e-Future Beijing totaling ¥3,084,020 as of December 31, 2006.

**Table of Contents**

**EXHIBIT INDEX**

- 1.1 Amended and Restated Memorandum and Articles of Association of the Registrant (1)
- 1.2 Amended and Restated Memorandum of Association of the Registrant (1)
- 1.3 Written resolutions of the Registrant amending the terms of its Memorandum of Association dated June 16, 2005 (1)
- 2.1 Specimen Certificate for Ordinary Shares (1)
- 4.1 Labor Contract by and between e-Future Beijing and Adam Yan (1)
- 4.2 Labor Contract by and between e-Future Beijing and Qicheng Yang (1)
- 4.3 Labor Contract by and between e-Future Beijing and Hongjun Zou (1)
- 4.4 Labor Contract by and between e-Future Beijing and Johnson Li (1)
- 4.5 Labor Contract by and between the e-Future Beijing and Zhou Kefu (1)
- 4.6 Summary of translation of Share Transfer Agreement of Hainan Future Computer Co., Ltd. by and between Qicheng Yang and Ling Zhang (1)
- 4.7 Summary of translation of Share Transfer Agreement of Hainan Future Computer Co., Ltd. by and between Adam Yan and Xuejun Zhang (1)
- 4.8 Summary of translation of Share Transfer Agreement of e-Future (Beijing) Tornado Information Technology, Inc. by and between Dafu Zou and Johnson Li (1)
- 4.9 Agreement to terminate Agreement and forgive debt (1)
- 4.10 Memorandum of Understanding by and between IBM China Company Limited and the Registrant (1)
- 4.11 ISV Advantage Agreement by and between IBM Engineering Technology (Shanghai) Co., Ltd. and the Registrant (1)
- 4.12 Termination and Debt Forgiveness Agreement by and among e-Future (Beijing) Tornado Information Technology Inc., e-Future Information Technology Inc. and Hainan Future Computer Co., Ltd. (1)
- 4.13 Summary of translation of Guarantee Agreement numbered 2005 Wangbaozhi No. 002 (1)
- 4.14 Summary of translation of Agreement, dated February 20, 2000, by and between e-Future Beijing and Hainan Future Computer Co., Ltd. transferring ONE POS-ERP (1)
- 4.15 Summary of translation of Agreement by and between e-Future (Beijing) Tornado Information Technology, Inc. and Limen (China) Group (2)
- 8.1 Subsidiaries of the Registrant (1)
- 11.1 Code of Business Conduct and Ethics (3)
- 12.1 Section 302 Certification of Adam Yan (3)
- 12.2 Section 302 Certification of Yu Ping (3)

**Table of Contents**

- 13.1 Section 906 Certification of Adam Yan (3)  
13.2 Section 906 Certification of Yu Ping (3)  
99.1 Schedule II Valuation and Qualifying Accounts (3)

- 
- (1) Incorporated by reference to the Registrant's Registration Statement on Form F-1 (File No. 333-126007).  
(2) Incorporated by reference to the Registrant's Annual Report on Form 20-F (File No. 001-33113) filed with the SEC on June 30, 2006.  
(3) Filed herewith.