ChinaNet Online Holdings, Inc.
Form 10-Q
May 21, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from ____ to _____

Commission File Number: 001-34647

ChinaNet Online Holdings, Inc.

(Exact name of registrant as specified in its charter)

Nevada	**20-4672080**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

No. 3 Min Zhuang Road, Building 6,

Yu Quan Hui Gu Tuspark, Haidian District, Beijing, PRC 100195

(Address of principal executive offices) (Zip Code)

+86-10-6084-6616

(Registrant’s telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of May 21, 2018, the registrant had 16,132,543 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Interim Financial Statements

CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	March 31, 2018 (US $) (Unaudited)	December 31, 2017 (US $)
Assets		
Current assets:		
Cash and cash equivalents	$ 7,503	$ 2,952
Accounts receivable, net	3,567	7,215
Other receivables, net	2,094	2,646
Prepayment and deposit to suppliers	5,424	4,073
Due from related parties, net	-	14
Total current assets	18,588	16,900
Long-term investments	477	918
Property and equipment, net	264	299
Intangible assets, net	3,786	3,808
Prepayment for blockchain applications development	1,200	-
Prepayment for acquisition of noncontrolling interest	1,193	-
Goodwill	5,483	5,277
Deferred tax assets, net	1,415	1,358
Total Assets	$ 32,406	$ 28,560
Liabilities and Equity		
Current liabilities:		
Short-term bank loan *	$ 795	$ 765
Accounts payable *	832	2,851
Advances from customers *	2,010	3,559
Accrued payroll and other accruals *	421	559
Due to investors related to terminated security purchase agreements	477	938
Payable for purchasing of software technology *	-	436
Taxes payable *	3,199	3,168
Other payables *	302	687
Total current liabilities	8,036	12,963

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CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands, except for number of shares and per share data)

	March 31, 2018 (US $) (Unaudited)	December 31, 2017 (US $)
Long-term liabilities:		
Long-term borrowing from a director	139	134
Warrant liabilities	801	-
Total Liabilities	8,976	13,097
Commitments and contingencies		
Equity:		
ChinaNet Online Holdings, Inc.'s stockholders' equity		
Common stock (US$0.001 par value; authorized 50,000,000 shares; issued and outstanding 16,132,543 shares and 13,982,542 shares at March 31, 2018 and December 31, 2017, respectively)	16	14
Additional paid-in capital	39,615	31,554
Statutory reserves	2,607	2,607
Accumulated deficit	(21,052)	(20,487)
Accumulated other comprehensive income	2,064	1,598
Total ChinaNet Online Holdings, Inc.'s stockholders' equity	23,250	15,286
Noncontrolling interests	180	177
Total equity	23,430	15,463
Total Liabilities and Equity	$ 32,406	$ 28,560

*All of the VIEs' assets can be used to settle obligations of their primary beneficiary. Liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company's general assets (Note 2).

See notes to condensed consolidated financial statements

CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands)

	Three Months Ended March 31, 2018 (US $) (Unaudited)	Three Months Ended March 31, 2017 (US $) (Unaudited)
Revenues		
From unrelated parties	$8,260	$ 7,245
From related parties	-	19
Total revenues	8,260	7,264
Cost of revenues	7,659	5,992
Gross profit	601	1,272
Operating expenses		
Sales and marketing expenses	564	834
General and administrative expenses	1,389	1,092
Research and development expenses	193	395
Impairment on long-term investments	471	-
Total operating expenses	2,617	2,321
Loss from operations	(2,016)	(1,049)
Other income/(expenses)		
Interest expense, net	(10)	(17)
Other expenses	(22)	(3)
Change in fair value of warrant liabilities	1,474	-
Total other income/(expense)	1,442	(20)
Loss before income tax benefit and noncontrolling interests	(574)	(1,069)
Income tax benefit	4	-
Net loss	(570)	(1,069)
Net loss/(income) attributable to noncontrolling interests	5	(18)
Net loss attributable to ChinaNet Online Holdings, Inc.	$(565)	$ (1,087)

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CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (CONTINUED)

(In thousands, except for number of shares and per share data)

	Three Months Ended March 31,	
	2018 (US $) (Unaudited)	2017 (US $) (Unaudited)
Net loss	$(570)	$(1,069)
Foreign currency translation gain	474	106
Comprehensive loss	(96)	(963)
Comprehensive (income)/loss attributable to noncontrolling interests	(3)	19
Comprehensive loss attributable to ChinaNet Online Holdings, Inc.	$(99)	$(944)
Loss per share		
Loss per common share		
Basic and diluted	$(0.04)	$(0.09)
Weighted average number of common shares outstanding:		
Basic and diluted	15,484,082	11,982,504

See notes to condensed consolidated financial statements

CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended March 31,	
	2018	2017
	(US $)	(US $)
	(Unaudited)	(Unaudited)
Cash flows from operating activities		
Net loss	$ (570)	$ (1,069)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	216	354
Share-based compensation expenses	75	211
Provision for/(reverse of) allowances for doubtful accounts	481	(29)
Impairment on long-term investments	471	-
Deferred taxes	(4)	-
Change in fair value of warrant liabilities	(1,474)	-
Changes in operating assets and liabilities		
Accounts receivable	3,413	(903)
Other receivables	(47)	20
Prepayment and deposit to suppliers	(1,178)	(3,192)
Due from related parties	3	(870)
Accounts payable	(2,105)	295
Advances from customers	(1,668)	3,185
Accrued payroll and other accruals	(147)	(90)
Other payables	(553)	44
Taxes payable	(92)	37
Net cash used in operating activities	(3,179)	(2,007)
Cash flows from investing activities		
Payment for purchase of office equipment	(1)	-
Short-term loan to an unrelated party	(2,000)	-
Repayment of short-term loan from an unrelated party	2,672	-
Prepayment for acquisition of noncontrolling interest	(1,179)	-
Prepayment for blockchain applications development	(1,200)	-
Payment for purchasing of software technology	(448)	-
Net cash used in investing activities	(2,156)	-

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CHINANET ONLINE HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(In thousands)

	Three Months Ended March 31,	
	2018	2017
	(US $)	(US $)
	(Unaudited)	(Unaudited)
Cash flows from financing activities		
Proceeds from issuance of common stock and warrant (net of cash issuance cost of US$809)	10,263	-
Repayment to investors related to terminated security purchase agreements	(493)	-
Net cash provided by financing activities	9,770	-
Effect of exchange rate fluctuation on cash and cash equivalents	116	19
Net increase/(decrease) in cash and cash equivalents	4,551	(1,988)
Cash and cash equivalents at beginning of the period	2,952	3,035
Cash and cash equivalents at end of the period	$7,503	$ 1,047
Supplemental disclosure of cash flow information		
Income taxes paid	$-	$ -
Interest expense paid	$127	$ 9

See notes to condensed consolidated financial statements

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CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Organization and nature of operations

ChinaNet Online Holdings, Inc. (the "Company") was incorporated in the State of Texas in April 2006 and re-domiciled to become a Nevada corporation in October 2006. On June 26, 2009, the Company consummated a share exchange transaction with China Net Online Media Group Limited (the "Share Exchange"), a company organized under the laws of British Virgin Islands ("China Net BVI"). As a result of the Share Exchange, China Net BVI became a wholly owned subsidiary of the Company and the Company is now a holding company, which, through certain contractual arrangements with operating companies in the People's Republic of China (the "PRC"), is engaged in providing advertising, precision marketing, online to offline (O2O) sales channel expansion and the related data services to small and medium enterprises ("SMEs") and entrepreneurial management and networking services for entrepreneurs in the PRC. In January 2018, the Company announced its expansion into the blockchain industry and the related technology. The Company aims to develop credible, traceable and highly secured blockchain applications for the large demand from the SMEs and gradually shift from an information services provider to a transaction services provider for business opportunities in the near future.

As of March 31, 2018, the Company operated its business primarily in China through its PRC subsidiaries and operating entities, or Variable Interest Entities ("VIEs") as discussed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, previously filed with the Securities and Exchange Commission (the "2017 Form 10-K").

On January 17, 2018, the Company consummated a registered direct offering of 2,150,001 shares of the Company's common stock to certain institutional investors at a purchase price of $5.15 per share ("the Financing"). As part of the transaction, the Company also issued to the investors warrants for the purchase of up to 645,000 shares of the Company's common stock at an exercise price of $6.60 per share. The warrants have a term of 30 months from the date of issuance. The Company received gross proceeds of approximately $11.1 million (See Note 20).

2. Variable interest entities

Summarized below is the information related to the VIEs' assets and liabilities reported in the Company's condensed consolidated balance sheets as of March 31, 2018 and December 31, 2017, respectively:

	March 31, 2018	December 31, 2017
	US$('000)	US$('000)

	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 2,008	$ 2,904
Accounts receivable, net	3,567	7,215
Other receivables, net	56	2,629
Prepayment and deposit to suppliers	4,761	4,009
Due from related parties, net	-	14
Total current assets	10,392	16,771
Property and equipment, net	155	177
Intangible assets, net	2,076	2,112
Prepayment for acquisition of noncontrolling interest	1,193	-
Goodwill	5,483	5,277
Deferred tax assets, net	1,017	975
Total Assets	$ 20,316	$ 25,312
Liabilities		
Current liabilities:		
Short-term bank loan	$ 795	$ 765
Accounts payable	810	2,848
Advances from customers	2,010	3,559
Accrued payroll and other accruals	177	159
Due to Control Group	11	11
Payable for purchasing of software technology	-	436
Taxes payable	2,724	2,711
Other payables	139	155
Total current liabilities	6,666	10,644
Total Liabilities	$ 6,666	$ 10,644

CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

All of the VIEs' assets can be used to settle obligations of their primary beneficiary. Liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company’s general assets. See additional discussion related to restrictions on foreign currency exchange in the PRC in Note 21 and Note 23.

Summarized below is the information related to the financial performance of the VIEs reported in the Company’s condensed consolidated statements of operations and comprehensive loss for the three months ended March 31, 2018 and 2017, respectively:

	Three Months Ended March 31,	
	2018	2017
	US$(’000)	US$(’000)
	(Unaudited)	(Unaudited)
Revenues	$ 8,253	$ 7,264
Cost of revenues	(7,659)	(5,992)
Total operating expenses	(1,262)	(1,633)
Net loss before allocation to noncontrolling interests	(678)	(353)

3. Summary of significant accounting policies

a) Basis of presentation

The unaudited condensed consolidated interim financial statements are prepared and presented in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

The unaudited condensed consolidated interim financial information as of March 31, 2018 and for the three months ended March 31, 2018 and 2017 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures, which are normally included in complete consolidated financial statements prepared in accordance with U.S. GAAP, have been omitted pursuant to those rules and regulations. The unaudited condensed consolidated interim financial information should be read in conjunction with the financial statements and the notes thereto, included in the 2017 Form 10-K.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company's condensed consolidated financial position as of March 31, 2018, its condensed consolidated results of operations for the three months ended March 31, 2018 and 2017, and its condensed consolidated cash flows for the three months ended March 31, 2018 and 2017, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

b) Principles of consolidation

The condensed consolidated interim financial statements include the financial statements of all the subsidiaries and VIEs of the Company. All accounts and balances between the Company and its subsidiaries and VIEs have been eliminated upon consolidation.

c) Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the related disclosure of contingent assets and liabilities at the date of these condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company continually evaluates these estimates and assumptions based on the most recently available information, historical experience and various other assumptions that the Company believes to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates.

CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

d) Foreign currency translation

The exchange rates used to translate amounts in RMB into US$ for the purposes of preparing the condensed consolidated financial statements are as follows:

	March 31, 2018	December 31, 2017
Balance sheet items, except for equity accounts	6.2881	6.5342

	Three Months Ended March 31,	
	2018	2017
Items in the statements of operations and comprehensive loss, and statements of cash flows	6.3632	6.8861

No representation is made that the RMB amounts could have been, or could be converted into US$ at the above rates.

e) Advertising costs

Advertising costs for the Company's own brand building are not includable in cost of revenues, they are expensed when incurred and are included in "sales and marketing expenses" in the statements of operations and comprehensive loss. For the three months ended March 31, 2018 and 2017, advertising expenses for the Company's own brand building were approximately US$389,000 and US$510,000, respectively.

f) Research and development expenses

The Company accounts for the cost of developing and upgrading technologies and platforms and intellectual property that are used in its daily operations in research and development cost. Research and development costs are charged to expense when incurred. Expenses for research and development for the three months ended March 31, 2018 and 2017 were approximately US$193,000 and US$395,000, respectively.

g) Revenue recognition

On January 1, 2018, the Company adopted ASC Topic 606, “Revenue from Contracts with Customers”, applying the modified retrospective method. The adoption didn’t result in a material adjustment to the accumulated deficit as of January 1, 2018.

In accordance with ASC Topic 606, revenues are recognized when control of the promised goods or services is transferred to the Company’s customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. In determining when and how much revenue is recognized from contracts with customers, the Company performs the following five-step analysis: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; (5) recognize revenue when (or as) the entity satisfies a performance obligation.

The Company’s contracts with customers do not include multiple performance obligations, significant financing component, variable consideration, nor any clause concerning with returns, refunds or other similar obligations.

CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company does not believe that significant management judgements are involved in revenue recognition, but the amount and timing of the Company's revenues could be different for any period if management made different judgments or utilized different estimates. Generally, the Company recognizes revenue under ASC Topic 606 for each type of its performance obligation either over time (generally, the transfer of a service) or at a point in time (generally, the transfer of a good (information)) as follows:

Online advertising placement service/TV advertising service

For online advertising placement service contracts and TV advertising service contracts that are established based on a fixed price scheme with the related advertisement placements obligation, the Company provides advertisement placements in specified locations on the Company's advertising portals for agreed periods and/or place the advertisements onto the Company's purchased advertisement time during specific TV programs for agreed periods. Revenue is recognized ratably over the period the advertising is provided and, as such, the Company considers the services to have been delivered ("over time").

Sales of effective sales lead information

For advertising contracts related to purchase of effective sales lead information, revenue is recognized based on a fixed price per sales lead and the quantity of effective sales lead, when information is delivered and accepted by customers ("point in time").

Search engine marketing and data service

Revenue from search engine marketing and data services is recognized on a monthly basis based on the direct cost consumed through search engines for providing such services with a premium ("over time"). The Company recognizes the revenue on a gross basis, because the Company determines that it is a principle in the transaction who control the goods or services before they are transferred to the customers.

All of the Company's revenues are generated from the PRC. The following tables present the Company's revenues disaggregated by products and services and timing of revenue recognition:

	Three Months Ended March 31, 2018 US$('000) (Unaudited)	2017 US$('000) (Unaudited)
Internet advertising and data service		
--online advertising placement	1,597	1,902
--sales of effective sales lead information	122	390
Search engine marketing and data service	6,443	4,972
TV advertising service	91	-
Others	7	-
Total revenues	8,260	7,264

	Three Months Ended March 31, 2018 US$('000) (Unaudited)	2017 US$('000) (Unaudited)
Revenue recognized over time	8,138	6,874
Revenue recognized at a point in time	122	390
Total revenues	8,260	7,264

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CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Contract costs

For the three months ended March 31, 2018, the Company did not have any significant incremental costs of obtaining contracts with customers incurred and/or costs incurred in fulfilling contracts with customers within the scope of ASC Topic 606, that shall be recognized as an asset and amortized to expenses in a pattern that matches the timing of the revenue recognition of the related contract.

Contract balances

The Company evaluates overall economic conditions, its working capital status and customer specific credit and negotiates the payment terms of a contract with individual customer on a case by case basis in its normal course of business.

Advances received from customers related to unsatisfied performance obligations are recoded as contract liabilities (advance from customers), which will be realized as revenues upon the satisfaction of performance obligations through the transfer of related promised goods and services to customers.

For contracts without a full or any advance payments required, the Company bills the customers any unpaid contract price immediately upon satisfaction of the related performance obligations when revenue is recognized, and the Company normally receives payment from customers within 90 days after a bill is issued.

The Company does not have any contract assets (unbilled receivables) since revenue is recognized when control of the promised goods or services is transferred and the payment from customers is not contingent on a future event.

The Company’s contract liabilities consist of advance from customers related to unsatisfied performance obligations in relation to internet adverting service, search engine marketing service, as well as TV advertising service. The Company’s contract liabilities are reported in a net position on a customer-by-customer basis at the end of each reporting period. All contract liabilities are expected to be recognized as revenue within one year. The table below summarized the movement of the Company’s contract liabilities for the three months ended March 31, 2018:

	Advance from customers US$('000)
Balance as of January 1, 2018	3,559
Revenue recognized from beginning contract liability balance	(3,113)
Advances received from customers related to unsatisfied performance obligations	1,564
Balance as of March 31, 2018 (Unaudited)	2,010

For the three months ended March 31, 2018, there is no revenue recognized from performance obligations that were satisfied in prior periods.

Transaction price allocated to remaining performance obligation

The Company has elected to apply the practical expedient in paragraph ASC Topic 606-10-50-14 and did not disclose the information related to transaction price allocated to the performance obligations that are unsatisfied or partially unsatisfied as of March 31, 2018, because all performance obligations of the Company's contracts with customers have an original expected duration of one year or less.

CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

h) Impact of recently issued accounting pronouncements

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles-Goodwill and Others (Topic 350)-Simplify the Test for Goodwill Impairment". To simplify the subsequent measurement of goodwill, the amendments in this ASU eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. The amendments in this ASU also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. Therefore, the same impairment assessment applies to all reporting units. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. An entity should apply the amendments in this ASU on a prospective basis. An entity is required to disclose the nature of and reason for the change in accounting principle upon transition. That disclosure should be provided in the first annual period and in the interim period within the first annual period when the entity initially adopts the amendments in this ASU. A public business entity that is a U.S. Securities and Exchange Commission (SEC) filer should adopt the amendments in this ASU for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the impact on its consolidated financial position and results of operations upon adopting these amendments.

In July 2017, the FASB issued ASU No. 2017-11, "Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815)-I. Accounting for Certain Financial Instruments with Down Round Features; II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception". The amendments in part I of this ASU change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. Convertible instruments with embedded conversion options that have down round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this ASU recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect. For public business entities, the amendments in Part I of this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in Part II of this ASU do not require any transition guidance because those amendments do not have an accounting effect. The Company has adopted the amendments in this ASU from January 1, 2018, when determining whether certain financial instruments issued by the Company after January 1, 2018 should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The adoption of the amendments in this ASU did not have a material impact on the Company's consolidated financial position and results of operations.

In February 2018, the FASB issued ASU 2018-02: "Income Statement—Reporting Comprehensive Income (Topic 220)-Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (the "Act"). Consequently, the amendments eliminate the stranded tax effects resulting from the Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this ASU also require certain disclosures about stranded tax effects. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact on its consolidated financial position and results of operations upon adopting these amendments.

CHINANET ONLINE HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In March 2018, the FASB issued ASU 2018-05: "Income Taxes (Topic 740)-Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118". The amendments in this ASU add various SEC paragraphs pursuant to the issuance of SEC Staff Accounting Bulletin No. 118, which expresses the view of the staff regarding application of Topic 740, Income Taxes, in the reporting period that includes December 22, 2017 - the date on which the Tax Cuts and Jobs Act was signed into law. The Company is currently evaluating the impact on its consolidated financial position and results of operations upon adopting these amendments.

4. Accounts receivable, net

	March 31, 2018 US$('000) (Unaudited)	December 31, 2017 US$('000)
Accounts receivable	6,946	10,008
Allowance for doubtful accounts	(3,379)	(2,793)
Accounts receivable, net	3,567	7,215

All of the accounts receivable are non-interest bearing. Based on the assessment of the collectability of the accounts receivable as of March 31, 2018 and December 31, 2017, the Company provided approximately US$3,379,000 and US$2,793,000 allowance for doubtful accounts, respectively, which were primarily related to the accounts receivable of the Company's internet advertising and TV advertising business segment with an aging over six months. The Company evaluates its accounts receivable with an aging over six months and determines the allowance based on aging data, historical collection experience, customer specific facts and economic conditions. For the three months ended March 31, 2018, approximately US$0.47 million allowance for doubtful accounts was provided. For the three months ended March 31, 2017, no allowance for doubtful accounts was provided or reversed.

5. Other receivables, net

Other receivables as of March 31, 2018 primarily represented a US$2.0 million short-term loan to an unrelated third party in February 2018, which was unsecured and non-interest bearing and has been fully collected by mid May 2018.

Other receivables as of December 31, 2017 primarily represented the remaining balance of a short-term working capital loan to another unrelated third party, which was fully repaid during the three months ended March 31, 2018.

As of March 31, 2018 and December 31, 2017, other receivables also included approximately RMB5.8 million (US$0.9 million) overdue contractual deposits, which were related to advertising resources purchase contracts that had been completed with no further cooperation. Based on the assessment of the collectability of these overdue deposits as of March 31, 2018 and December 31, 2017, the Company had provided full allowance against these doubtful accounts.

For the three months ended March 31, 2018, no allowance for doubtful accounts was provided or reversed against the Company's other receivables. For the three months ended March 31, 2017, approximately US$0.03 million allowance for doubtful accounts related to other receivables was reversed due to subsequent collection.

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6. Prepayments and deposit to suppliers

	March 31, 2018	December 31, 2017
	US$('000) (Unaudited)	US$('000)
Deposits to TV and internet resources providers	2,107	1,870
Prepayments to TV and internet resources providers	3,141	1,331
Deposits to other service providers	-	765
Other deposits and prepayments	176	107
	5,424	4,073

The Company purchases internet resources from large internet search engines and technical services from suppliers to attract more internet traffic to its advertising portals and provide value-added services to its clients. The Company also purchases TV advertising time slots for the broadcasting of infomercials to promote brands, business information, products and services of its clients.

Deposits to TV and internet resources providers are paid as contractual deposits to the Company's resources and services suppliers. As of March 31, 2018 and December 31, 2017, deposit to TV and internet resources providers primarily consisted of the contractual deposits paid for purchasing internet resources from two of the Company's largest internet resources suppliers. The contractual deposits will be refunded to the Company upon expiration of the contracts.

According to the contracts signed between the Company and its suppliers, the Company is normally required to pay the contract amounts in advance. These prepayments will be transferred to cost of revenues when the related services are provided. As of March 31, 2018 and December 31, 2017, prepayments to TV and internet resources providers primarily consisted of advance payments paid for purchasing internet resources from two of the Company's largest internet resources suppliers.

As of December 31, 2017, deposits to other service provider represented the deposit for an advisory contract related to finding new investors for the Company, which expired on December 31, 2017. The service provider refunded the deposit to the Company in March 2018.

Other deposits and prepayments as of March 31, 2018 and December 31, 2017 represented deposits and prepayments to the Company's other service providers, which including but not limited to deposits for office lease contracts, prepayment for legal services, etc.

7. Due from related parties, net

	March 31, 2018 US$('000) (Unaudited)	December 31, 2017 US$('000)
Beijing Saimeiwei Food Equipment Technology Co., Ltd.	17	33
Chuangshi Meiwei (Beijing) International Investment Management Co., Ltd.	162	156
Guohua Shiji (Beijing) Communication Co., Ltd.	219	184
ChinaNet Chuang Tou (Shenzhen) Co., Ltd.	-	14
	398	387
Allowance for loan losses	(398)	(373)
Due from related parties, net	-	14

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Related parties of the Company represented the Company's direct or indirect unconsolidated investee companies. As of March 31, 2018 and December 31, 2017, due from related parties primarily included a total amount of short-term working capital loans of RMB2.38 million (approximately US$0.38 million) and RMB2.2 million (approximately US$0.34 million) to Chuangshi Meiwei and Guohua Shiji, respectively. The working capital loans are advanced to supplement the short-term operational needs of these related parties to assist certain of their business developing projects. The working capital loans are non-interest bearing and needs to be repaid to the Company within one year.

Based on the assessment of the collectability of these related party balances as of March 31, 2018 and December 31, 2017, the Company provided full allowance for doubtful accounts against its service fee receivables due from Saimeiwei, Chuangshi Meiwei and Guohua Shiji and its short-term working capital loans advanced to Guohua Shiji and Chuangshi Meiwei, as a result of the unfavorable facts related to the business status of these related parties, as discussed in Note 9 to the audited financial statements in the Company's 2017 Form 10-K.

For the three months ended March 31, 2018, the Company provided an additional of approximately US$0.01 million allowance for doubtful accounts against the Company's balances due from related parties. For the three months ended March 31, 2017, no allowance for doubtful accounts was provided or reversed against the Company's balances due from related parties.

8. Long-term investments

	March 31, 2018	December 31, 2017
	US$('000) (Unaudited)	US$('000)
Equity method investments:		
Investment in equity method investees	782	753
Advance to equity method investees	83	80
Impairment on equity method investments	(865)	(833)
Total equity method investments	-	-
Cost method investments:		
Investment in cost method investees	1,168	1,125
Impairment on cost method investments	(691)	(207)
Total cost method investments	477	918
Total long-term investments	477	918

Equity method investments

As of March 31, 2018 and December 31, 2017, the Company beneficially owned 23.18% and 25.5% equity interest in Shenzhen Mingshan and Zhao Shang Ke Hubei, respectively. The Company accounts for its investments in these companies under equity method of accounting. Based on the facts of the significant decline in level of business activities from 2015, insufficient amount of working capital and the lack of commitment from majority shareholders, these two investment affiliates had become dormant and the possibility of the business recovery is remote. As a result, the Company reduced the carrying value of these investments to zero as of December 31, 2015.

Cost method investments

As of March 31, 2018 and December 31, 2017, the Company beneficially owned a 19% equity interest in both ChinaNet Chuang Tou and Guohua Shiji, a 10% equity interest in both Chuangshi Meiwei and Beijing Saturday, and a 15% equity interest in ChinaNet Korea. The Company accounts for its investments in these companies under cost method of accounting. The Company adopted ASU 2016-01 and chose to measure its cost method investments which do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the Company.

As of December 31, 2017, the Company had reduced the carrying value of its investments in ChinaNet Korea, Chuangshi Meiwei, Guohua Shiji and Beijing Saturday to zero, due to the business activities of these companies had become dormant. The following table summarizes the movement of the Company’s investment in ChinaNet Chuang Tou for the three months ended March 31, 2018:

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	ChinaNet Chuang Tou US$('000)
Balance as of January 1, 2018	918
Impairment on cost method investments	(477)
Exchange translation adjustment	36
Balance as of March 31, 2018 (Unaudited)	477

As of the date hereof, the shareholders of ChinaNet Chuang Tou have decided to terminate the operation of this investee company within 2018. As a result, the Company recognized approximately US$0.47 million of other-than temporary impairment loss for the three months ended March 31, 2018, representing the amount expected not recoverable.

9. Property and equipment, net

	March 31, 2018 US$('000) (Unaudited)	December 31, 2017 US$('000)
Leasehold improvement	350	337
Vehicles	841	810
Office equipment	1,467	1,410
Electronic devices	1,209	1,164
Property and equipment, cost	3,867	3,721
Less: accumulated depreciation	(3,433)	(3,258)
Less: impairment loss on idle fixed assets	(170)	(164)
Property and equipment, net	264	299

Depreciation expenses for the three months ended March 31, 2018 and 2017 were approximately US$48,000 and US$51,000, respectively.

10. Intangible assets, net

	March 31, 2018 US$('000) (Unaudited)	December 31, 2017 US$('000)
Intangible assets not subject to amortization:		
Domain name	1,536	1,478
Intangible assets subject to amortization:		
Customer relationship	2,118	2,038
Non-compete agreements	1,166	1,122
Software technologies	326	314
Cloud compute software technology	1,476	1,420
Internet safety, information exchange security and data encryption software	2,067	1,990
Intelligent marketing data service platform	5,135	4,942
Cloud video management system	1,511	1,454
Other computer software	125	120
Intangible assets, cost	15,460	14,878
Less: accumulated amortization	(6,865)	(6,443)
Less: accumulated impairment losses	(4,809)	(4,627)
Intangible assets, net	3,786	3,808

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Amortization expenses for the three months ended March 31, 2018 and 2017 were approximately US$168,000 and US$303,000, respectively.

Based on the adjusted carrying value of the finite-lived intangible assets after the deduction of the impairment losses, which has a weighted average remaining useful life of 6.16 years as of March 31, 2018, and assuming no further subsequent impairment of the underlying intangible assets, the estimated future amortization expenses is approximately US$511,000 for the nine months ending December 31, 2018, approximately US$682,000 each year for the year ending December 31, 2019 and 2020, approximately US$671,000 for the year ending December 31, 2021 and approximately US$516,000 for the year ending December 31, 2022.

11. Prepayment for blockchain applications development

In February 2018, the Company entered into a contract with an unrelated third party to development certain blockchain technology based applications. Total amount of the contract was US$4.5 million. As of March 31, 2018, the Company had paid US$1.2 million in accordance with the payment schedule set forth in the contract.

12. Prepayment for acquisition of noncontrolling interest

In March 2018, the Company entered into an agreement with the noncontrolling interest holder of Chuang Fu Tian Xia to purchase the remaining 49% equity interest of Chuang Fu Tian Xia for a total consideration of RMB15 million (approximately US$2.4 million), of which 50% of the total consideration need to be paid in cash and the remaining 50% of the total consideration will be paid in form of the Company’s common stock. As of March 31, 2018, the Company had paid the cash part of the consideration, RMB7.5 million (approximately US$1.2 million), as a prepayment to the noncontrolling interest holder of Chuang Fu Tian Xia. The counterparty is required to complete the registration of the transfer of equity interest with the local branch of the State Administration of Industry and Commerce before the Company shall pay the remaining consideration in form of the Company’s common stock. This transaction is expected to be consummated in June 2018.

The Company will account for this transaction as an equity transaction with no gain or loss to be recognized in its consolidated statement of operations. The carrying amount of the noncontrolling interest will be adjusted to reflect the change in its ownership interest in the subsidiary, any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted will be recognized in equity attributable to the parent and reallocated the subsidiary’s accumulated comprehensive income, if any, among the parent and the noncontrolling interest through an adjustment to the parent’s equity.

13. Goodwill

	Amount US$('000)
Balance as of January 1, 2018	5,277
Exchange translation adjustment	206
Balance as of March 31, 2018 (unaudited)	5,483

14. Short-term bank loan

Short-term bank loan as of March 31, 2018 and December 31, 2017 represented short-term bank loans of RMB5.0 million (approximately US$0.8 million), in the aggregate, borrowed by one of the Company's VIEs from a major financial institution in China to supplement its short-term working capital needs, of which RMB3.0 million (approximately US$0.5 million) was borrowed on August 16, 2017 and will mature on August 15, 2018, the remaining RMB2.0 million (approximately US$0.3 million) was borrowed on October 23, 2017 and will mature on October 22, 2018. The interest rate of these short-term bank loans was 5.655% per annum as of March 31, 2018 and December 31, 2017, which is 30% over the benchmark rate of the People's Bank of China (the "PBOC").

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15. Accrued payroll and other accruals

	March 31, 2018 US$('000) (Unaudited)	December 31, 2017 US$('000)
Accrued payroll and staff welfare	229	203
Accrued operating expenses	192	356
	421	559

16. Due to investors related to terminated security purchase agreements

In May 2015, the Company entered into securities purchase agreements with Beijing Jinrun Fangzhou Science & Technology Co, Ltd. ("Jinrun Fangzhou") and Dongsys Innovation (Beijing) Technology Development Co., Ltd. ("Dongsys Innovation"), public companies listed on the National Equities Exchange and Quotations of the PRC (the "NEEQ"), respectively, pursuant to which these companies agreed to purchase a certain number of shares of common stock of the Company. As of December 31, 2017, the Company had received the 10% guarantee payment and 15% prepayment in an aggregate amount equal to US$819,000 from Jinrun Fangzhou, and the 10% guarantee payment in an amount equal to US$119,000 from Dongsys Innovation, respectively.

Due to certain restriction stipulated in the "Measures for Overseas Investment Management" issued by the Ministry of Commerce of the PRC (the "MOFCOM"), the Company and its investors experienced difficulties in obtaining approval for the transactions from the MOFCOM. As a result, on May 12, 2016, the Company terminated the security purchase agreements with these two investors, respectively. The Company did not make any repayment to these investors afterwards during 2016 and 2017. As agreed by the parties, beginning on January 1, 2017, the outstanding balances bear a 12% annualized interest rate and shall be refunded to the investors no later than December 31, 2017.

In February 2018, the Company fully repaid Dongsys Innovation the principal and interest through December 31, 2017 of approximately US$0.14 million. In March 2018, the Company repaid approximately RMB2.36 million (approximately US$0.37 million) of principal and RMB0.64 million (approximately US$0.10 million) of total interest of 2017 to Jinrun Fangzhou, respectively. The Company repaid another RMB1.0 million (approximately US$0.16 million) of principal to Jinrun Fangzhou in April 2018 and expects to settle the remaining principal balance of this liability before June 2018. Both Dongsys Innovation and Jinrun Fangzhou agreed not to charge additional interest in fiscal 2018.

17. Payable for purchasing of software technology

As of December 31, 2017, payable for purchasing of software technology presented the remaining outstanding payment balance of approximately RMB2.85 million (approximately US$0.4 million) for purchasing of software technology, which transaction consummated in the fourth fiscal quarter of 2016. The Company settled the balance with the counterparty in March 2018.

18. Taxation

1) Income tax

The entities within the Company file separate tax returns in the respective tax jurisdictions in which they operate.

i). a. On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act ("TCJA" or the "Act") (which is commonly referred to as "U.S. tax reform"). The Act significantly changes U.S. corporate income tax laws including but not limited to reducing the U.S. corporate income tax rate from 35% to 21% beginning in 2018, imposing a one-time transition tax on previously deferred foreign earnings and imposing a new tax on global intangible low-taxed income ("GILTI") effective for tax years of non-U.S. corporations beginning after December 31, 2017.

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i). b. The Company is incorporated in the state of Nevada. Under the current law of Nevada, the Company is not subject to state corporate income tax. Following the Share Exchange, the Company became a holding company and does not conduct any substantial operations of its own. No provision for federal corporate income tax has been made in the financial statements as the Company has no assessable profits for the three ended March 31, 2018, or any prior periods. Before enactment of the Act, the Company did not provide for U.S. taxes or foreign withholding taxes on undistributed earnings from its non-U.S. subsidiaries because such earnings are intended to be reinvested indefinitely. If undistributed earnings were distributed, foreign tax credits could become available under current law to reduce the resulting U.S. income tax liability. Please see additional discussion regarding the assessment of the income tax effect of the Act in item i). d. below.

i). c. On December 22, 2017, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of the Act. SAB 118 provides a measurement period that should not extend beyond one year from the Act enactment date for companies to complete the accounting under ASC 740 “Income Taxes”. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Act for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements.

i). d. As disclosed in Note 17 to the audited financial statements in the Company’s 2017 Form 10-K, based on a preliminary assessment, the Company concluded that no incremental income tax expense of the one-time transition tax on its previously deferred foreign earnings would be charged for the year ended December 31, 2017. Effective January 1, 2018, the Company is subject to the new GILTI tax rules. The GILTI provisions impose a tax on foreign income in excess of a deemed return on tangible assets of specified foreign corporations (“SFCs”), subject to the possible use of foreign tax credits and a deduction equal to 50 percent to offset the income tax liability, subject to some limitations. Under U.S. GAAP, the Company is allowed to make an accounting policy choice of either treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current period expense when incurred (the “period cost method”) or factoring such amounts into the Company’s measurement of its deferred taxes (the “deferred method”). According to the Company’s preliminary assessment based on its SFCs’ quarterly financial results, there was no taxable income related to GILTI for the three months ended March 31, 2018. However, due to complexity of the new tax rules under the Act, the Company did not have sufficient information currently to perform a comprehensive analysis on the historical operating results of each of its PRC subsidiaries to complete its assessment of the U.S. deferred tax assets that would have been utilized and or are expected to be utilizable under the Act and has not elected an accounting policy for the treatment of the taxes related to GILTI. In summary, the Company has not completed its accounting for the tax effects of enactment of the Act and is still analyzing certain aspects of the Act and is refining its calculations, which could potentially affect the measurement of the balances or potentially give rise to new deferred tax amounts. In addition, further regulatory guidance related to the Act is expected to be issued in 2018 which may result in changes to the Company’s estimates. Additional analysis of the law and the impact to the Company will be performed and any impact will be finalized no later than the fourth quarter of 2018.

ii). China Net BVI was incorporated in the British Virgin Islands ("BVI"). Under the current law of the BVI, China Net BVI is not subject to tax on income or capital gains. Additionally, upon payments of dividends by China Net BVI to its shareholders, no BVI withholding tax will be imposed.

iii). China Net HK was incorporated in Hong Kong and does not conduct any substantial operations of its own. No provision for Hong Kong profits tax has been made in the financial statements as China Net HK has no assessable profits for the three months ended March 31, 2018 or any prior periods. Additionally, upon payments of dividends by China Net HK to its shareholders, no Hong Kong withholding tax will be imposed.

iv). The Company's PRC operating subsidiaries and VIEs, being incorporated in the PRC, are governed by the income tax law of the PRC and is subject to PRC enterprise income tax ("EIT"). The EIT rate of PRC is 25%, which applies to both domestic and foreign invested enterprises.

- In November 2015, Business Opportunity Online was re-approved by the related PRC governmental authorities as a High and New Technology Enterprise, which enabled the entity, as approved by the local tax authorities of Beijing, the PRC, to continue enjoying the preferential income tax rate of 15% until November 2018. Therefore, for the three months ended March 31, 2018 and 2017, the applicable income tax rate of Business Opportunity Online was 15%.

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- The applicable income tax rate for other PRC operating entities of the Company was 25% for the three months ended March 31, 2018 and 2017.

- The current EIT law also imposed a 10% withholding income tax for dividends distributed by a foreign invested enterprise to its immediate holding company outside China. A lower withholding tax rate will be applied if there is a tax treaty arrangement between mainland China and the jurisdiction of the foreign holding company. Holding companies in Hong Kong, for example, will be subject to a 5% withholding tax rate.

For the three months ended March 31, 2018 and 2017, the preferential income tax treatment enjoyed by the Company's PRC VIE, Business Opportunity Online was based on the current applicable laws and regulations of the PRC and approved by the related government regulatory authorities and local tax authorities where Business Opportunity Online operates in. The preferential income tax treatment is subject to change in accordance with the PRC government economic development policies and regulations. The preferential income tax treatment is primarily determined by the regulation and policies of the PRC government in the context of the overall economic policy and strategy. As a result, the uncertainty of the preferential income tax treatment is subject to, but not limited to, the PRC government policy on supporting any specific industry's development under the outlook and strategy of overall macroeconomic development.

2) Turnover taxes and the relevant surcharges

Service revenues provided by the Company's PRC operating subsidiaries and VIEs were subject to Value Added Tax ("VAT"). VAT rate for provision of modern services (other than lease of corporeal movables) is 6% and for small scale taxpayer, 3%. Therefore, for the three months ended March 31, 2018 and 2017, the Company's service revenues are subject to VAT at a rate of 6%, after deducting the VAT paid for the services purchased from suppliers, or at a rate of 3% without any deduction of VAT paid for the services purchased from suppliers. The surcharges of the VAT in the aggregate is 12%-14% of the VAT, depending on which tax jurisdiction the Company's PRC operating subsidiaries and VIE operate in.

As of March 31, 2018 and December 31, 2017, taxes payable consists of:

	March 31, 2018	December 31, 2017
	US$('000) (Unaudited)	US$('000)
PRC turnover tax and surcharge payable	1,253	1,295
PRC enterprise income tax payable	1,946	1,873

Total taxes payable	3,199	3,168

A reconciliation of the income tax benefit determined at the U.S. federal corporate income tax rate to the Company's effective income tax benefit is as follows:

	Three Months Ended March 31,	
	2018	2017
	US$('000)	US$('000)
Pre-tax loss	(574)	(1,069)
U.S. federal rate	21 %	35 %
Income tax benefit computed at U.S. federal rate	121	374
Reconciling items:		
Rate differential for PRC earnings	74	(93)
Preferential tax treatment effect	(52)	(16)
Tax effect on non-taxable change in fair value of warrant liabilities	310	-
Valuation allowance on deferred tax assets	(412)	(272)
Others	(37)	7
Effective income tax benefit	4	-

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For the three months ended March 31, 2018 and 2017, the Company's income tax benefit consisted of:

	Three Months Ended March 31,	
	2018	2017
	US$('000)	US$('000)
	(Unaudited)	(Unaudited)
Current-PRC	-	-
Deferred-PRC	4	-
Income tax benefit	4	-

The Company's deferred tax assets at March 31, 2018 and December 31, 2017 were as follows:

	March 31, 2018	December 31, 2017
	US$('000)	US$('000)
	(Unaudited)	
Tax effect of net operating losses carried forward	8,146	7,657
Bad debts provision	1,035	879
Valuation allowance	(7,766)	(7,178)
Deferred tax assets, net	1,415	1,358

The U.S. holding company has incurred aggregate net operating losses ("NOLs") of approximately US$13,477,660 and US$13,275,660 at March 31, 2018 and December 31, 2017, respectively. The NOLs carryforwards as of December 31, 2017 gradually expire over time, the last of which expires in 2037. NOLs incurred after December 31, 2017 will no longer be available to carry back, but will carry forward indefinitely. Furthermore, the Act imposes an annual limit of 80% on the amount of taxable income that can be offset by NOLs arising in tax years ending after December 31, 2017. The Company maintains a full valuation allowance against its net U.S. deferred tax assets, since due to uncertainties surrounding future utilization, the Company estimates there will not be sufficient future earnings to utilize its U.S. deferred tax assets.

The NOLs carried forward incurred by the Company's PRC subsidiaries and VIEs were approximately US$25,180,000 and US$23,959,000 at March 31, 2018 and December 31, 2017, respectively. The losses carryforwards gradually expire over time, the last of which expires in 2023. The related deferred tax assets were calculated based on the respective net operating losses incurred by each of the PRC subsidiaries and VIEs and the respective corresponding enacted tax rate that will be in effect in the period in which the losses are expected to be utilized.

The Company recorded approximately US$7,766,000 and US$7,178,000 valuation allowance as of March 31, 2018 and December 31, 2017, respectively, because it is considered more likely than not that this portion of the deferred tax assets will not be realized through sufficient future earnings of the entities to which the operating losses related.

For the three months ended March 31, 2018 and 2017, the Company recorded approximately US$412,000 and US$272,000 deferred tax valuation allowance, respectively.

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19. Long-term borrowing from a director

Long-term borrowing from a director is a non-interest bearing loan from a director of the Company relating to the original paid-in capital contribution in the Company's wholly-owned subsidiary Rise King WFOE, which is not expected to be repaid within one year.

20. The Financing and warrant liabilities

On January 17, 2018 (the "Closing Date"), the Company consummated a registered direct offering of 2,150,001 shares of the Company's common stock to certain institutional investors at a purchase price of $5.15 per share ("the Financing"). As part of the transaction, the Company also issued to the investors warrants (the "Investor warrants") for the purchase of up to 645,000 shares of the Company's common stock at an exercise price of $6.60 per share. The Investors warrants have a term of 30 months from the date of issuance. The Company received gross proceeds of approximately $11.1 million.

The placement agent of the Financing received (i) a placement fee in the amount equal to 6% of the gross proceeds and (ii) warrants to purchase up to 129,000 shares of common stock at an exercise price of US$6.60 per share, with a three-year term ("Placement agent warrants" and together with the Investor warrants, the "Warrants"). The Placement agent warrants is not exercisable for a period of six months and one day after the Closing Date.

The Warrants have an initial exercise price of USS6.60 per share, which is subject to anti-dilution provisions that require adjustment of the number of shares of common stock that may be acquired upon exercise of the warrant, or to the exercise price of such shares, or both, to reflect stock dividends and splits, subsequent rights offerings, pro-rata distributions, and certain fundamental transactions. The Warrants also contain "full ratchet" price protection in the event of subsequent issuances below the applicable exercise price (the "Down round feature").

The Warrants may not be exercised if it would result in the holder beneficially owning more than 4.99% of the Company's outstanding common shares (the "Beneficial Ownership Limitation"). The holder of the Warrants, upon notice to the Company, may increase or decrease the Beneficial Ownership Limitation, provided that the Beneficial Ownership Limitation in no event exceeds 9.99% of the Company's outstanding common shares. Any increase in the Beneficial Ownership Limitation will not be effective until the 61st day after such notice is delivered to the Company.

Accounting for securities issued in the Financing

The Company determined that common stock issued in the Financing should be classified as permanent equity as there was no redemption provision at the option of the holders that is not within the control the Company on or after an agreed upon date.

The Company analyzed the Warrants issued in the Financing in accordance with ASC Topic 815 "Derivatives and Hedging". In accordance with ASC Topic 815, the Company determined that the Warrants should not be considered index to its own stock, as the strike price of the Warrants is dominated in a currency (U.S. dollar) other than the functional currency of the Company (Renminbi or Yuan). As a result, the Warrants does not meet the scope exception of ASC Topic 815, therefore, should be accounted for as derivative liabilities and measure at fair value with changes in fair value be recorded in earnings in each reporting period.

Fair value of the warrants

The Company used Binomial model to determine the fair value of the Warrants based on the assumptions summarized as below:

	Investors warrants		Placement agent warrants	
	As of January 17, 2018	As of March 31, 2018	As of January 17, 2018	As of March 31, 2018
Stock price	$3.98	$1.67	$3.98	$1.67
Years to maturity	2.5	2.3	3.0	2.8
Risk-free interest rate	2.22%	2.35%	2.39%	2.50%
Dividend yield	-	-	-	-
Expected volatility	158 %	164 %	147 %	152 %
Exercise Price	$6.60	$6.60	$6.60	$6.60
Fair value of the warrant	$2.93	$1.03	$2.99	$1.06

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Stock price is the closing bid price of the Company’s common stock at the respective valuation date. Years to maturity is the respective remaining contract life of the warrants. Yield-to-maturities in continuous compounding of the United States Government Bonds with the time-to-maturities same as the respective warrant are adopted as the risk-free rate. Annualized historical stock price volatility of the Company at the respective valuation date is deemed to be appropriate to serve as the expected volatility of the stock price of the Company. The dividend yield is calculated based on management’s estimate of dividends to be paid on the underlying stock. Exercise price of the Warrants is the contractual exercise price of the Warrants.

Allocation of gross proceeds from the Financing

The Company allocated the total proceeds from the Financing as summarized below:

	Initial measurement (USD’000)
Investor warrants	1,890
Common Stock (par value and additional paid in capital)	9,183
Total proceeds from the Financing	11,073

Investor warrants issued in the Financing was initially measurement at fair value. The residual amount, representing difference between the total proceeds and the fair value of the Investor warrants as of the Closing Date was assigned as the carrying value of the common stock issued in the Financing.

Offering costs

Offering costs in the amount of approximately US$1.2 million consisting of cash payment of approximately US$0.66 million placement fee, approximately US$0.15 million legal expense and fair value of placement agent warrants of approximately US$0.39 million, which were charged to additional paid-in-capital.

Warrant Liabilities

The Company accounted for the Warrants issuing in the Financing as derivative liabilities which were measured at fair value with changes in fair value be recorded in earnings in each reporting period.

	As of March 31, 2018 US$'000	As of January 17, 2018 US$'000	Change in Fair Value (gain)/loss US$'000
Fair value of the Warrants:			