

The9 LTD
Form 20-F
June 30, 2006
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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, 2005

OR

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

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission file number: 000-51053

THE9 LIMITED

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Cayman Islands

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(Jurisdiction of incorporation or organization)

Building No.3, 690 Bibo Road

Zhang Jiang Hi-Tech Park

Pudong New Area, Pudong

Shanghai 201203, People's Republic of China

(Address of principal executive offices)

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

[NONE]

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

Name of each exchange and Title of each class on which registered:

American Depositary Shares, each representing one ordinary share, par value

US\$0.01 per share, Nasdaq National Market

(Title of Class)

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

[NONE]

(Title of Class)

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: 24,214,130 ordinary shares, par value US\$0.01 per share.

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:

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Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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INTRODUCTION

In this annual report, unless otherwise indicated, (1) the terms we, us, our company, our and The9 refer to The9 Limited and its subsidiaries, in the context of describing our operations and risk factors, also include 9Webzen and our other affiliated PRC entities, (2) the term 9Webzen refers to 9Webzen Limited and its subsidiary, 9Webzen (Shanghai) Co., Ltd., (3) shares and ordinary shares refer to our ordinary shares, preferred shares refers to our convertible preferred shares, all of which were converted into our ordinary shares upon the completion of our initial public offering on December 20, 2004, ADSs refers to our American depositary shares, each of which represents one ordinary share, and ADRs refers to the American depositary receipts which evidence our ADSs, (4) all share numbers reflect the 2.86-for-1 share split of our ordinary shares and preferred shares which became effective on November 25, 2004, (5) China and PRC refer to the People's Republic of China, and solely for the purpose of this annual report, excluding Taiwan, Hong Kong and Macau, (6) all references to RMB and Renminbi are to the legal currency of China and all references to U.S. dollars, dollars, US\$ and \$ are to the legal currency of the United States, (7) all discrepancies in any table between the amounts identified as total amounts and the sum of the amounts listed therein are due to rounding; and (8) all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report were made at a rate of RMB8.0702 to US\$1.00, the noon buying rate in effect as of December 30, 2005.

This annual report on Form 20-F includes our audited consolidated statement of operations data for the years ended December 31, 2003, 2004 and 2005, and consolidated balance sheet data as of December 31, 2004 and 2005.

We and certain selling shareholders of our company completed the initial public offering of 6,075,000 ADSs, each representing one ordinary share, par value US\$0.01 per share, on December 20, 2004. On December 15, 2004, we listed our ADSs on the Nasdaq National Market, or Nasdaq, under the symbol NCTY.

FORWARD-LOOKING INFORMATION

This annual report on Form 20-F contains statements of a forward-looking nature. These statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as may, will, expects, anticipates, future, intend, plan, believe, estimate, is/are likely to or other and similar expressions. The accuracy of these statements may be impacted by a number of risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but not limited to, the following:

our ability to retain existing users and attract new users for the World of Warcraft®, or WoW, game;

our ability to successfully launch and operate additional online games licensed by us in China;

our ability to license, develop or acquire additional online games that are attractive to users;

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the maintenance and expansion of our relationships with online game developers, including our existing licensors;

uncertainties in and the timeliness of obtaining necessary governmental approvals and licenses for operating any new online game;

risks inherent in the online game business;

risks associated with our future acquisitions and investments;

our ability to compete successfully against our competitors;

risks associated with our corporate structure and the regulatory environment in China; and

other risks outlined in our filings with the Securities and Exchange Commission, or the SEC, including this annual report on Form 20-F.

These risks are not exhaustive. We operate in an emerging and evolving environment. New risk factors emerge from time to time and it is impossible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

We would like to caution you not to place undue reliance on forward-looking statements and you should read these statements in conjunction with the risk factors disclosed in Item 3.D. of this annual report, Key Information Risk Factors. We do not undertake any obligation to update the forward-looking statements except as required under applicable law.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

ITEM 3. KEY INFORMATION

A Selected Financial Data

The following table presents the selected consolidated financial information for our company. You should read the following information in conjunction with Item 5 Operating and Financial Review and Prospects below. The selected consolidated statement of operations data for the years ended December 31, 2003, 2004 and 2005 and the selected consolidated balance sheet data as of December 31, 2004 and 2005 have been derived from our audited consolidated financial statements and should be read in conjunction with those statements, which are included in this annual report beginning on page F-1. The selected consolidated statement of operations data for the year ended December 31, 2001 and 2002 and the selected consolidated balance sheet data as of December 31, 2001, 2002 and 2003 have been derived from our audited consolidated financial statements, which are not included in this annual report.

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	For the Year Ended December 31,					
	2001 RMB	2002 RMB	2003 RMB	2004 RMB	2005 RMB	2005 US\$(¹) (unaudited)
<i>(in thousands, except for per share and per ADS data)</i>						
Consolidated Statement of Operation Data:						
Revenues	5,527	3,280	17,268	36,636	489,191	60,617
Sales taxes	(283)	(192)	(883)	(1,913)	(24,164)	(2,994)
Net revenues	5,244	3,088	16,385	34,723	465,027	57,623
Costs of services	(3,413)	(3,730)	(6,492)	(9,139)	(240,416)	(29,791)
Gross profit (loss)	1,831	(642)	9,893	25,584	224,611	27,832
Operating expenses	(17,265)	(19,070)	(15,930)	(35,347)	(164,898)	(20,433)
Income (loss) from operations	(15,434)	(19,712)	(6,037)	(9,763)	59,713	7,399
Interest income (expenses), net	(484)	(907)	(1,381)	81	10,022	1,242
Other income (expense), net	74	(173)	165	15,792	14,467	1,793
Income (loss) before income tax benefit (expense), gain on investment disposal, minority interests and equity in profit (loss) of affiliated companies	(15,844)	(20,792)	(7,253)	6,110	84,202	10,434
Income tax benefit (expense)	(156)	(338)	5,850	(5,073)	(168)	(21)
Minority interests				6,871	(4,541)	(563)
Income (loss) before gain on investment disposal and equity in profit (loss) of affiliated companies	(16,000)	(21,130)	(1,403)	7,908	79,493	9,850
Gain on investment disposal					6,716	832
Equity in profit (loss) of affiliated companies, net of taxes		(5,211)	49,877	16,571	(13,737)	(1,702)
Net income (loss)	(16,000)	(26,341)	48,474	24,479	72,472	8,980
Net income (loss) attributable to shareholders	(18,169)	(28,692)	31,699	12,047	72,472	8,980
Earnings (loss) per share						
- Basic	(1.84)	(2.91)	3.21	1.17	3.00	0.37
- Diluted	(1.84)	(2.91)	1.94	0.87	2.92	0.36
Earnings (loss) per ADS ⁽²⁾						
- Basic	(1.84)	(2.91)	3.21	1.17	3.00	0.37
- Diluted	(1.84)	(2.91)	1.94	0.87	2.92	0.36

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	As of December 31,					
	2001 RMB	2002 RMB	2003 RMB	2004 RMB	2005 RMB	2005 US\$(¹) (unaudited)
	<i>(in thousands)</i>					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	1,730	5,628	62,766	793,405	488,245	60,500
Non-current assets	12,166	8,817	60,801	171,565	602,744	74,688
Total assets	23,836	20,494	155,798	1,026,595	1,213,735	150,397
Current liabilities	23,204	46,982	134,210	149,265	271,750	33,673
Minority interests				12,165		
Series A convertible preferred shares ⁽³⁾	29,357	31,708	34,242			
Total shareholders' equity (deficit)	(30,144)	(58,461)	(12,654)	865,165	941,985	116,724
Total liabilities and shareholders' equity (deficit)	23,836	20,494	155,798	1,026,595	1,213,735	150,397

(1) Translation from RMB amounts into U.S. dollars was made at a rate of RMB8.0702 to US\$1.00. See Exchange Rate Information.

(2) Each ADS represents one ordinary share.

(3) Series A convertible preferred shares were not included as part of shareholders' equity as such shares were redeemable at the option of the holders thereof.

As of December 31, 2005, we and Webzen Inc., or Webzen, owned 30% and 70% of 9Webzen Limited, or 9Webzen, respectively. Prior to December 2005, we and Webzen owned 51% and 49% of 9Webzen, respectively. Due to Webzen's right to participate in certain decisions to be made in the ordinary course of business of 9Webzen, we have accounted for our interest in 9Webzen using the equity method. Our equity share of 9Webzen's net income contributed significantly to our net income for our fiscal years ended December 31, 2003 and 2004. In 2005, due to the declining popularity of the MU game, which comprised substantially all of 9Webzen's revenues, and due to our substantial increase in revenues resulting from the commercial launch of WoW in China, the portion of our income attributable to our equity interest in 9Webzen and our share of the total assets of 9Webzen were less than 20% of our operating income and total assets, respectively, for the year. Because 9Webzen's financial position and results of operation are no longer material to us, the audited financial statements for 9Webzen are not required for 2005. 9Webzen's audited consolidated financial statements for the years ended December 31, 2003 and 2004 and unaudited consolidated financial statements for the year ended December 31, 2005 are included in this annual report beginning on page F-44. For a discussion of 9Webzen's results of operations for the years ended December 31, 2003 and 2004, see Item 5, Operating and Financial Review and Prospects Overview 9Webzen's Results of Operations. For a more detailed discussion of 9Webzen's historical operating and financial information, see our annual report on Form 20-F for the year 2004, filed with the SEC on June 30, 2005.

Exchange Rate Information

Our business is primarily conducted in China and almost all of our revenues are denominated in RMB. However, periodic reports made to shareholders will be expressed in U.S. dollars using the then current exchange rates. This annual report contains translations of RMB amounts into U.S. dollars at specific rates solely for the convenience of the reader. The conversion of RMB into U.S. dollars in this annual 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. For your convenience, this annual report contains translations of some RMB or U.S. dollar amounts for 2005 at US\$1.00: RMB8.0702, which was the noon buying rate in effect as of December 30, 2005. The prevailing rate at June 20, 2006 was US\$1.00: RMB8.0009. 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, the rates stated below, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign currency and through restrictions on foreign exchange activities.

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The following table sets forth information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated. These rates are provided solely for your convenience and are not necessarily the exchange rates that we used in this annual report or will use in the preparation of our periodic reports or any other information to be provided to you. The source of these rates is the Federal Reserve Bank of New York.

Period	Period End	Noon Buying Rate		
		Average ⁽¹⁾	Low	High
(RMB per US\$1.00)				
2001	8.2766	8.2770	8.2786	8.2676
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	8.1826	8.2765	8.0702
2006				
January	8.0608	8.0654	8.0702	8.0596
February	8.0415	8.0512	8.0616	8.0415
March	8.0167	8.0350	8.0505	8.0167
April	8.0165	8.0143	8.0248	8.0040
May	8.0215	8.0131	8.0300	8.0005
June (through June 20)	8.0009	8.0082	8.0225	7.9985

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

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Risks Related to Our Company

Our limited relevant operating history and the unproven long-term potential of our online game business model make evaluating our business and prospects difficult.

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We began to offer our self-developed online virtual community game the9 City in 2000, commenced the distribution and operation of MU, our first massively multiplayer online role playing game, or MMORPG, in China in February 2003. We launched two additional MMORPGs, Mystina Online and WoW, in China in February and June 2005, respectively. As a result, we have a limited relevant operating history for you to evaluate our business. It is also difficult to evaluate our prospective business, because we may not have sufficient experience to address the risks frequently encountered by early stage companies using new and unproven business models and entering new and rapidly evolving markets, including the online game market. These risks may include our potential failure to:

retain existing customers and attract new customers;

successfully launch and operate new online games licensed by us;

license, acquire or develop additional online games that are appealing to customers;

anticipate and adapt to changing consumer preferences;

adapt to competitive market conditions;

timely respond to technological changes or resolve unexpected network delays or interruptions;

adequately and efficiently operate, upgrade and develop our transaction and service platform; or

maintain adequate control of our expenses.

If we are unsuccessful in addressing any of the risks listed above, our results of operations may be materially and adversely affected.

We have incurred net losses in the past and may experience earnings declines or net losses in the future.

We incurred net losses in the first half of 2005. Although we have achieved net profit since the second half of 2005 as a result of the commercial launch of WoW in China, we cannot assure you that we can avoid net losses in the future nor that there will not be any earnings or revenue declines for any future quarterly or other periods. We expect that our operating expenses will increase as we incur additional expenditures in connection with our operation of WoW and other new games in China. As a result, any decrease or delay in generating more revenues could result in material operating losses and cause the market price of our ADSs to decline.

As we expect to continue to depend on WoW for most of our revenues in the near future, any adverse developments relating to WoW may materially and adversely affect our results of operations.

In February 2004, our subsidiary, China The9 Interactive Limited, or C9I, obtained an exclusive license to operate WoW in China from Vivendi Universal Games Inc., or VUG, and we commercially launched WoW in China in June 2005. In 2005, 98% of our total revenues were attributable to the operation of WoW in China, including game play time, merchandise sales and other related revenues. We expect to continue to depend on WoW for most of our revenues in the near future.

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In order to maximize the life span of a game, which we believe is typically four to five years for successful online games or two to three years for most other online games, it is necessary to continuously enhance, expand or upgrade the game with new features. We do not have any control over VUG's product development. As WoW's remaining economic life shortens, we will need to rely on other games to generate more revenues and to develop, license or acquire new games. If we are unable to do so, our future revenues will decline. In addition, any reduction in the user fees we charge to WoW game players as a result of intensifying competition or other factors, any breach of game-related software security, prolonged server delays, interruption due to network failure, illegal server activities, hacking or any other adverse developments relating to WoW, could materially and adversely affect our future results of operations.

We have invested and plan to continue to invest a significant amount of financial and personnel resources in operating WoW in China. While WoW has generated significant revenue in 2005 with 3.3 million activated user accounts as of December 31, 2005, we cannot assure you that WoW will continue to attract as many users as are required for our operation on a commercially viable basis. We have made significant financial commitments in connection with the licensing and operating of WoW in China. We are obligated to pay royalties equal to 22% of the face value of WoW prepaid cards and online points and either 37.7% or 39% of the face value of the CD-Keys sold by us by making recoupable advances against royalty payments in an aggregate amount of approximately US\$51.3 million over a four-year period commencing from the commercial launch in June 2005. We are also obligated to commit no less than approximately US\$13.0 million for the marketing and promotion of WoW in China during the four-year license period. If we lose our exclusive WoW license for failing to meet our financial obligations or for other reasons, or if we are unable to generate revenues from WoW exceeding the amount of operating costs and expenses incurred in connection with WoW, our future results of operations will be materially and adversely affected.

If we are unable to maintain a satisfactory relationship with VUG or any other online game developer which has licensed a game to us, our future results of operations or the growth of our business may suffer.

If we are unable to maintain a satisfactory relationship with VUG or any other online game developer which has licensed a game to us, or if VUG or any of our other online game licensors either establishes similar or more favorable relationships with our competitors in violation of its contractual arrangements with us or otherwise, our operating results and our business would be harmed, because our business depends significantly upon our exclusive licenses to operate WoW and other online games in China. We are currently in discussions with VUG regarding the terms of a license for the Burning Crusade expansion pack for the WoW game. We cannot assure you that VUG or any of our other online game licensors will renew its license agreement with us, or grant us an exclusive license for any new online games that it may develop or make expansion packs, including the Burning Crusade expansion pack, for existing games available to us in the future. Any deterioration of our relationship with VUG or any of our other online game licensors could harm our future results of operations or the growth of our business.

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Illegal game servers, unauthorized character enhancements and other infringements of our intellectual property rights could harm our business and reputation and materially and adversely affect our results of operation.

With the increase in the number of online game players in China, we have faced the risks of illegal game servers, unauthorized character enhancements and other infringements of our intellectual property rights. Our historical results of operations prior to our commercial launch of WoW in China were materially and adversely affected by illegal game servers. Although we have adopted a number of measures to address illegal server usage, misappropriation of our game server installation software and the establishment of illegal game servers could harm our business and reputation and materially and adversely affect our results of operations.

From time to time we have detected a number of players who have gained an unfair advantage by installing cheating tools to facilitate character progression. In response to these act