

## Ninetowns Digital (NINE)

August 14, 2006

### Company Profile

Founded in 1995, Ninetowns is a Chinese software company that enables enterprises and trade related PRC government agencies to streamline the import/export process. The Company has historically derived its revenue primarily through a subscription based software model, augmented by professional IT services.

**Technology  
IT Services, China**

Rating: Buy  
Price: 4.8  
Price Target: 8.00  
Suitability: Speculative Risk  
Value Investor

#### MARKET DATA:

52-Week Range: 4.21 - 8.04  
Market Capital: 168M  
Shares Outstanding: 35M  
Insider Ownership: 61%  
Institutional: 25%  
Float: 5M  
Avg. Daily Volume: 99K

#### FINANCIAL SUMMARY:

Cash: 116M  
Debt: 0

USD	2005A	2006E	2007E
Revenue:	29.3	23M	29M
EV/Rev.:	2.2X	2.86X	2.27X
EPS:			
Mar	0.16	0.08	0.07
Jun	0.14	0.08	0.09
Sep	0.11	0.07	0.11
Dec	0.09	0.07	0.12
FY Dec	0.52	0.30	0.39
FY P/E	10.0X	16X	13X

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#### Synopsis

Through its scalable enterprise software products Ninetowns' clients have the ability to automate import/export processing over the internet, which is a more cost effective and efficient alternative to the traditional paper-based method.

#### Second Quarter 2006 Preview

Ninetowns Digital is scheduled to release its 2nd quarter 2006 quarterly results after the close of market on August 17th. As stated by the NINE management, 2006 will be a transitional period, and as a result will not be giving forward guidance with the quarterly release. We are expecting a decrease in Yr / Yr revenue and EPS of around 6M and .08 respectively.

More important will be the progress of newer products, I-Process and I-Monitor. Management stated that by mid 2006 they will start charging for I-Process as an upgrade to the free version already given to customers, and announced that approximately 2500 customers were using I-Process. Other areas of importance will be how the NINE's relationship with the PRC Inspections Administration is progressing, and weather anything is new regarding the possibility of an acquisition that could be accreditive to eps in the future.

#### First Quarter 2006 Results

As expected, 2006 will be a transition period for Ninetowns. First quarter earnings revealed declining new software sales, and as discussed during the fourth quarter conference call, they have refrained from giving forward guidance.

- Ninetowns reported 1st Q 06 revenues of 6.2M (down from 6.5M in the 4th Q and 7.7M in the 1st Q in 2005) and EPS of .08 (down from .09 in Q4 05 and .16 in Q1 05).
- In the 1st quarter the company sold 1,500 I-Declare packages (down from 2800 in the 4th Q 2005) and 6,800 maintenance contracts (down from 12,800 in the 4th Q 2005).
- Customers have deferred from purchasing Ninetowns products in anticipation of the governments free software rollout. Management indicated that the government was about finished with the free software rollout in May. The company recognizes the revenue associated with new sales over a 12 month basis, so the revenue decline has not been as severe as the decline in new sales.
- The company plans to upgrade customers with Ninetowns premium products after the government introduces the free software. A risk to the investment case is that the government might upgrade the software to include additional features similar to Ninetowns premium services.

#### Compelling Value

At this point we believe the investment risk has already been priced into the stock. Of the 124K companies using e-filing for import/export processes in China, Ninetowns currently does business with 90% of them. Gross margins are running around 94% and the company has 116M (3 plus per share) in cash and is debt free.

	Mar 05A	Jun 05A	Sep 05A	Dec 05A	2005	Mar 06A	Jun 06E	Sep 06E	Dec 06E	2006	Mar 07E	Jun 07E	Sep 07E	Dec 07E	2007
<b>REVENUE</b>															
Enterprise Software	6,442	6,270	6,489	5,800	25,001	5,000	4,800	4,600	4,600	19,000	4,700	5,405	6,300	6,950	23,355
Software Development	1,300	1,500	800	705	4,305	1,100	1,100	1,100	1,100	4,400	1,200	1,250	1,400	1,450	5,300
<b>Net Revenues</b>	7,742	7,770	7,289	6,505	29,306	6,100	5,900	5,700	5,700	23,400	5,900	6,655	7,700	8,400	28,655
<b>Total COGS</b>	577	735	513	516	2,341	328	320	320	320	1,288	320	360	380	415	1,475
<b>Gross Profit</b>	7,165	7,035	6,776	5,989	26,965	5,758	5,580	5,380	5,380	22,112	5,580	6,295	7,320	7,985	27,180
<b>Sell &amp; Marketing</b>	448	636	1,023	1,054	3,161	851	900	950	950	3,651	950	980	1,000	1,100	4,030
<b>G&amp;A</b>	992	1,408	1,878	1,779	6,057	1,914	1,914	1,900	1,900	7,628	1,900	2,000	2,250	2,400	8,550
<b>R&amp;D Expense</b>	300	267	266	545	1,378	583	600	630	630	2,443	630	640	700	740	2,710
<b>Total Op Ex</b>	1,740	2,311	3,167	3,378	10,596	3,348	3,414	3,480	3,480	13,722	3,480	3,620	3,950	4,240	15,290
<b>Operating Income</b>	5,425	4,724	3,609	2,611	16,369	2,410	2,166	1,900	1,900	8,390	2,100	2,675	3,370	3,745	11,890
<b>Net Interest Income</b>	519	394	509	775	2,197	553	625	630	630	2,438	640	650	660	670	2,620
<b>Other</b>				2	2										
<b>Income before Tax</b>	5,944	5,118	4,118	3,388	18,568	2,963	2,791	2,530	2,530	10,828	2,740	3,325	4,030	4,415	14,510
<b>TAXES</b>	20	19	14	23	76	96	94	96	96	382	98	105	125	144	472
<b>Options Expense</b>															
<b>NET INCOME</b>	5,924	5,099	4,104	3,365	18,492	2,867	2,697	2,434	2,434	10,446	2,642	3,220	3,905	4,271	14,038
<b>Shares Diluted</b>	35,989	35,889	35,812	35,620	35,828	35,721	35,721	35,721	35,721	35,721	35,721	35,721	35,721	35,721	35,721
<b>Income / Avg Shs</b>	0.165	0.142	0.115	0.094	0.516	0.080	0.076	0.068	0.068	0.292	0.074	0.090	0.109	0.120	0.393
<b>As % of Sales</b>															
<b>Taxes/Income</b>	0.3%	0.4%	0.3%	0.7%	0.4%	3.2%	3.4%	3.8%	3.8%	3.5%	3.6%	3.2%	3.1%	3.3%	3.3%
<b>Total COGS</b>	7.45%	9.46%	7.04%	7.93%	7.99%	5.38%	5.42%	5.61%	5.61%	5.50%	5.42%	5.41%	4.94%	4.94%	5.15%
<b>Gross Profit</b>	92.5%	90.5%	93.0%	92.1%	92.0%	94.4%	94.6%	94.4%	94.4%	94.5%	94.6%	94.6%	95.1%	95.1%	94.9%
<b>Sell &amp; Marketing</b>	5.8%	8.2%	14.0%	16.2%	10.8%	14.0%	15.3%	16.7%	16.7%	15.6%	16.1%	14.7%	13.0%	13.1%	14.1%
<b>G&amp;A</b>	12.8%	18.1%	25.8%	27.3%	20.7%	31.4%	32.4%	33.3%	33.3%	32.6%	32.2%	30.1%	29.2%	28.6%	29.8%
<b>R&amp;D</b>	3.9%	3.4%	3.6%	8.4%	4.7%	9.6%	10.2%	11.1%	11.1%	10.4%	10.7%	9.6%	9.1%	8.8%	9.5%
<b>Total Operating Exp</b>	22.5%	29.7%	43.4%	51.9%	36.2%	54.9%	57.9%	61.1%	61.1%	58.6%	59.0%	54.4%	51.3%	50.5%	53.4%
<b>Operating Income</b>	70.1%	60.8%	49.5%	40.1%	55.9%	39.5%	36.7%	33.3%	33.3%	35.9%	35.6%	40.2%	43.8%	44.6%	41.5%
<b>Net Income</b>	76.5%	65.6%	56.3%	51.7%	63.1%	47.0%	45.7%	42.7%	42.7%	44.6%	44.8%	48.4%	50.7%	50.8%	49.0%