

Acorn International, Inc.
Form 20-F/A
July 11, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F/A

(Amendment No.1)

(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, 2016

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

Date of event requiring this shell company report _____

For the transition period from _____ to _____

Commission file number: 001-33429

Acorn International, Inc.

(Exact name of Registrant as specified in its charter)

Not applicable

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

19/F, 20th Building, 487 Tianlin Road, Shanghai 200233

(Address of principal executive offices)

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing twenty ordinary shares, par value \$0.01 per share	New York Stock Exchange

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

None

(Title of Class)

(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: 75,406,875.

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 transaction 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. x 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, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer Accelerated filer Non-accelerated filer Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, 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.

[†]The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

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

ACORN INTERNATIONAL, INC.

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EXPLANATORY NOTE

We filed our Annual Report on Form 20-F for the year ended December 31, 2016 (our “Annual Report”) with the Commission on May 15, 2017. We are amending our Annual Report solely to reflect that the financial statements for the years ended 2014 and 2015 (our “2014 and 2015 financial statements”) appearing in that report are unaudited and to remove the audit report of Deloitte Touche Tomatshu Certified Public Accountants LLP (“Deloitte”) dated May 16, 2016.

Our 2014 and 2015 Financial Statements were audited by Deloitte as of the date of their audit report and we are not aware of any misstatement or inaccuracy in those financial statements. Deloitte has not advised us that it is aware of any misstatement or inaccuracy in those financial statements. However, the staff of the Commission has advised us that PCAOB guidelines require Deloitte to conduct certain subsequent events procedures and to grant permission to reprint the financial statements and its audit report (even though the report is dated May 16, 2016 and is not being re-dated) and that, until that work is completed, the staff of the Commission views those financial statements as unaudited.

We are engaged in discussions with Deloitte over the terms of engagement for conducting those additional procedures. We will file a further amendment to our Annual Report with the audit report for our 2014 and 2015 financial statements once those procedures are completed.

INTRODUCTION

Except where the context otherwise requires and for purposes of this annual report only, references to:

•“ordinary shares” are to our ordinary shares, par value \$0.01 per share;

•“ADSs” are to our American depositary shares, each of which represents twenty ordinary shares;

•“ADRs” are to American depositary receipts, which, if issued, evidence our ADSs;

•“\$”, “US\$”, “USD” and “U.S. dollars” are to the legal currency of the United States;

“China” and the “PRC” are to the People’s Republic of China, excluding Taiwan and the special administrative regions of Hong Kong and Macau;

“variable interest entities,” or “VIEs,” refer to Shanghai Acorn Network Technology Development Co., Ltd., Beijing Acorn Trade Co., Ltd. and Beijing HJX Technology Development Co., Ltd., the domestic PRC companies in which we do not have equity interests but whose financial results have been consolidated into our consolidated financial statements in accordance with U.S. GAAP due to our having effective control over, and our being the primary beneficiary of, the three companies;

“consolidated affiliated entities” refer to our variable interest entities and their direct and indirect subsidiaries;

“RMB” and “Renminbi” are to the legal currency of China; and

“we”, “us”, “our”, “our company” and “our Group” refer to Acorn International, Inc., its predecessor entities, subsidiaries and consolidated affiliated entities, as the context may require.

This annual report on Form 20-F includes our audited consolidated statements of operations data for the years ended December 31, 2014, 2015 and 2016, and audited consolidated balance sheet data as of December 31, 2015 and 2016.

We completed the initial public offering of our ADSs in May 2007. Our ADSs are listed on the New York Stock Exchange under the symbol “ATV”.

FORWARD-LOOKING STATEMENTS

This annual report on Form 20-F contains forward-looking statements that involve risks and uncertainties. All statements other than statements of historical facts are forward-looking statements based on our current expectations, assumptions, estimates and projections about us and our industry. These statements involve known and unknown risks, uncertainties and other factors, including those listed under “Risk Factors,” which may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward- looking statements. These statements are made under the “safe harbor” provisions of the U.S. Private Securities Litigations Reform Act of 1995. In some cases, these forward-looking statements can be identified by words or phrases such as “aim”, “anticipate”, “believe”, “continue”, “estimate”, “expect”, “intend”, “is/are likely to”, “may”, “plan”, “potential”, “will” expressions. The forward-looking statements included in this annual report relate to, among others:

• anticipated operating results for 2017;

• our ability to reduce our operating losses, generate cash flows and fund our operations;

our goals and strategies, and our success in developing our business model;

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- expected trends in our e-commerce channels, our direct sales platform and our distribution network, and in our margins and certain cost or expense items as a percentage of our net revenues;

our future business development, financial condition and results of operations;

our ability to introduce successful new products and attract new customers;

our ability to maintain and build our brand and revenue for our direct sales products, particularly following our decisions to terminate the purchase of TV airtime for TV direct sales;

- our ability to manage our featured product lines;

competition from companies in a number of industries, including internet companies that provide direct sales marketing in China for consumer products;

our ability to effectively control our cost of sales and efficiently access media channels;

PRC governmental policies and regulations relating to our businesses;

general economic and business condition in China and elsewhere; and

assumptions underlying or related to any of the foregoing.

The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. 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. Key Information — Risk Factors.” Those risks are not exhaustive. We operate in an emerging and evolving environment. New risk factors and uncertainties emerge from time to time and it is not possible for our management to predict all risk factors and uncertainties, 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. You should read thoroughly this annual report and the documents that we refer to with the understanding that our actual future results may be materially different from what we expect. All forward-looking statements included herein attributable to us or other parties or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

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 selected consolidated statements of operations data for the three years ended December 31, 2014, 2015 and 2016, and the selected consolidated balance sheet data as of December 31, 2015 and 2016, have been derived from our audited consolidated financial statements for the year ended December 31, 2016 and our unaudited consolidated financial statements for the years ended December 31, 2014 and 2015, and are included elsewhere in this annual report. Our selected consolidated statements of operations data for the years ended December 31, 2012 and 2013, and our consolidated balance sheet data as of December 31, 2012, 2013 and 2014, have been derived from our audited consolidated financial statements that are not included in this annual report. Our selected consolidated financial statements are prepared and presented in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. Our historical results for any period are not necessarily indicative of results to be expected for any future period. The selected consolidated financial data should be read in conjunction with those consolidated financial statements and related notes and Item 5, "Operating and Financial Review and Prospects" in this annual report.

	For the years ended December 31,				
	2012	2013	2014	2015	2016
	(in thousands, except share and per share data)				
			(unaudited)	(unaudited)	
Condensed Consolidated Statements of Operations Data					
Revenues:					
Direct sales, net	\$193,615	\$136,416	\$45,233	\$19,406	\$13,833
Distribution sales, net	48,959	48,295	49,522	28,140	10,695
Total revenues, net	242,574	184,711	94,755	47,546	24,528
Cost of revenues:					
Direct sales	96,472	57,445	24,353	13,388	2,728
Distribution sales	35,475	35,046	32,570	21,499	9,244
Total cost of revenues	131,947	92,491	56,923	34,887	11,972
Gross profit	110,627	92,220	37,832	12,659	12,556
Operating (expenses) income:					
Advertising expenses	(58,338)	(51,731)	(16,233)	(2,204)	(24)
Other selling and marketing expenses	(50,346)	(54,874)	(40,177)	(25,185)	(12,970)
General and administrative expenses ⁽¹⁾	(27,071)	(30,681)	(28,417)	(27,839)	(16,437)
Other operating income, net	3,277	2,615	2,121	1,712	7,607
Total operating expenses	(132,478)	(134,671)	(82,706)	(53,516)	(21,824)
Loss from operations	(21,851)	(42,451)	(44,874)	(40,857)	(9,268)
Other income , net	5,755	3,394	1,954	1,017	18,138
Income tax expense	(1,822)	(646)	(1,171)	(183)	(4,593)
Equity in losses of affiliates	—	(206)	(235)	(227)	(868)
Net income (loss) ⁽²⁾⁽³⁾	(17,918)	(39,908)	(44,326)	(40,250)	3,409
Net income (loss) attributable to non-controlling interests	8	(12)	3	(91)	(29)
Net income (loss) attributable to Acorn International, Inc. shareholders	(17,926)	(39,896)	(44,329)	(40,159)	3,438
Income (loss) per ordinary share:					
Basic and Diluted	\$(0.20)	\$(0.47)	\$(0.54)	\$(0.51)	\$0.05
Weighted average number of shares used in calculating income (loss) per ordinary share					
Basic	89,965,979	84,115,169	82,690,613	79,226,404	75,600,700
Diluted	89,965,979	84,115,169	82,690,613	79,226,404	75,600,700

	As of December 31,				
	2012	2013	2014	2015	2016
	(in thousands)				
			(unaudited)	(unaudited)	
Condensed Consolidated Balance Sheet Data					
Cash and cash equivalents	\$90,975	\$82,552	\$34,686	\$12,147	\$25,506
Prepaid advertising expenses	8,563	3,215	6,162	475	11
Total assets	207,397	175,354	125,732	240,719	133,320
Deferred revenue	904	787	667	548	381
Total liabilities	27,596	39,082	34,060	62,006	33,810
Ordinary shares	946	949	952	890	918
Additional paid-in capital	161,057	161,500	161,925	161,308	161,938
Retained earnings	(1,966)	(41,862)	(86,191)	(126,349)	(122,911)
Accumulated other comprehensive income	30,721	35,285	34,585	162,580	80,865
Treasury stock	(11,464)	(20,109)	(20,109)	(20,109)	(21,640)
Non-controlling interests	507	509	510	392	340
Total equity	179,801	136,272	91,672	178,713	99,510
Total liabilities and equity	\$207,397	\$175,354	\$125,732	\$240,719	\$133,320

Note: Accumulated other comprehensive income in 2016 primarily reflects our unrealized gain on available-for-sales securities. See Notes 8 and 9 to our audited financial statements included elsewhere in this annual report.

	For the years ended December 31,					
	2014		2015		2016	
	(in thousands, except percentages)					
Selected Operating Data						
Number of inbound calls generated through direct sales platforms	1,204		92		—	
Conversion rate for inbound calls to product purchase orders	13.0 %		11.5 %		—%	
Total TV direct sales program minutes	131		3		—	

Note: Beginning in 2014, we reduced our TV advertising purchases for infomercials and in the first quarter of 2015 we discontinued our TV direct sales operations.

(1) Includes share-based compensation of:

	For the years ended December 31,				
	2012	2013	2014	2015	2016
	(in thousands)				
General and administrative expenses	\$(424)	\$(446)	\$(428)	\$(71)	\$(658)

(2)Includes:

	For the years ended December 31,				
	2012	2013	2014	2015	2016
	(in thousands)				
Share-based compensation	\$(424)	\$ (446)	\$ (428)	\$ (71)	\$(658)

(3) Net income (loss) for the periods presented reflect effective tax rates, which may not be representative of our long-term expected effective tax rates in light of the tax holidays and exemptions enjoyed by certain of our PRC subsidiaries and our consolidated affiliated entities. See Item 5.A, “Operating and Financial Review and Prospects—Operating Results—Taxation”.

Exchange Rate Information

We have published our financial statements in U.S. dollars. Our business is primarily conducted in China and substantially all of our revenues are denominated in Renminbi. Periodic reports will be made to shareholders and will be expressed in U.S. dollars using the then current exchange rates. The conversion of Renminbi into U.S. dollars in this annual report is based on the official base exchange rate published by the People’s Bank of China. Monetary assets and liabilities denominated in Renminbi are translated into U.S. dollars at the rates of exchange as of the balance sheet date; equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year as published by the People’s Bank of China. Unless otherwise noted, all translations from Renminbi to U.S. dollars in this annual report were made at \$1.00 to RMB6.937, which was the prevailing rate on December 31, 2016. The prevailing rate on May 11, 2017 was \$1.00 to RMB6.9051. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or Renminbi, as the case may be, at any particular rate, the rates stated below, or at all. The PRC government imposes controls over its foreign currency reserves in part through direct regulation of the conversion of Renminbi into foreign exchange and through restrictions on foreign trade.

The following table sets forth various information concerning exchange rates between the Renminbi 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.

Period	Noon Buying Rate			
	Period End	Average ⁽¹⁾	Low	High
	(RMB per U.S. Dollar)			
2012	6.2855	6.3085	6.3495	6.2670
2013	6.0969	6.1896	6.2898	6.0969
2014	6.1190	6.1428	6.1710	6.0930
2015	6.4936	6.2284	6.4936	6.1079
2016	6.9370	6.6529	6.4564	6.9508
October	6.7641	6.7303	6.6513	6.6908
November	6.8865	6.8402	6.7491	6.9168
December	6.9370	6.9198	6.8575	6.9508
2017				
January	6.8588	6.8907	6.8331	6.9526
February	6.8750	6.8694	6.8458	6.8898
March	6.8993	6.8940	6.8701	6.9125
April	6.8931	6.8844	6.6851	6.9042
May (through May 11, 2016)	6.9051	6.8974	6.8884	6.9066

Annual average for any given year is calculated by using the average of the exchange rates on the end of each (1) month during such year. Monthly average for any given month is calculated by using the average of the daily rates during such month.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Relating to Our Business and Industry

If various measures to reduce operating expenses or generate additional cash flows are unsuccessful, we may continue to experience significant net losses and negative cash flows. Moreover, we believe we must achieve operating profitability in order to position the business for long term sustainable success.

We had a net loss of approximately \$39.9 million, \$44.3 million and \$40.2 million in 2013, 2014 and 2015, respectively. While we had net income of approximately \$3.4 million in 2016, our operating loss was around \$9.3 million and we achieved profitability only due to other income of approximately \$17.7 million, which resulted primarily from sales of approximately 8 million shares in Yimeng Software Technology Co., Ltd. In our 2014 annual report filed with the U.S. SEC in May 2015, we indicated that there was substantial doubt as to our ability to continue as a going concern. In response, we began implementing, a series of initiatives, some of which are ongoing, designed to liquidate our non-core assets, stabilize our core businesses, reduce our expenses and losses, and generate additional cash flow. Our liquidity position improved in 2015 and 2016, in part due to these measures, allowing us to realize our assets and satisfy our liabilities in the normal course of business. Nonetheless, a number of these measures continued during this time. Among other related actions:

in 2015 and 2016, we sold a number of non-core properties in Shanghai and Beijing for a total consideration of approximately \$14.5 million;

we are negotiating for a potential transfer of our land use rights to a piece of land in the Qingpu district of Shanghai and selling a warehouse and factory constructed by us which is located on that land;

in the first quarter of 2015, we discontinued our TV direct sales channel and related TV advertising time purchases in response to various increasingly restrictive PRC regulations on TV advertising time (in 2014 we had already begun reducing our TV advertising expenditures in response to increasing PRC regulation and TV advertising pricing);

we consolidated our four call center facilities into one call center in Wuxi, China with significant related headcount reductions;

in 2016 and the first four months of 2017, we have sold approximately 12.6 million shares in Yimeng Software Technology Co., Ltd. for aggregate consideration of RMB190.7 million, or \$27.5 million; and

we have subleased excess warehouse space to third parties, resulting in a decrease in associated costs and an increase in other operating income in 2015 and 2016.

Our ability to achieve and maintain profitability and positive cash flow from operating activities depends on various factors, including our ability to grow revenue and control our costs and expenses, the effectiveness of our selling and marketing activities, consumer acceptance of our products and the growth and maintenance of our customer base. We may fail to achieve or sustain profitability or positive cash flow from operating activities. See “Operating and Financial Review and Prospects—A. Operating Results—Overview” and “—B. Liquidity and Capital Resources.”

We do not believe our 2015 and 2016 results of operations are comparable to our historical operating results or are necessarily a reliable indicator of our future operating results, making it difficult for you to evaluate our business or future prospects; our 2017 total net revenues may be lower than 2016 total net revenues.

Our 2015 and 2016 operating results were impacted by, among other factors, our decision to deemphasize our TV direct sales channel beginning in 2014 and then to discontinue those operations in the first quarter of 2015; the decline in sales of our electronic learning products in the face of intense competition, which was partially offset by increased sales of our Babaka branded posture correction products; our cash generation and cost cutting efforts and related charges and expenses; the streamlining of our business model; and the legal dispute between two groups of our shareholders relating to the management and direction of our company and the related diversion of our management's attention from our business and litigation-related prohibitions on our pursuing transactions outside our ordinary course of business. Our 2017 results may be impacted by these events and our ongoing efforts to evolve our business model.

Historically, a significant portion of our revenues were generated through TV direct sales and one of our largest expenses was our purchase of TV advertising time (which typically was 90% dedicated to TV infomercial time). Consistent with deemphasizing in 2014, and then discontinuing in the first quarter of 2015, our TV direct sales channel, TV direct sales revenues decreased from \$5.7 million in 2014 to \$0.3 million in 2015 and further to nil in 2016 (or approximately 6.0%, 0.7% and nil of our total gross revenues in those periods). We also believe that product sales through our distribution channel are also adversely impacted by decreased advertising expenditures.

More recently, sales of our electronic learning products had decreased significantly from \$44,137,557 in 2014 to \$24,637,772 in 2015, representing 46.5% and 51.7%, respectively, of our total gross revenues in those years. However, due to intense competition and other factors, sales of our electronic learning products declined to \$8,071,401 in 2016, representing only 32.8% of our total gross revenues in that year. While these declines were partially offset in 2016 by increased sales of our Babaka branded posture correction products, we cannot assure you this trend will continue.

Our 2016 operating results include various charges and expenses in connection with efforts to generate cash and cut costs, including approximately \$1.5 million of severance costs in connection with our headcount reductions.

In addition, as a result of the shareholder dispute that is more generally described in “Item 8A Financial Information—Consolidated financial statements and other financial information—Legal Proceedings”, we incurred substantial direct costs associated with ongoing legal proceedings in the Cayman Islands, including fees and expenses of various professionals to advise us on this matter, including legal advisors, as well as substantial indirect costs to us resulting from the dispute, including potentially (in some cases), but not limited to derivative law suits in China separate from but related to the dispute, inappropriate severance payments, excess payment to third-party vendors and suppliers, distraction of management and staff from the core business to focus, and lost opportunities. We estimate

that the total direct costs associated with the legal proceedings related to the shareholder dispute were approximately \$0.4 million for 2015. Although the shareholder dispute was generally resolved in May 2015, on December 1, 2016, we filed a related action in the Grand Court of the Cayman Islands against Mr. Andrew Yan and two other directors for damages resulting from breach of fiduciary duties and related misconduct and mismanagement, and initially will face further expenses in relation to this action, although we have asked the Court to award costs. Furthermore, we may experience ongoing related disputes or expenses.

As more fully described below under “Historical disputes regarding control of our strategic direction and control of our board of directors could adversely impact our business, operating results and prospects” and in “Item 7 Major Shareholders and Related Party Transactions—Related Party Transactions— Transitional Services and Separation Agreement”, we entered into settlement arrangements with Mr. Yang and Mr. Roche and exchanged certain liability releases. Other than those arrangements, we have not entered into any agreements settling any claims or provided or received any releases from any of the directors or shareholders involved in the dispute with respect to the matters leading up to or resulting from the dispute. We may be subject to indemnification claims or legal proceedings with respect to these matters which may result in corresponding fees and expenses (including attorney’s fees) which would negatively impact our future financial results.

The overall impact of these events on our future operating results depends on, among other things, our success in reshaping our business model, our ability to promote our products through our other existing platforms and distribution networks, and our ability to establish new direct sales platforms or distribution networks.

Our evolving business model and the evolution of China’s direct sales industry makes it difficult to evaluate our business and future prospects.

Our business model has varied throughout our operating history in response to changes in the direct sales industry and the regulatory environment in China. In response to regulatory changes our direct sales model now consists of primarily outbound marketing and Internet sales. Also, as the direct sales industry has evolved we have begun to focus on sourcing other branded products to complement our own proprietary-branded product lines, including Ozing electronic learning products and Youngleda health products for distribution through our direct sales channel and our distribution channel.

The evolution of our business model makes it difficult for you to evaluate our business and future prospects. Our longer term goal is to become one of the leading direct marketing and branding companies in China that markets and distributes our proprietary, self-owned brands and products as well as well-established and promising new third-party brands and products. To achieve this goal, we need to continue to grow our business across platforms and product lines. Our ability to successfully implement our strategy is subject to various risks and uncertainties, including:

- our relatively short history in the Internet business;

- dramatic changes in success levels of our different brands from year to year, e.g., from Ozing electronic learning products last year to BABAKA branded posture correction products this year;

- our ability to maintain awareness of our brands, generate sales and develop customer loyalty through our direct sales platform, particularly following our termination of TV direct sales in early 2015;

- our ability to anticipate and adapt to new media platforms and technological developments;

- changes in government regulations, industry consolidation and other significant competitive and market dynamics;

- our ability to upgrade our technology or infrastructure to keep pace with our current and future direct sales platforms; and

- the potential need in the future for additional capital to finance our expansion of these business operations, which may not be available on reasonable terms or at all; and

- the need to recruit additional skilled employees, including technicians and managers at different levels.

There can be no assurance that we will be able to effectively manage these risks or execute our business strategies, which could have a material adverse effect on our growth, results of operations and business prospects.

Our operating results fluctuate from period to period, making them difficult to predict.

Our operating results are highly dependent upon, and will fluctuate based on, the following product-related factors:

- the mix of products selected by us for marketing through our direct sales platforms and our nationwide distribution network and their average selling prices;

- Declining impact of historical large TV marketing spend on our primary products as time passes and we are no longer marketing on TV;

• Positive and negative publicity about our products and our company generally;

• new product introductions by us or our competitors and our ability to identify new products;

• the availability of competing products and possible reductions in the sales price of our products over time in response to competitive offerings or in anticipation of our introduction of new or upgraded offerings;

• seasonality with respect to certain of our products, such as our electronic learning products, for which sales are typically higher around our first and third fiscal quarters corresponding with the end and beginning of school semesters in China, respectively;

• the market of certain featured products becoming saturated over time;

• discounts offered to our distributors as part of incentive plans to stimulate sales;

• the success of our distributors in promoting and selling our products locally;

• the potential negative impact distributor sales may have on our own direct sales efforts; and

- depletion of our pool of quality names or data for outbound marketing.

In addition, factors not directly relating to our products which could cause our operating results to fluctuate in a particular period or in comparison to a prior period include:

- new laws, regulations or rules promulgated by the PRC government governing the consumer products marketing and branding industries;

- natural disasters, such as the severe snow storms or earthquake experienced by China in 2008;

- the amount and timing of operating expenses incurred by us, including our media procurement expenses, inventory-related losses, bad debt expense, product returns and options grants to our employees;

- gains and losses related to our sale of non-core assets and our investments in marketable and other securities; and

- the level of advertising and other promotional efforts by us and our competitors in a particular period.

Due to these and other factors, our operating results will vary from period to period, will be difficult to predict for any given period, may be adversely affected from period to period and may not be indicative of our future performance. If our operating results for any period fall below our expectations or the expectations of investors or any market analyst that may issue reports or analyses regarding our ADSs, the price of our ADSs is likely to decrease.

Changes in the quoted prices for Shanghai Yimeng Software Technology Co., Ltd., or Yimeng, on the China National Equities Exchange and Quotations, or NEEQ, will cause the carrying value of our Yimeng shares to vary impacting our comprehensive net income; and our ability to sell our Yimeng shares at desired prices or in desired volumes will be impacted by related developments in the NEEQ market and the market for Yimeng shares.

In July 2015, Yimeng listed on the NEEQ and at December 31, 2016 our 8.5% ownership stake in Yimeng was valued at \$74.7 million. During 2017, we continued to sell Yimeng shares on the NEEQ. Through April 30, 2017, we reduced our ownership stake in Yimeng to 7.5% and at such date our remaining ownership stake (consisting of approximately 32.7 million Yimeng shares) was valued at \$66.8 million. Our management will consider additional sales of Yimeng shares as it deems appropriate.

The NEEQ is a new over-the-counter (OTC) market in China listing companies not otherwise eligible for listing on China's other markets including the Shanghai and Shenzhen Main Boards. Both the NEEQ and Yimeng's shares on the NEEQ have experienced significant volatility and limited liquidity. On March 28, 2017, Yimeng announced that it is temporarily halting the trading of its stock on NEEQ in anticipation of a potential material event and is expected to resume trading no later than June 28, 2017. We may be unable to sell our Yimeng shares at prices equal to the then-quoted price and or in desired volumes. Sales of Yimeng shares by us or others could also impact the price of Yimeng shares due to the limited trading volume. Actions by Yimeng may also restrict our ability to sell Yimeng shares. For example, Yimeng has publicly announced that it is engaged in a counseling period for listing on China's Shanghai Mainboard. As a result, with the permission of the Mainboard, Yimeng may de-list its shares on the NEEQ which could result in there being no potential public market for Yimeng shares for an extended period of time (possibly for as long as four years or longer).

If we are deemed an "investment company" under the U.S. Investment Company Act of 1940, it would adversely affect the price of our ADSs and ordinary shares and could have a material adverse effect on our business.

As of the date of this annual report, our assets include a 7.5% interest in Yimeng. This may be deemed to be "investment securities" within the meaning of the Investment Company Act of 1940, as amended. Our investment in Yimeng and other factors may cause us to be deemed to be an "investment company" under the Investment Company Act. As a foreign private issuer, we would not be eligible to register under the Investment Company Act, so if we are deemed to be an investment company within the meaning of the Investment Company Act, we would either have to obtain exemptive relief from the SEC or dispose of investments in order to fall outside the definition of an investment company. Additionally, we may have to forego potential future acquisitions of interests in companies that may be deemed to be investment securities within the meaning of the Investment Company Act. Failure to avoid being deemed an investment company under the Investment Company Act coupled with our inability as a foreign private issuer to register under the Investment Company Act could make us unable to comply with our reporting obligations as a public company in the United States and lead to our being delisted from the New York Stock Exchange, which would have a material adverse effect on the liquidity and value of our ADSs and ordinary shares.

Our best-selling featured product lines, such as our Babaka product line, have varied significantly but account for, and are expected to continue to account for, the substantial majority of our sales in the near term. Featured products sales may decline, these products may have limited product lifecycles, and we may fail to introduce new products to offset declines in sales of our featured products.

Over the three years ended in 2015, we became increasingly dependent on our electronic learning device product line which is one of our oldest product lines and accounted for 22.1%, 46.5% and 51.7% of our gross revenue in 2013, 2014 and 2015. However, due to intense competition and other factors, sales of our electronic learning products declined in 2016, representing only 32.8% of our total gross revenues last year. While these declines were partially offset in 2016 by increased sales of our Babaka branded posture correction product, we cannot assure you this trend will continue. In addition, our five best-selling featured product lines accounted for 89.7%, 94.4% and 95.7% of our gross revenues in 2014, 2015 and 2016, respectively. Our featured products may fail to maintain or achieve sufficient consumer market popularity and sales may decline due to, among other factors, the introduction of competing products, entry of new competitors, customer dissatisfaction with the value or quality offered by our products, negative publicity or market saturation. Consequently, our future sales success depends on our ability to successfully

identify, develop, introduce and distribute in a timely and cost- effective manner new and upgraded products.

Our product sales for a given period will depend upon, among other things, a positive customer response to our direct sales efforts, as well as the efforts of our distributors, our effective management of product inventory, the stage of our products' lifecycles during the period or our add-on services provided in connection with our products. Positive customer responses depend on many factors, including the appeal of the products and services being marketed, the effectiveness of our direct sales platforms and the viability of competing products. Our new products may not receive market acceptance. In addition, from time to time, we experience delays in the supply of our products to customers due to production delays or shortages or inadequate inventory management, and we lose potential product sales as a result. Furthermore, during a product's lifecycle, problems may arise regarding regulatory, intellectual property, product liability or other issues which may affect the continued viability of the product for sale.

If we fail to identify and introduce additional successful products, including those to replace existing featured products suffering from declining sales or approaching the end of their product lifecycle, our gross revenues may not grow or may decline and our market share and value of our brand may be materially and adversely affected. In addition, any change in the provision of our add-on services, such as the internet interactive services provided for our featured electronic learning products could materially and adversely affect the perception and acceptance of our products, which could materially and adversely affect our business, financial condition and results of operations.

Our failure to quickly identify and adapt to changing industry conditions may have a material and adverse effect on our business, financial condition and results of operations.

The online and offline consumer marketing and sales industries are subject to changing consumer preferences and industry conditions. Consequently, we must stay abreast of emerging fashion, lifestyle, design, technological and other industry and consumer trends. This requires timely collection of market feedback, accurate assessments of market trends, deep understanding of industry dynamics and flexible manufacturing capabilities.

We must also maintain relationships with suppliers who can adapt to fast-changing consumer preferences. If one or more of our existing suppliers cannot meet these requirements effectively, we will need to find and source from new suppliers, which may be costly and time-consuming. We or our suppliers may overestimate customer demand, face increased overhead expenditures without a corresponding increase in sales and incur inventory write-downs, which will adversely affect our results of operations.

If we cannot offer appealing products on our websites or through our other direct sales platforms or distributors, our customers may purchase fewer products from us or stop purchasing products from us altogether. Our reputation may also be negatively impacted. If we do not anticipate, identify and respond effectively to consumer preferences or changes in consumer trends at an early stage, we may not be able to generate our desired level of sales. Failure to properly address these challenges may materially and adversely affect our business, financial condition and results of operations.

Our business depends significantly on the strength of our product brands and corporate reputation; our failure to develop, maintain and enhance our product brands and corporate reputation may materially and adversely affect the level of market recognition of, and trust in, our products.

In China's fragmented, developing and increasingly competitive consumer market, product brands and corporate reputation have become critical to the success of our new products and the continued popularity of our existing products. Our brand promotion efforts, particularly our brand promotion activities, may be materially and adversely affected by our suspending purchases of TV airtime for TV direct sales programs, and our other promotion activities may prove to be expensive and may fail to either effectively promote our product brands or generate additional sales.

In addition, our product brands, corporate reputation and product sales could be harmed if, for example:

- our advertisements, or the advertisements of the owners of the third-party brands that we market or those of our distributors, are deemed to be misleading or inaccurate;
- our products fail to meet customer expectations;
- we provide poor or ineffective customer service;
- our products contain defects or otherwise fail;
- consumers confuse our products with inferior or counterfeit products; or
- consumers find our outbound marketing intrusive or annoying.

Furthermore, some of our customers reported that they have received phone calls from certain unidentified third parties impersonating our staff. These unidentified individuals called our customers to request that they (i) modify their order because the ordered product was out of stock or (ii) reject an ordered product upon delivery because it was damaged. In some cases, these unidentified individuals delivered counterfeit or inferior products to our customers. After our internal investigation and the investigation conducted by relevant PRC authorities, a group of impersonators were arrested by the police and were sentenced by the court in August 2011. Since 2011, we have identified other occurrences involving individuals impersonating our staff and calling our customers to achieve similar results, and in each case we identified such activities, have taken steps necessary to thwart and prosecute the impersonators. Although we continue to take steps reasonably aimed at preventing such events from recurring, including periodic internal investigations, there can be no assurance that we will be able to effectively prevent the recurrence of such events in the future, and in case such events recurs in the future, it could materially adversely affect our reputation among our customers and potential customers and our result of operations.

We rely on our nationwide distribution network for a substantial portion of our revenues. Failure to maintain good distributor relations could materially disrupt our distribution business and harm our net revenues.

Our distribution sales account for a substantial portion of our net revenues. In 2014, 2015 and 2016, 52.3%, 59.2%, and 43.6% respectively, of our net revenues were generated through our distributors across China. Our largest distributor accounted for approximately 4.5%, 14.2%, and 6.0% of our gross revenues in 2014, 2015 and 2016, respectively. We do not maintain long-term contracts with our distributors. Maintaining relationships with existing distributors and replacing any distributor may be difficult or time consuming. In addition, we are in the process of rationalizing and streamlining our distribution network to adapt to our evolving business model. If we cannot negotiate favorable terms regarding our distribution agreement with our existing distributors, they may discontinue their relationships with us and we may not be able to identify and attract new distributors or find suitable replacement of our existing distributors. Our failure to maintain good relationships with our distributors could materially disrupt our distribution business and harm our net revenues.

We may be unable to effectively manage our nationwide distribution network. Any failure by our distributors to operate in compliance with our distribution agreements and applicable law may result in liability to us, may interrupt the effective operation of our distribution network, may harm our brands and our corporate image and of which may result in decreased sales.

We have limited ability to manage the activities of our distributors, who operate independently from us. In addition, our distributors or the retail outlets to which they sell our products may violate our distribution agreements with them or the sales agreements between our distributors and the retail outlets. Such violations may include, among other things:

• failure to meet minimum sales targets for our products or minimum price levels for our products in accordance with relevant agreements;

• failure to properly promote our products through local marketing media, including Internet and local print media, violation of our media content requirements, or failure to meet minimum required media spending levels;

• selling products that compete with our products, including product imitations, or selling our products outside their designated territories, possibly in violation of the exclusive distribution rights of other distributors;

• providing poor customer service of the after-sale repair or return; or

violating PRC law in the marketing and sale of our products, including PRC restrictions on advertising content or product claims.

In particular, we have discovered that some of the retail outlets to which our distributors sell our products are selling imitation products that compete with our products, such as our Ozing electronic learning product. Although we continue to rigorously monitor this situation and require our distributors to abide by their contractual obligation to eliminate any such violation by the retail outlets, we may be unable to police or stop violations such as the selling of imitation products by retail outlets.

If we determine to fine, suspend or terminate our distributors for acting in violation of our distribution agreements, or if the distributors fail to address material violations committed by any of their retail outlets, our ability to effectively sell our products in any given territory could be negatively impacted. In addition, these and similar actions could negatively affect our brands and our corporate image, possibly resulting in loss of customers and a decline in sales.

We may not realize the anticipated benefits of our potential future joint ventures, acquisitions or investments or be able to integrate any acquired employees, businesses, products, which in turn may negatively affect their performance and respective contributions to our results of operations.

From time to time, we conduct acquisitions, make investments or enter into joint ventures or other investment structures with other entities as a means of developing new products, acquiring managerial expertise or further expanding our complementary distribution network infrastructure. In addition to the two joint ventures and other minority investments that we currently maintain, we may continue to enter into similar joint ventures or make other acquisitions or investments when proper opportunities occur. Risks related to our existing and future joint ventures, acquisitions and investments include, as applicable:

our ability to enter into, exit or acquire additional interests in our joint ventures or other acquisitions or investments may be restricted by or subject to various approvals under PRC law or may not otherwise be possible, may result in a possible dilutive issuance of our securities or may require us to secure financing to fund those activities;

we may disagree with our joint venture partner(s) or other investors on how the venture or business investment should be managed and/or operated;

to the degree we wish to do so, we may be unable to integrate and retain acquired employees or management personnel; incorporate acquired products, or capabilities into our business; integrate and support pre-existing manufacturing or distribution arrangements; consolidate duplicate facilities and functions; or combine aspects of our accounting processes, order processing and support functions; and

the joint venture or investment could suffer losses and we could lose our total investment, which would have a negative effect on our operating results.

Any of these events could distract our management's attention and result in our not obtaining the anticipated benefits of our joint ventures, acquisitions or investments and, in turn, negatively affect the performance of such joint ventures, acquisitions and investments and their respective contributions to our results of operations.

Our business could be disrupted and our business prospects could be adversely affected if we were to lose the services of our co-founder, Mr. Robert W. Roche, our business could be further disrupted.

Mr. Roche has played an important role in the growth and development of our business since its inception. If Mr. Roche is unable or unwilling to continue in his present position, we may be unable to replace him easily or at all, our business could be severely disrupted, and our financial condition and results of operations could be materially and adversely affected. We do not maintain key-man life insurance on Mr. Roche.

If we are unable to attract, retain and motivate key personnel or hire qualified personnel, or if such personnel do not work well together, our growth prospects and profitability will be harmed.

Our business is supported and enhanced by a team of highly skilled employees who are critical to maintaining the quality and consistency of our business and reputation. It is important for us to attract qualified employees, especially marketing personnel, supply chain managers, call center operators and employees with high levels of experience in Internet-related sales.

During 2015, 2016 and continuing into 2017, we have effected a substantial reduction in our work force across all functions of our operations and restructured our senior management, which reductions are primarily driven by cost control efforts as well as restructuring and streamlining our business structure and operation. In addition, through voluntary attrition, certain key personnel have recently left, and we have yet to recruit replacements. The reductions and adjustments in our workforce and the loss of such key personnel could seriously harm the moral of existing employees and our ability to attract prospective employees in key areas of need or retain current key personnel in critical areas of operations, which could disrupt our business and operations and negatively affect our financial performance.

We must also provide continuous training to our employees so that they have up-to-date knowledge of various aspects of our operations and can meet our demand for high quality services. If we fail to do so, the quality of our services

may deteriorate in one or more of the markets where we operate, which may cause a negative perception of our brand and adversely affect our business. Finally, disputes between us and our employees may arise from time to time and if we are not able to properly handle our relationship with our employees, our business, financial condition and results of operations may be adversely affected.

In fulfilling sales through our direct sales platforms, we face customer acceptance, delivery, payment and collection risks that could adversely impact our direct sales net revenues and overall operating results. We are dependent on China Express Mail Service Corporation, or EMS and local delivery companies, to make our product deliveries and from time to time we have been required to write off certain accounts receivable from them.

We rely on EMS, the largest national express mail service operated by the China Post Office, and certain local delivery companies such as Yuantong and Zhai-ji-song to deliver products sold through our direct sales platforms. EMS and local delivery companies made deliveries of products representing 11.3% and 36.4% of our sales in 2014, respectively, 16.4% and 24.4% of our sales in 2015, respectively, and 16.3% and 40.1% of our sales in 2016, respectively. Although we offer credit/debit card and other payment options for our customers, substantially all of the products that we sell through our direct sales platforms are delivered and paid for by customers on a cash-on-delivery, or COD, basis. We rely on EMS and local delivery companies to remit customer payment collections to us. Of the total attempted product deliveries by EMS and local delivery companies on a COD basis, approximately 68%, 54% and 45% were successful in 2014, 2015 and 2016, respectively. Reasons for delivery failure primarily include customer refusal to accept a product upon delivery or failure to successfully locate the delivery address. Although we continue to explore alternative payment methods and expand our credit card payment options, we expect to continue to be dependent on COD customer payments for the foreseeable future.

EMS typically requires two to three weeks to remit to us the COD payments received from our customers. Of our total accounts receivable balance as of December 31, 2014, 2015 and 2016, no single delivery company accounted for more than 10% of our total accounts receivables. In addition, from time to time, we have been required to write off certain EMS accounts receivable due to a difference between EMS's collections according to our records and cash amounts actually received by EMS according to their records. The total amount of EMS-related accounts receivable written off in 2014 was approximately \$0.2 million. While we did not record any write-off in connection with EMS-related accounts receivable in 2015 and 2016, we may be required to make such write-off in the future. We do not maintain a long-term contract with EMS or local delivery companies. Failure or inability to renew our contract with EMS or local delivery companies could disrupt our business and operations and negatively affect our financial performance.

We expect competition in China's consumer market to intensify. If we do not compete successfully against new and existing competitors, we may lose our market share, and our profitability may be adversely affected.

Competition from current or future competitors could cause our products to lose market acceptance or require us to significantly reduce our prices or increase our promotional activities to maintain and attract customers. Many of our current or future competitors may have longer operating histories, better brand recognition and consumer trust, strong media management capabilities, better media and supplier relationships, a larger technical staff and sales force and/or greater financial, technical or marketing resources than we do. We face competition from the following companies operating in our value chain:

numerous domestic and international sellers of consumer branded products that sell their products in China and which compete with our products, such as our Youngleda health products which compete with Oxygen-generating devices from Yuwell, Ding Xiang, De Li Kang and other brands, and our mobile phone products which compete with similar products sold by local and international mobile phone manufacturers; and

other Internet and e-commerce companies in China that offer consumer products online via an Internet platform, such as Tmall, JD.COM, Dang Dang Wang and Yihaodian.

Interruption or failure of our telephone system and management information systems could impair our ability to effectively sell and deliver our products or result in a loss or corruption of data, which could damage our reputation and negatively impact our results of operations.

In 2015, we consolidated our four call centers into our call center located in Wuxi, China. In 2014, 2015 and 2016, approximately 47.9%, 29.7% and 14.5% of our total net revenues, respectively, were generated through our direct sales platforms with orders processed by our call centers. In 2014 and through early 2015, our call center relies heavily on our telephone and management information systems, or MIS, to receive customer calls at our call center, process customer purchases, arrange product delivery and assess the effectiveness of advertising placements and

consumer acceptance of our products, among other things. We may experience difficulties or call center interruptions due to our consolidation activities. As our business evolves and our MIS requirements change, we may need to modify, upgrade and replace our systems. We work closely with third-party vendors and our related party vendors to provide telephone service tailored to our specific needs. We are and will continue to be substantially reliant on these third-party vendors for the provision of maintenance, modifications, upgrades and replacements to our systems. If these third-party vendors can no longer provide these services, it may be difficult, time consuming and costly to replace them. Any such modification, upgrading or replacement of our systems may be costly and could create disturbances or interruptions to our operations. Similarly, undetected errors or inadequacies in our telephone and MIS may be difficult or expensive to timely correct and could result in substantial service interruptions.

From time to time, our computer systems may experience short periods of power outage resulted from unexpected damage of the facilities where our computers system locate, natural disasters or other reasons. Any telephone or MIS failure (including as a result of natural disaster or power outage), particularly during peak or critical periods, could inhibit our ability to receive calls and complete orders or evaluate the effectiveness of our promotions or consumer acceptance of our products or otherwise operate our business. These events could, in turn, impair our ability to effectively sell and deliver our products or result in the loss or corruption of customer, supplier and distributor data, which could damage our reputation and negatively impact our results of operations.

The provision of our add-on services via third party service providers may be beyond our control and negatively impact our customer experience, and we may not be able to continue to provide such services if we are deemed to be providing online education service, which could substantially harm our business, financial condition and results of operations and expose us to liabilities.

In order to provide internet interactive services to users of our electronic learning products or mobile apps, we maintain a large team of service providers with an aim to respond to inquiries from our customers on their inquiries on a real time basis. However, we may not be able to properly control or monitor the quality of these third party service providers engaged by us. If our third party service providers fail to provide quality services that meet the expectation of our customers or fail to continuously provide their services, it could damage our reputation and adversely affect our customer's experience. Moreover, if our provision of such add-on services were to be deemed by relevant PRC government authorities to be providing online education services, we may not be able to continue to product such services as we would need to obtain relevant licenses and permits from relevant PRC government authorities. If any such circumstances happen, it could substantially harm our business, financial condition and results of operations and expose us to liabilities.

Failure to protect personal and confidential information of our customers could damage our reputation and substantially harm our business, financial condition and results of operations and expose us to liability.

We collect and store personally identifiable information of our customers in our database through which we sell and market our products. We may not be able to prevent our employees or other third parties, such as hackers, criminal organizations, our external service providers and business partners, from stealing or leaking information provided by our customers to us. In addition, significant capital and other resources may be required to protect against security breaches or to alleviate problems caused by such breaches. The methods used by hackers and others engaged in online criminal activities are increasingly sophisticated and constantly evolving. Even if we are successful in adapting to and preventing new security breaches, any perception by the public that the privacy of customer information are becoming increasingly unsafe or vulnerable to attack could inhibit the growth of online business generally, which in turn may reduce our customers' confidence and materially and adversely affect our business and prospects. Moreover, we are required to comply with laws and regulations in connection with protection of electronic personal information of our customers in China and we may be obligated to comply with the privacy and data security laws of foreign countries where our customers reside. With the promulgation of the PRC Cyber Security Law in November 7, 2016 and effective from June 1, 2017, we will face more stringent requirements to protect the personal information we collect from being divulged or tampered with. Failure to comply with such requirements will result in more severe administrative penalties. Our exposure to the PRC and foreign countries' privacy and data security laws impacts our ability to collect and use personal data, increases our legal compliance costs and may expose us to liability. As such laws proliferate, there may be uncertainty regarding their application or interpretation, which consequently increases our exposure to potential compliance costs and liability. Even if a claim of noncompliance against us does not ultimately result in liability, investigating or responding to a claim may present significant costs and demands on our management.

We could be liable for breaches of security of our service and third-party payment systems, which may have a material and adverse effect on our reputation and business.

In recent years, we have generated an increasingly significant proportion of our net revenues from payments collected through third-party online payment systems, which are primarily generated from our Internet sales. In such transactions, confidential information, such as customers' debit and credit card numbers and expiration dates, personal information and billing addresses, is transmitted over public networks and security of such information is essential for maintaining customer confidence. While we have not experienced any breach of our security to date, current security measures may prove to be inadequate. In addition, we expect that an increasing number of our sales will be conducted over the Internet as a result of our expanding customer base and the growing use of online payment systems. We also expect that associated online criminal activities will likely increase accordingly. We strive to be prepared to increase our security measures and efforts in order to maintain customer confidence in the reliability of our online payment systems. However, we may not be able to prevent future breaches of our security, which may have a material and adverse effect on our reputation and business.

We may not be able to prevent others from unauthorized use of our intellectual property, which could harm our product brand, reputation and competitive position. In addition, we may have to enforce our intellectual property rights through litigation. Such litigation may result in substantial costs and diversion of resources and management attention.

We rely on a combination of patent, copyright, trademark and unfair competition laws, as well as nondisclosure agreements and other methods to protect our intellectual property rights. In particular, we rely on the trademark law in China to protect our product brands. We currently maintain 624 trademark registrations in China which expire between 2017 and 2025. We are in the process of extending the trademarks which are expected to expire in the near future. Separately, we are in the process of applying for registration or transfer of approximately 182 trademarks among our group companies in China. The legal regime in China for the protection of intellectual property rights is still at a relatively early stage of development. Despite many laws and regulations promulgated and other efforts made by China over the years to enhance its regulation and protection of intellectual property rights, private parties may not enjoy intellectual property rights in China to the same extent as they would in many western countries, including the United States, and enforcement of such laws and regulations in China has not achieved the levels reached in those countries. Although the PRC State Council approved the State Outlines on the Protection of Intellectual Property on April 9, 2008 in an effort to protect intellectual property, we shall keep on making endeavors to prevent the misappropriation of our intellectual property.

We may be unable to enforce our proprietary rights in connection with these trademarks before such registrations or transfers are approved by the relevant authorities and it is possible that such registrations or transfers may not be approved at all. In addition, manufacturers or suppliers in China may imitate our products, copy our various brands and infringe our intellectual property rights. We have discovered unauthorized products on e-commerce platforms and in the marketplace that are counterfeit reproductions of our products sold by the retailers within our nationwide distribution network and by third parties in retail stores and on websites. The counterfeit products that we found include our Babaka posture correction products, our Yierjian fitness products, Vibrashape fitness products, cosmetic products and our health products.

It is difficult and expensive to police and enforce against infringement of intellectual property rights in China. Imitation or counterfeiting of our products or other infringement of our intellectual property rights, including our trademarks, could diminish the value of our various brands, harm our reputation and competitive position or otherwise adversely affect our net revenues. We may have to enforce our intellectual property rights through litigation. Such litigation may result in substantial costs and diversion of resources and management attention.

We have in the past been and in the future may again be, subject to intellectual property rights infringement claims by third parties, which could be time-consuming and costly to defend or litigate, divert our attention and resources, or require us to enter into licensing agreements. These licenses may not be available on commercially reasonable terms, or at all.

We have in the past been and in the future may again be, the subject of claims for infringement, invalidity, or indemnification relating to other parties' proprietary rights. The defense of intellectual property suits, including copyright infringement suits, and related legal and administrative proceedings can be costly and time consuming and may significantly divert the efforts and resources of our technical and management personnel. Furthermore, an adverse determination in any such litigation or proceeding to which we may become a party could cause us to pay damages, seek licenses from third parties, pay ongoing royalties, redesign our products or become subject to injunctions, each of which could prevent us from pursuing some or all of our businesses and result in our customers or potential customers deferring or limiting their purchase or use of our products, which could materially and adversely affect our financial condition and results of operations.

We may from time to time be involved in legal or other disputes, or become a party to legal, administrative or other proceedings which, if adversely decided, could lead to significant liabilities and materially adversely affect us.

We may from time to time be involved in disputes with various parties involved in our daily operations, including but not limited to our suppliers, customers and distributors. These disputes may lead to legal, administrative or other proceedings to which we are a party, and defense of which may increase our expenses and divert management attention and resources. For example, in September 2015, Beijing Mai-La-Ke Technology Center, or the Mai-La-Ke, the previous holder of the trademark of our Oxygen-generating devices, filed a lawsuit in the Haidian People's Court in Beijing against Beijing Acorn Trade Co., Ltd and Beijing Acorn Younslide Science and Technology Co., Ltd., alleging that the two defendants should provide relevant data of selling our Oxygen-generating devices from November 2000 to November 2005 in order for them to claim for 50% of the net profit for the period based on a previous agreement with the two defendants. In July 25, 2016, the Haidian People's Court in Beijing issued the first-instance judgment in which all claims raised by Mai-La-Ke were rejected. As of the date of this annual report, Mai-La-Ke has not appealed.

We were also the subject of the legal dispute between our shareholders as described immediately below.

Any adverse outcome in any legal, administrative or other similar proceedings that we are a party could lead to significant liabilities and could have a material adverse effect on our business, results of operations and financial condition.

Historical and ongoing disputes regarding control of our strategic direction and control of our board of directors could adversely impact our business, operating results and prospects.

From mid-2014 through mid-2015, we and our board of directors were involved in a protracted dispute between various shareholders for the control of our strategic direction and our board of directors. The alignment of the various parties to this dispute generally fell across two lines, with Mr. Robert W. Roche, our co-founder and our executive chairman and chief executive officer, and shareholders that are allied with him, in one camp, and the other camp comprised of our other largest shareholders, Mr. Don Dongjie Yang, our other co-founder and our former executive chairman and chief executive officer, and SB Asia Investment Fund II L.P.

As described in greater detail in Item 8.A, “Financial Information—Consolidated statements and other financial information— Legal Proceedings,” this dispute involved, among other things (i) the improper removal of Mr. Roche by our then-board of directors, comprising Mr. Robert W. Roche, Mr. Don Dongjie Yang, Mr. Andrew Y. Yan, Mr. Gordon Xiaogang Wang, Mr. Jing Wang and Mr. William Liang, from his role as executive chairman in August 2014 and, as a result, his preclusion from involvement in our day-to-day operations and management, (ii) various efforts by Mr. Roche (which were rejected by our then-board of directors) to call an extraordinary general meeting of shareholders, or EGM, for the purpose of removing certain of our directors, (iii) Mr. Roche, through a shareholder of our company controlled by him, filing a petition in the Cayman Islands in September 2014, seeking a winding up of the company (or, in the alternative, other remedies), (iv) a cross-petition brought by shareholders of our company controlled or aligned with Mr. Yang also seeking a winding up of the company (or, in the alternative, other remedies) based on, among other things, allegations that Mr. Roche engaged in conduct and/or threatened to engage in conduct harmful to the company, and (v) four new directors being elected in December 2014 at our annual general meeting over Mr. Roche’s objection.

In March 2015, the Grand Court of the Cayman Islands, or the Cayman Islands Court, found in Mr. Roche’s favor and made an order dismissing the cross-petition and, in lieu of making a winding-up order, granting Mr. Roche certain of the alternative remedies he (through Acorn Composite Corporation) sought by directing that we call an EGM that was held on May 4, 2015 for the purpose of considering resolutions: (i) to remove four then current directors from our board; (ii) to elect to our board of directors three new individuals nominated by Mr. Roche; and (iii) to amend our articles of association to allow shareholders who, together hold not less than 30% of our issued shares, to convene an EGM unilaterally. The EGM was held on May 4, 2015 with each of the resolutions passed. Following the EGM, our board elected Mr. Roche as our executive chairman and chief executive officer.

In addition, the Grand Court of the Cayman Islands also found that certain of these directors “acted in bad faith and exercised their powers, both in connection with Mr. Roche’s removal from office and in connection with the AGM and

the related refusal to convene and EGM, for an improper purpose”.

On May 27, 2015, we entered into the TSSA with Mr. Yang in connection with his resignation as a director and officer of the Company (as described in greater detail in “Item 7 Major Shareholders and Related Party Transactions—Related Party Transactions— Transitional Services and Separation Agreement”). Among other things, pursuant to the terms of the TSSA:

we acquired all the ordinary shares in our company (6,518,656 ordinary shares) held by Mr. Yang through his wholly-owned company, D.Y. Capital, Inc., for nominal aggregate consideration of \$1.00. At the time, these shares represented approximately 7.3% of our total outstanding ordinary shares, and were equivalent to 325,933 ADSs (with one ADS equivalent to twenty ordinary shares). Based on the closing price for our ADSs on the New York Stock Exchange on May 27, 2015 (the last trading day before our announcement of the TSAA), the acquired shares had a value of approximately \$3.3 million. Promptly following acquisition, we cancelled the shares reducing our outstanding ordinary shares; and

each of the company, Mr. Yang and our and his respective associated entities and persons gave a mutual waiver and release of all claims that may have against one another for any matters arising or occurring prior to May 27, 2015 (the date of the TSSA).

In 2015, our board approved the settlement with Mr. Roche and in January 2016, we entered into a settlement agreement with Mr. Roche and ACCI, a company wholly owned by Mr. Roche, for the purpose of settling (i) various amounts incurred by ACCI and/or its associated companies on behalf of and for the benefit of securing the commercial and business interests of our company prior to his 2014 removal from the office; and (ii) damages and legal fees incurred by Mr. Roche arising from that removal. Pursuant to the settlement agreement, we reimbursed Mr. Roche approximately \$0.9 million for various costs incurred by him and ACCI in connection with securing certain business contracts for our company and for the employment-related damages and legal fees incurred by Mr. Roche from August 2014 to April 2015.

The May 4, 2015 EGM and related events, including the TSSA and the settlement agreement with Mr. Roche, may not serve to completely resolve the dispute. Other than the TSSA with Mr. Yang and the settlement agreement with Mr. Roche, we have not entered into any similar releases or agreements settling any claims we or any other person may have in connection with the dispute or matters leading up to the dispute, with any of the other directors that were involved in the dispute, and therefore we may be subject to ongoing legal proceedings with them in the future.

Although no appeal has been brought as of the date of this annual report, it is possible an appeal of all or part of the Cayman Islands Court’s order may occur with the winding up of our company being one of the possible remedies sought. Continuing ramifications of the dispute may also include a public perception that our future direction, strategy or leadership is uncertain, potentially causing us to lose business opportunities, or harming our ability to attract new investors or business partners, and causing our ADS price to experience periods of volatility or stagnation. The dispute has resulted in, and, if it continues or if other related shareholder activities ensue, could result in disruption to our operations and diversion of the attention of management and our employees as a result of responding to these matters,

which has been and may continue to be costly and time-consuming. This could result in our business being adversely affected. We have retained the services of various professionals to advise us on this matter, including legal advisors, the costs of which may negatively impact our future financial results. We also may be subject to claims for indemnification related to these matters, and we cannot predict the impact that indemnification claims may have on our business, cash position or financial results.

On December 1, 2016, we filed a related action in the Grand Court of the Cayman Islands against Mr. Andrew Yan and two other directors for damages resulting from breach of fiduciary duties and related misconduct and mismanagement. More specifically, the complaint alleges that the Defendants breached their fiduciary duties and are responsible for alleged misconduct in and/or mismanagement of our business resulting from, in addition to other actions outlined in the complaint, the wrongful removal of Mr. Roche as our chief executive officer, exposing us to contractual breach of contract claims, refusing to pursue valuable business opportunities and wrongful termination of certain employees resulting in unnecessary severance costs. Relief sought in connection with the alleged breach of fiduciary duties and misconduct and/or mismanagement consists of (i) initial monetary damage claims comprised of (x) US dollar denominated damages of approximately US\$26,326,389.76, and (y) Renminbi denominated damages of approximately RMB 120,045,222 (equivalent to US\$17,433,989.57 utilizing a conversion rate of 0.1452 as of November 30, 2016)), (ii) costs and (iii) such further or other relief as the Cayman Court considers just.

Mr. Robert Roche, our chief executive officer and executive chairman, is a significant shareholder, which makes it possible for him to have significant influence over the outcome of all matters submitted to our shareholders for approval and which influence may be alleged to conflict with our interests and the interests of our other shareholders.

As of April 30, 2017, members of Mr. Roche's family own directly, indirectly or through one or more trusts approximately 50.0% of our outstanding ordinary shares, giving Mr. Roche substantial influence over the outcome of all matters submitted to our shareholders for approval. Our current memorandum and articles of association provide that the chairman of our board of directors or any one or more shareholders who collectively own at least 30% of our outstanding ordinary shares may convene an EGM, or an extraordinary meeting of our shareholders, to vote on matters proposed for consideration at such EGM. As a 30.0% plus shareholder and chairman of our board of directors, Mr. Roche has the ability to unilaterally convene an EGM. This influence may conflict with the interests of our other shareholders. In addition, such concentration of ownership and influence by Mr. Roche may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their ADSs as part of any contemplated sale of our company and may reduce the price of our ADSs or could create actual or perceived governance instabilities that could adversely affect the price of our ADSs.

We have limited general business insurance coverage and we may be subject to losses that might not be covered by our existing insurance policies, which may result in our incurring substantial costs and the diversion of resources.

Except the insurance for certain of our inventory at Zhai-ji-song warehouse, we currently do not have any business liability, disruption or litigation insurance coverage for our operations in China. Any business disruption or litigation may result in our incurring substantial costs and the diversion of resources.

Our sale of our and other parties' products could subject us to product liability claims, potential safety-related regulatory actions or product recalls. These events could damage our brand and reputation and the marketability of the products that we sell, divert our management's attention and result in lower net revenues and increased costs.

The manufacture and sale of our products, in particular, our oxygen generating in our health product category and e-learning product lines, and our sale of other parties' products could each expose us to product liability claims for personal injuries. Also, if our products are deemed by the PRC authorities to fail to conform to product quality and personal safety requirements in China, we could be subject to PRC regulatory action. Violation of PRC product quality and safety requirements by our or others' products sold by us may subject us to confiscation of the products, imposition of penalties or an order to cease sales of the violating products or to cease operations pending rectification. If the offense is determined to be serious, our business license could be suspended and imposition of criminal liabilities. Any product liability claim or governmental regulatory action could be costly and time-consuming to defend. If successful, product liability claims may require us to pay substantial damages. Also, a material design, manufacturing or quality failure in our and other parties' products sold by us, other safety issues or heightened regulatory scrutiny could each warrant a product recall by us and result in increased product liability claims. Furthermore, customers may not use the products sold by us in accordance with our product usage instructions, possibly resulting in customer injury. All of these events could materially harm our brand and reputation and marketability of our products, divert our management's attention and result in lower net revenues and increased costs.

Any disruption of our or our manufacturing service providers' manufacturing operations could negatively affect the availability of our products and our net revenues derived therefrom.

We manufactured approximately 7.3% of the products we sell in terms of revenues in 2016, with the balance provided by third-party suppliers and manufacturers in China. We purchase the materials we need to manufacture our Youngleda health products from outside suppliers in China. We typically purchase all production materials, including critical components, on a purchase order basis and do not have long-term contracts with our suppliers.

We rely on the manufacturing services of third party suppliers to produce the substantial majority of our products, If we fail to develop or maintain our relationships with our suppliers, we may be unable to obtain our products, and we could be prevented from supplying our products to our customers in the required quantities. Problems of this kind could cause us to experience loss of market share and result in decreased net revenues. In addition, the failure of a supplier to supply materials and components that meet our quality, quantity and cost requirements in a timely manner could impair our ability to manufacture our products or increase our costs, particularly if we are unable to obtain these materials and components from alternative sources on a timely basis or on commercially reasonable terms.

Other risks for the products manufactured by us, include, among others:

having too much or too little production capacity;

being unable to obtain raw materials on a timely basis or at commercially reasonable prices, which could adversely affect the pricing and availability of our products;

experiencing quality control problems;

accumulating obsolete inventory;

failing to timely meet demand for our products; and

experiencing delays in manufacturing operations due to understaffing during the peak seasons and holidays.

Currently, products manufactured and supplied by third parties for us include our mobile phones, cosmetics, fitness products, collectibles and other products. Some of our products are supplied by third-party manufacturers based on designs or technical requirements provided by us. These manufacturers may fail to produce products that conform to our requirements. In addition, for products manufactured or supplied by third-party manufacturers, we indirectly face many of the risks described above and other risks. For example, our third-party manufacturers may not continue to supply products to us of the quality and/or in the quantities we require. It may also be difficult or expensive for us to replace a third-party manufacturer.

We may incur impairment losses on our investments in equity securities.

We have made non-controlling investments in the equity securities of a number of companies. Under U.S. generally accepted accounting principles that we are subject to, if there is a decline in the fair value of the shares we hold in these companies, or any other company we invest in, over a period of time, and we determine that the decline is other-than-temporary, we will need to record an impairment loss for the applicable fiscal period. We may incur expenses related to the impairment of existing or future equity investments. Any such impairment charge could have a material adverse effect on our business, financial condition, results of operations and prospects.

Our asset impairment reviews may result in future write-downs.

We are required, among other things, to test intangible assets and other long-lived assets for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In connection with our business acquisitions, we make assumptions regarding estimated future cash flows and other factors to determine the fair value of goodwill and intangible assets. In assessing the useful lives of the intangible assets, we must make assumptions regarding their fair value, the recoverability of those assets and our ability to successfully develop and ultimately commercialize acquired technology. If those assumptions change in the future when we conduct our periodic reviews in accordance with applicable accounting standards, we may be required to record impairment charges.

We may not be able to properly implement the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 and this failure could have a material adverse impact on our ability to provide financial information in a timely and reliable manner.

As a public company in the United States, we are subject to provisions of the Sarbanes-Oxley Act of 2002. Section 404(a) of the Sarbanes-Oxley Act requires that we include a report from management on the effectiveness of our internal control over financial reporting in our annual reports on Form 20-F. In 2014, our management identified several material weaknesses in our internal controls over financial reporting. While our management concluded that these material weaknesses were remediated in 2015, and that our internal control over financial reporting was effective as of December 31, 2015 and December 31, 2016, there is no assurance that our management will conclude that our internal controls are effective in future periods. If we are unable to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud, which could result in a loss of investor confidence in the reliability of our reporting processes and could materially and adversely affect the trading price of our ADSs.

Our businesses and growth prospects are dependent upon the expected growth in China's consumer retail markets. Any future slowdown or decline in China's consumer retail markets could adversely affect our business, financial condition and results of operations.

Currently, all of our revenues are generated by sales of consumer products in China. Presently, the success of our business depends on the continued growth of China's consumer retail markets. The consumer retail markets in China are characterized by rapidly changing trends and continually evolving consumer preferences and purchasing patterns and power. China's consumer retail market is expected to grow in line with expected growth in consumer disposable income and the economy in China generally. However, projected growth rates for the Chinese economy and China's consumer retail markets may not be realized. Any slowdown or decline in China's consumer retail markets, or evolving consumer purchases and purchasing patterns away from our products, would have a direct adverse impact on us and

could adversely affect our business, financial condition and results of operations.

Risks Related to the Regulation of Our Business and Industry

PRC regulations relating to our industry are evolving. Any adverse or unanticipated regulatory changes, particularly those regarding the regulation of our direct sales business, could significantly harm our business or limit our ability to operate.

We and our distributors are subject to various laws regulating our advertising and any violation of these laws by us or our distributors could result in fines and penalties, harm our product brands and result in reduced net revenues.

PRC advertising laws and regulations require advertisers and advertising operators to ensure that the content of the advertising they prepare, publish or broadcast is fair and accurate, is not misleading and is in full compliance with applicable laws. Specifically, we, as an advertiser or advertising operator, and our distributors, as advertisers, are each required to independently review and verify the content of our respective advertising for content compliance before displaying the advertising through print media, radio or Internet portals. Moreover, the PRC unfair competition law prohibits us and our distributors from conveying misleading, false or inaccurate information with respect to quality, function, use, or other features of products, through advertising. Violation of these laws or regulations may result in penalties, including fines, confiscation of advertising income, orders to cease dissemination of the advertising, orders to publish an advertisement correcting the misleading information and criminal liabilities. In circumstances involving serious violations, the PRC government may suspend or revoke a violator's business license.

For advertising related to certain types of our products, such as those products constituting medical devices and health related products, we and our distributors must also file the advertising content with the provincial counterpart of the China's State Administration for Food and Drug, or SAFD, or other competent authorities, and obtain required permits and approvals for the advertising content from the SAFD or other competent authorities, in each case, before publication or broadcasting of the advertising. In addition, pursuant to the Food Safety Law of the PRC effective from June 1, 2009 and amended on April 24, 2015, the contents of food advertisements should be true and no disease-prevention or remedial function should be mentioned. We endeavor to comply, and encourage our distributors to comply, with such requirements. However, we and our distributors may fail to comply with these and other laws. Commencing on January 1, 2008, advertisements related to medical devices and health related foods are subject to the credit rating administration. The provincial counterpart of SAFD is responsible for collecting, recording, identifying and publishing the credit rating information of the advertiser. The credit rating of every advertiser will be categorized as one of good credit, dishonor credit or material dishonor credit and this rating is reviewed each year. An advertiser who receives a rating of dishonor credit or material dishonor credit may be ordered to improve its rating within a specified time limit and its business activities may be subject to special scrutiny if necessary. Therefore, any violations by us or our distributors relating to our oxygen generating devices may result in SAFD imposing on us or our distributors a dishonor credit or material dishonor credit rating. Our and our distributors' past and any future violations and a dishonor credit or material dishonor credit rating imposed upon us, if any, could seriously harm our corporate image, product brands and operating results.

In addition, the PRC Advertising Law, as recently amended in April 2015, outlines the regulatory framework for the advertising industry and requires advertisers, advertising operators and advertising distributors to ensure that the contents of the advertisements they prepare or distribute are true and in full compliance with applicable laws and regulations. For example, pursuant to PRC Advertising Law, advertisements must not contain, among other prohibited contents, terms such as “the state-level”, “the highest grade”, “the best” or other similar words. In addition, where a special government review is required for certain categories of advertisements before publishing, the advertisers, advertising operators and advertising distributors are obligated to confirm that such review has been performed and the relevant approval has been obtained. Pursuant to the PRC Advertising Law, the use of internet to distribute advertisements shall not affect the normal use of the internet by users. Particularly, advertisements distributed on internet pages such as pop-up advertisements shall be indicated with conspicuous mark for “close” to ensure the close of such advertisements is possible by one click. Where internet information service providers know or should know that illegal advertisements are distributed using their services, they shall prevent such advertisements from being distributed. Violation of these regulations may result in penalties, including fines, confiscation of advertising income, orders to cease dissemination of the advertisements and orders to publish an advertisement correcting the misleading information. In the case of serious violations, the State Administration for Industry and Commerce or its local branches may force the violator to terminate its advertising operation or even revoke its business license. Furthermore, advertisers, advertising operators or advertising distributors may be subject to civil liability if they infringe on the legal rights and interests of third parties.

Moreover, government actions and civil claims may be filed against us for misleading or inaccurate advertising, fraud, defamation, subversion, negligence, copyright or trademark infringement or other violations due to the nature and content of our advertising produced by us or our distributors. We have been fined by the relevant authorities for certain advertising that was considered misleading or false by the authorities. Historically, such fines have not been significant and related investigations into our advertising practices did not consume significant amounts of our management resources. In some cases, we were required to accept product returns. However, it is possible that we may have to expend significant resources in the future in defending against such actions and these actions may damage our reputation, result in reduced net revenues, negatively affect our results of operations, and even result in our business licenses being suspended or revoked and in criminal liability for us and our officers and directors.

If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising under Guideline Catalog of Foreign Investment Industries (2004 Revision), we could be subject to penalties.

On September 24, 2007, we acquired 100% of the legal ownership of Shanghai Advertising, which had been one of our affiliated entities, through Shanghai Acorn Enterprise Management Consulting Co., Ltd., or Acorn Consulting. At the time of our acquisition, the advertising industry was a restricted industry for foreign investment under the Guideline Catalog of Foreign Investment Industries (2004 Revision). Strictly speaking, Acorn Consulting, as a domestic subsidiary of foreign invested enterprises, might have been required under PRC law to obtain the approval of the Ministry of Commerce, or MOFCOM, or its local counterpart to invest in restricted industries, such as the advertising industry. However, on October 31, 2007, the National Development and Reform Commission, or NDRC, and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2007 Revision) which

identified the advertising industry as permitted industry for foreign investment. On December 24, 2011 the NDRC and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2011 Revision) as amended on March 10, 2015, under which the advertising industry continues to remain as permitted industry. As a permitted industry, approval of MOFCOM or its local counterpart is no longer required for a foreign invested enterprise or its domestic subsidiary to invest in advertising unless required by other specific PRC laws and regulations. Based upon the published interpretation on the website of Shanghai Foreign Investment Commission, or SFIC, MOFCOM's local counterpart in Shanghai, and oral advice we received from SFIC prior to the acquisition, we believe that it was not necessary for us to seek such approval at the time when we made the acquisition. However, because our acquisition occurred prior to, yet approaching, the removal of the advertising industry from the restricted list for foreign investment, and we did not receive the approval of SFIC, we may be deemed not in strict compliance with the then effective rules and could be subject to penalties. We were advised by SFIC in an anonymous consultation prior to the acquisition that this acquisition was a purely domestic acquisition without any foreign-related issues. Based on the advice of SFIC, Pudong Administration of Industry and Commerce in Shanghai accepted the registration of such acquisition and issued a new business license to Shanghai Advertising on September 24, 2007. We understand that it is unlikely that we would be required by the PRC regulatory authorities, in particular SAIC and MOFCOM or their local counterparts, to seek such approval to make up for our deficiency, or that any penalties would be imposed upon us for failure to obtain such approval.

However, we cannot assure you that SAIC or MOFCOM will not take a different view from ours and we would not be subject to penalties that, if imposed, could have a material adverse effect on our business and results of operation.

If the PRC government takes the view that our acquisition of Shanghai Advertising does not comply with PRC governmental restrictions on foreign investment in advertising under Administrative Regulation on Foreign-Invested Advertising Enterprises, we could be subject to severe penalties.

Direct investment by foreign investors in the advertising industry in China was previously subject to the Administrative Regulation on Foreign-Invested Advertising Enterprises jointly promulgated by MOFCOM and SAIC on March 2, 2004 and further revised on October 1, 2008. Under this advertising regulation, foreign investors are required to have had at least three years of experience in directly operating an advertising business outside of China before they may receive approval to own 100% of an advertising business in China. Foreign investors that do not have three years of experience are permitted to invest in advertising businesses, provided that such foreign investors have at least two years of direct operations in the advertising business outside of China and that such foreign investors may not own 100% of advertising businesses in China. Furthermore, all foreign invested advertising companies must obtain approval from SAIC or MOFCOM or their local counterparts. On June 29, 2015, the Administrative Regulation on Foreign-Invested Advertising Enterprises was abolished.

On September 24, 2007, we acquired 100% of the legal ownership of Shanghai Advertising, which had been one of our affiliated entities, through Acorn Consulting. Pudong Administration of Industry and Commerce in Shanghai did not require us to show that Acorn Consulting had the requisite years of operating experience in an advertising business outside of China either before or after it accepted the registration of the acquisition and issued a new business license to Shanghai Advertising. Furthermore, according to an anonymous consultation with SFIC, because our acquisition of Shanghai Advertising was completed through Acorn Consulting, a domestic subsidiary of a foreign invested enterprise, the acquisition was not subject to the requirement that foreign investors have the requisite years of operating experience in an advertising business outside of China.

Since our acquisition of Shanghai Advertising occurred prior to the revocation of Administrative Regulation on Foreign-Invested Advertising Enterprises, if the PRC government determines that our acquisition of Shanghai Advertising violated the then-effective requirements on foreign investment or re-investment in advertising businesses in China, as neither Acorn Consulting nor its shareholders had the requisite years of experience in the advertising industry required of foreign investors, we could be subject to severe penalties including among others, the revocation of the business licenses of our related subsidiaries, discontinuance of our advertising operations, the imposition of conditions with which we or our PRC subsidiaries may be unable to comply, or the restructuring of Shanghai Advertising. The imposition of any of these penalties could result in a material adverse effect on our ability to do business.

We may not fully comply with regulations on personal information protection which may subject us to administrative penalties.

Recently China has been imposing more stringent requirements on personal information protection. In particular, on December 28, 2012, the Standing Committee of the National People's Congress promulgated the Decision on Strengthening Internet Information Protection, or Internet Information Protection Rules, which required that, among other things, internet service providers and other entities must obtain consent from relevant persons before collecting and using personal electronic information during business activities and must make public rules on collecting and using personal information; personal electronic information collected must be strictly kept confidential and must not be divulged, tampered with, damaged, sold or illegally provided to others; anyone is not allowed to send commercial electronic information to an recipient without his or her consent or request, or after he or she has given an explicit refusal. The MIIT promulgated Provisions on Protecting Personal Information of Telecommunications and Internet Users, or Personal Information Protection Rules, on July 16, 2013 which provides detailed rules for standards on collection and use of users' personal information by telecommunications business operators and internet information service providers and security measures on protecting users' personal information. In addition, the Law on the Protection of Consumers' Rights and Interests amended on October 25, 2013 and effective from March 15, 2014 provides that business operators may not send commercial information to consumers without their consent or request, or after the consumers have expressly refused to receive such information. Furthermore, the Measures for Punishments against Infringements on Consumer Rights and Interests promulgated on January 5, 2015 and effective from March 15, 2015 provides that a business operator must refrain from any of the following acts: (i) collecting or using the consumers' personal information without the consent of the consumers; (ii) divulging, selling or illegally providing others with the consumers' personal information collected; and (iii) sending commercial information to

consumers without their consent or request, or after the consumers have expressly refused to receive such information. On November 7, 2016, the Standing Committee of the National People's Congress promulgated the PRC Cyber Security Law which, effective from June 1, 2017, imposes the following new requirements for the internet operators like us: (i) internet operators must notify the relevant consumers and the applicable government authority of the occurrence or potential occurrence of any divulging, damaging or loss of the personal information collected; and (ii) the internet operators must take proper measures to delete or correct the personal information collected at the request of the consumers whose personal information is used inappropriately or contains erroneous information. The PRC Cyber Security Law also increased the administrative punitive measures that the competent government authorities can take as well as the monetary penalty for any noncompliance.

During our business activities we have collected a large amount of our clients' information, such as names, addresses and phone numbers and from time to time send to our clients' promotion messages and mail in connection with our products through the contact information we have collected. After effectiveness of Internet Information Protection Rules, we have taken certain actions to comply with the requirements. However, given the limited interpretation on the rules, we cannot assure you that our business practices and the additional steps we take in response to the rules will be sufficient to fully comply with the Internet Information Protection Rules and the to-be-effective PRC Cyber Security Law, and that all of our clients' personal information are legally collected and used and fully protected in all respects. If relevant competent governmental authority holds that our business activities have violated Internet Information Protection Rules, we may be subject to certain administrative penalties, such as fines, and confiscating illegal gains.

If we fail to obtain permits or approvals applicable to our release, broadcasting and transmission of e-books and video and audio programs and internet information service, we may incur significant financial penalties and other government sanctions.

During operation of our business, we post information, including e-books and video and audio programs on our www.hjx.com website operated by us for the purpose of enabling our customers' downloads. Under applicable PRC laws, rules and regulations, the release, broadcasting and transmission of e-books and video and audio programs may be deemed as providing internet publication services as well as transmission of video and audio programs on the internet, which could require internet publication licenses and licenses for online transmission of audio-visual programs. However, our relevant operating entity has not obtained such licenses. We applied for the internet publication licenses but have not yet successfully obtained such license. In addition, our relevant operating entity is not qualified to obtain the licenses for online transmission of audio-visual programs under the current legal regime as it is not a wholly state-owned or state-controlled company. We plan to apply for licenses for online transmission of audio-visual programs when feasible to do so. Furthermore, according to relevant laws and regulations, as internet information service in our website of <http://www.hjx.com> is deemed an operating business, we need to obtain an ICP License from the relevant information industry authorities. On January 17, 2014, Beijing HJX Technology Development Co., Ltd., or Beijing HJX Technology, one of our affiliated entities, obtained an ICP License with a validity period of five years. However, due to management changes and our improper management of the original ICP License of Beijing HJX Technology, Beijing HJX Technology was not able to complete its annual inspection on such license, which may subject us to potential penalties. As of the date of this annual report, Beijing HJX Technology has not successfully renewed its ICP License, though it has very limited business that may require utilization of such license. In conjunction with shifting our core business from Beijing to Shanghai, we are currently in the process of preparing application documents for a new ICP License under the name of our subsidiary Shanghai Network. Any failure to obtain the above licenses may subject our affected operating entity to various penalties, including

confiscation of revenues, fines or the discontinuation of operations. Any such disruption in the business operations of our operating entity could materially and adversely affect our business, financial condition and results of operations.

Risks Related to Our Corporate Structure

If the PRC government takes the view that the agreements that establish the structure for operating our direct sales business and internet interactive service in China do not comply with PRC governmental restrictions on foreign investment in these areas, we could be subject to severe penalties.

Our direct sales business is regulated by MOFCOM and SAIC. Foreign investment in the direct sales business is highly restricted and must be approved by MOFCOM. To address these restrictions, two affiliated domestic entities of our Company, Shanghai Acorn Network Technology Development Co., Ltd., or Shanghai Network, and Beijing Acorn Trade Co., Ltd., or Beijing Acorn, were structured to operate our direct sales business. Until we obtain MOFCOM's approval to operate our direct sales business, we must continue to rely on these affiliated entities to sell our products to the customers. Furthermore, due to these restrictions on the direct sales business as well as certain restrictions or prohibitions on foreign ownership of companies that engage in internet and other related businesses imposed by current PRC laws and regulations, including the provision of internet content, we have set up another consolidated affiliated entity, Beijing HJX Technology, to conduct internet interactive services through Beijing HJX Technology (which held an ICP License expired). Our two affiliated domestic entities are currently owned by two PRC citizens, Mr. Kuan Song and Ms. Pan Zong, who are nominee shareholders engaged by us to hold the equity interests in our two affiliated domestic entities on our behalf. We have entered into contractual arrangements with these affiliated entities pursuant to which our wholly owned subsidiaries, Acorn Information Technology (Shanghai) Co., Ltd., or Acorn Information, and Acorn Trade (Shanghai) Co. Ltd., or Acorn Trade (Shanghai), provide technical support and operation and management services to these affiliated entities. In addition, we have entered into agreements with these affiliated entities and Mr. Song and Ms. Zong as their shareholders, providing us substantial ability to control each of these affiliated entities. For detailed descriptions of these contractual arrangements, see Item 4.C, "Information on the Company— Organizational Structure".

We understand that the ownership structures of (i) Acorn Information, Shanghai Network and Beijing Acorn; and (ii) Acorn Trade (Shanghai) and Beijing HJX Technology are in compliance with existing PRC laws and regulations and our contractual arrangements among (i) Acorn Information, Shanghai Network and Beijing Acorn and their shareholders; and (ii) Acorn Trade (Shanghai) and Beijing HJX Technology and their shareholders are valid, binding and enforceable. However, there are uncertainties regarding the interpretation and application of current and future PRC laws and regulations. If we, Acorn Information, Acorn Trade (Shanghai) or any of our affiliated entities are found to be in violation of any existing or future PRC laws or regulations or fail to obtain or maintain any of the required licenses, permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with these violations, including, among others:

• revoking the business and operating licenses of Acorn Information, Acorn Trade (Shanghai) and our affiliated entities;

• discontinuing or restricting the operations of Acorn Information, Acorn Trade (Shanghai) and our affiliated entities;

• limiting our business expansion in China by way of entering into contractual arrangements;

• imposing conditions or requirements with which we, Acorn Information, Acorn Trade (Shanghai) or our affiliated entities may be unable to comply;

• requiring us or Acorn Information, Acorn Trade (Shanghai) or our affiliated entities to restructure the relevant ownership structure or operations; or

• restricting or prohibiting our use of the proceeds of any additional public offering or other offshore or onshore capital raising transaction to finance our business and operations in China.

Our ability to conduct our business may be negatively affected if the PRC government were to carry out any of the aforementioned actions.

The contractual arrangements with our affiliated Chinese entities and its shareholders which relate to critical aspects of our operations, may not be as effective in providing operational control as direct ownership. In addition, these arrangements may be difficult and costly to enforce under PRC law.

We rely on contractual arrangements with our variable interest entities and their shareholders to operate our business in China. For a description of these contractual arrangements, see Item 4.C, “Information on the Company—Organizational Structure”. These contractual arrangements may not be as effective as direct ownership in providing us control over our consolidated affiliated entities. Direct ownership would allow us, for example, to directly exercise our rights as a shareholder to effect changes in the board of each affiliated entity, which, in turn, could effect changes, subject to any applicable fiduciary obligations, at the management level. If our variable interest entities or their shareholders fail to perform their respective obligations under these contractual arrangements, our recourse to the assets held by our consolidated affiliated entities is indirect and we may have to incur substantial costs and expend significant resources to enforce such arrangements in reliance on legal remedies under PRC law. These remedies may not always be effective, particularly in light of uncertainties in the PRC legal system.

In addition, all of these contractual arrangements are governed by PRC laws and provide for the resolution of disputes through arbitration in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC laws and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. Moreover, there have been certain instances where similar contractual arrangements with variable interest entities such as ours have been found unenforceable in PRC arbitration, and we cannot assure that will not happen to us. In the event that we are unable to enforce these contractual arrangements, or if we suffer significant time delays or other obstacles in the process of enforcing these contractual arrangements, it would be very difficult to exert effective control over our variable interest entities, and

our ability to conduct our business and our financial conditions and results of operations may be materially and adversely affected. See “—Risks Related to Doing Business in China—The PRC legal system embodies uncertainties which could limit the available legal protections.”

The shareholders of our variable interest entities may have potential conflicts of interest with us, which may materially and adversely affect our business and financial condition.

Shanghai Network, Beijing Acorn Trade Co., Ltd., and Beijing HJX Technology Development Co., Ltd. are our variable interest entities. Mr. Kuan Song and Ms. Pan Zong, together hold 100% of the equity interest in Shanghai Network, Beijing Acorn and Beijing HJX Technology.

The interests of Mr. Kuan Song and Ms. Pan Zong as the shareholders of our variable interest entities may differ from the interests of our Company as a whole, as what is in the best interests of our variable interest entities may not be in the best interests of our Company. We cannot assure you that if conflicts of interest arise, any or all of these individuals will act in the best interests of our Company or that conflicts of interest will be resolved in our favor. In addition, these individuals may breach or cause our variable interest entities and their subsidiaries to breach or refuse to renew the existing contractual arrangements with us.

Currently, we do not have arrangements to address potential conflicts of interest that the shareholders of our variable interest entities may encounter; provided that we could, at all times, exercise our option under the optional share purchase agreement to cause them to transfer all of their equity ownership in our variable interest entities to a PRC entity or individual designated by us as permitted by the then applicable PRC laws. In addition, if such conflicts of interest arise, we could also, in the capacity of attorney-in-fact of the then existing shareholders of our variable interest entities as provided under the power of attorney, directly appoint new directors of our variable interest entities. We rely on the shareholders of our variable interest entities to comply with the laws of China, which protect contractual rights. The laws also require them to avoid conflicts of interest and not to take advantage of their positions for personal gains. The laws of the Cayman Islands provide that directors owe a duty of care and a duty of loyalty to act honestly in good faith with a view to the Company's best interests. However, the legal frameworks of China and Cayman Islands do not provide guidance on how to resolve conflicts in the event of a conflict with another corporate governance regime.

If we cannot resolve any conflicts of interest or disputes between us and the shareholders of our variable interest entities, we would have to rely on legal proceedings, which could result in disruption of our business and subject us to substantial uncertainty as to the outcome of any such legal proceedings. Under the current contractual arrangements, as a legal matter, if any consolidated affiliated entity or Mr. Kuan Song or Ms. Pan Zong fails to perform its or their respective obligations under these contractual arrangements, we may have to incur substantial costs and expend significant resources to enforce those arrangements, and rely on legal remedies under PRC law. These remedies may include seeking specific performance or injunctive relief, and claiming damages, any of which may not be effective. For example, if either Mr. Kuan Song or Ms. Pan Zong refuses to transfer his or her equity interest in any affiliated entity to us or our designee when we exercise the purchase option pursuant to these contractual arrangements, or if either Mr. Kuan Song or Ms. Pan Zong otherwise acts in bad faith toward us, we may have to take legal action to compel him or her to fulfill his or her contractual obligations. In addition, as each of our affiliated entity is jointly owned and effectively managed by Mr. Kuan Song or Ms. Pan Zong, it may be difficult for us to change our

corporate structure or to bring claims against any affiliated entity or Mr. Kuan Song or Ms. Pan Zong if any of them fails to perform its or his or her obligations under the related contracts or does not cooperate with any such actions by us.

We may lose the ability to use and enjoy assets held by our PRC consolidated affiliated entities that are important to the operation of our business if such entities go bankrupt or become subject to a dissolution or liquidation proceeding.

As part of our contractual arrangements with our variable interest entities, such entities hold certain assets, such as patents for the proprietary technology that are essential to the operations of our platform and important to the operation of our business. If any of our variable interest entities goes bankrupt and all or part of its assets become subject to liens or rights of third party creditors, we may be unable to continue some or all of our business activities, which could materially and adversely affect our business, financial condition and results of operations. If any of our variable interest entities undergoes a voluntary or involuntary liquidation proceeding, the unrelated third party creditors may claim rights to some or all of these assets, thereby hindering our ability to operate our business, which could materially and adversely affect our business, financial condition and results of operations.

Our ability to enforce the equity pledge agreements between us and PRC variable interest entities' shareholder may be subject to limitations based on PRC laws and regulations.

Pursuant to the equity interest pledge agreements between our wholly owned subsidiaries in China and the shareholders of our variable interest entities, each shareholder of each variable interest entities agrees to pledge its equity interests in the variable interest entity to one of our subsidiaries to secure performance by the relevant variable interest entity, as well as by the shareholders of such variable interest entity, of its, his or her obligations under the relevant contractual arrangements. The equity interest pledges of shareholders of variable interest entities under these equity pledge agreements have been registered with the relevant local branch of the State Administration for Industry and Commerce, or SAIC. We may change our variable interest entities structure in the future. We have released the pledge over the equity interests held by the two nominee shareholders. Such changes are expected to reduce the cost of operation within our Group. In addition, in the registration forms of the local branch of State Administration for Industry and Commerce for the pledges over the equity interests under the equity interest pledge agreements, the aggregate amount of registered equity interests pledged to our wholly owned subsidiaries in China represents 100% of the registered capital of our variable interest entities. The equity interest pledge agreements with each of the variable interest entities' shareholders provide that the pledged equity interest shall constitute continuing security for any and all of the indebtedness, obligations and liabilities under all of the principal service agreements and the scope of pledge shall not be limited by the amount of the registered capital of that variable interest entity. However, it is possible that a PRC court may take the position that the amount listed on the equity pledge registration forms represents the full amount of the collateral that has been registered and perfected. If this is the case, the obligations that are supposed to be secured in the equity interest pledge agreements in excess of the amount listed on the equity pledge registration forms could be determined by the PRC court as unsecured debt, which takes last priority among creditors.

Our corporate structure may limit our ability to receive dividends from, and transfer funds to, our PRC subsidiaries, which could restrict our ability to act in response to changing market conditions and reallocate funds from one affiliated PRC entity to another in a timely manner.

We are a Cayman Islands holding company and substantially all of our operations are conducted through our 12 PRC subsidiaries and three variable interest entities. We may rely on dividends and other distributions from our PRC subsidiaries to provide us with our cash flow and allow us to pay dividends on the shares underlying our ADSs and meet our other obligations. Current regulations in China permit our PRC subsidiaries to pay dividends to us only out of their accumulated distributable profits, if any, determined in accordance with their articles of association and PRC accounting standards and regulations. The ability of these subsidiaries to make dividends and other payments to us may be restricted by factors that include changes in applicable foreign exchange and other laws and regulations. In particular, under PRC law, these operating subsidiaries may only pay dividends after 10% of their net profit has been set aside as reserve funds, unless such reserves have reached at least 50% of their respective registered capital. Such reserve may not be distributed as cash dividends. In addition, if any of our 12 PRC operating subsidiaries incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other payments to us. Moreover, the profit available for distribution from our Chinese operating subsidiaries is determined in accordance with generally accepted accounting principles in China. This calculation may differ from that performed in accordance with U.S. GAAP. As a result, we may not have sufficient distributions from our PRC subsidiaries to enable necessary profit distributions to us or any distributions to our shareholders in the future, which calculation would be based upon our financial statements prepared under U.S. GAAP. Furthermore, distributions by our PRC subsidiaries to us other than as dividends may be subject to governmental approval and taxation.

In addition, any transfer of funds from our offshore company to our PRC subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of Chinese governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our offshore company to our PRC subsidiaries. These limitations on the free flow of funds between us and our PRC subsidiaries could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese subsidiary to another in a timely manner.

The contractual arrangements entered into among our consolidated affiliated entities and their shareholders and those arrangements entered into between us or one of our Chinese subsidiaries and our consolidated affiliated entities may be subject to audit or challenge by the Chinese tax authorities. A finding that we, Acorn Information, Acorn Trade (Shanghai), our consolidated affiliated entities or any of our Chinese subsidiaries owe additional taxes could substantially reduce our net earnings and the value of your investment.

Under PRC laws and regulations, arrangements and transactions among related parties may be subject to audit or challenge by the PRC tax authorities. As a result of our corporate structure and the contractual arrangements among our PRC subsidiaries, our PRC consolidated affiliated entities and their shareholders, we are effectively subject to the

5% PRC business tax and generally subject to 6% PRC value added tax and related surcharges on revenues generated by our subsidiaries from our contractual arrangements with our PRC consolidated affiliated entities. The current EIT Law became effective on January 1, 2008 and provides authority for the PRC tax authority to make special adjustments to taxable income as well as additional reporting requirements. In particular, an enterprise must submit its annual tax return together with information on related party transactions to the tax authorities. The tax authorities may impose reasonable adjustments on taxation if they have identified any related party transactions that are inconsistent with arm's-length principles. In addition, the PRC tax authorities issued Implementation Measures for Special Tax Adjustments (Trial) on January 8, 2009 which set forth tax-filing disclosure and contemporaneous documentation requirements, clarify the definition of "related party", guide the selection and application of transfer pricing methods, and outline the due process procedures for transfer pricing investigation and assessment. These transactions may be subject to audit or challenge by the PRC tax authorities within ten years after the taxable year during which the transactions are conducted. We may be subject to adverse tax consequences if the PRC tax authorities were to determine that the contracts between us and our PRC consolidated affiliated entities were not on an arm's length basis and therefore constitute a favorable transfer pricing arrangements. If this occurs, the PRC tax authorities could request that either of our PRC consolidated affiliated entities adjust its taxable income upward for PRC tax purposes. A transfer pricing adjustment could, among other things, result in a reduction of expense deductions for PRC tax purposes recorded by us, our consolidated affiliated entities, or our PRC subsidiaries or an increase in taxable income, all of which could increase our tax liabilities. In addition, the PRC tax authorities may impose late payment fees and other penalties on us, our consolidated affiliated entities or our PRC subsidiaries for under-paid taxes.

The draft PRC Foreign Investment Law, if enacted as proposed, may materially impact the viability of our current corporate structure, corporate governance, business operations and financial results.

The MOFCOM published a discussion draft of the proposed Foreign Investment Law in January 2015 aiming to, upon its enactment, replace the trio of existing laws regulating foreign investment in China, namely, the Sino-foreign Equity Joint Venture Enterprise Law, the Sino-foreign Cooperative Joint Venture Enterprise Law and the Wholly Foreign-invested Enterprise Law, together with their implementation rules and ancillary regulations. The draft Foreign Investment Law embodies an expected PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. While the MOFCOM solicited public comments on this draft in January and February, 2015, substantial uncertainties exist with respect to its enactment timetable, interpretation and implementation, if any. The draft Foreign Investment Law, if enacted as proposed, may materially impact the entire legal framework regulating the foreign investments in China and may materially impact the viability of our current corporate structure, corporate governance, business operations and financial results.

Among other things, the draft Foreign Investment Law expands the definition of foreign investment and introduces the principle of “actual control” in determining whether a company is considered a foreign invested enterprise, or an FIE. The draft Foreign Investment Law specifically provides that entities established in China but “controlled” by foreign investors will be treated as FIEs, whereas an entity set up in a foreign jurisdiction would nonetheless be, upon market entry clearance by the MOFCOM or its local branches, treated as a PRC domestic investor provided that the entity is “controlled” by PRC entities and/or citizens. In this connection, “control” is broadly defined in the draft law to cover, among others, having the power to exert decisive influence, via contractual or trust arrangements, over the subject entity’s operations, financial matters or other key aspects of business operations. Once an entity is determined to be an FIE and its investment amount exceeds certain thresholds or its business operation falls within a “negative list”, to be separately issued by the State Council in the future, market entry clearance by the MOFCOM or its local branches would be required. Otherwise, all foreign investors may make investments on the same terms as Chinese investors without being subject to additional approval from the government authorities as mandated by the existing foreign investment legal regime.

The “variable interest entity” structure, or VIE structure, has been adopted by many PRC-headquartered offshore companies, to obtain necessary licenses and permits in the industries that are currently subject to foreign investment restrictions in China. We also set up the VIE structure to do our business in China. Under the draft Foreign Investment Law, variable interest entities that are controlled via contractual arrangement would also be deemed as FIEs, if they are ultimately “controlled” by foreign investors. Therefore, for any companies with a VIE structure in an industry category that is on the “negative list,” the VIE structure may be deemed legitimate only if the ultimate controlling person(s) is/ are of PRC nationality (either PRC individual, or PRC government and its branches or agencies). Conversely, if the actual controlling person(s) is/are of foreign nationalities, then the variable interest entities will be treated as FIEs and any operation in the industry category on the “negative list” without market entry clearance may be considered as illegal.

However, the draft Foreign Investment Law has not taken a position on what actions shall be taken with respect to the existing companies with a VIE structure, although a few possible options were proffered. Under these options, a company with VIE structures and in the business on the “negative list” at the time of enactment of the new Foreign Investment Law has either the option or obligation to disclose its corporate structure to the authorities, while the authorities, after reviewing the ultimate control structure of the company, may either permit the company to continue its business by maintaining the VIE structure (when the company is deemed ultimately controlled by PRC citizens), or require the company to dispose of its businesses and/or VIE structure based on circumstantial considerations. Moreover, it is uncertain whether the business that our VIEs are operating will be subject to the foreign investment restrictions or prohibitions set forth in the “negative list” to be issued. If the enacted version of the Foreign Investment Law and the final “negative list” mandate further actions, such as MOFCOM market entry clearance, to be completed by companies with existing VIE structure like us, we face uncertainties as to whether such clearance can be timely obtained, or at all.

The draft Foreign Investment Law, if enacted as proposed, may also materially impact our corporate governance practice and increase our compliance costs. For instance, the draft Foreign Investment Law imposes stringent ad hoc and periodic information reporting requirements on foreign investors and the applicable FIEs. Aside from the

investment implementation report and investment amendment report that are required at each investment and alteration of investment specifics, an annual report is mandatory, and large foreign investors meeting certain criteria are required to report on a quarterly basis. Any company found to be non-compliant with these information reporting obligations may potentially be subject to fines and/or administrative or criminal liabilities, and the persons directly responsible may be subject to criminal liabilities.

Risks Relating to Doing Business in China

Our operations may be adversely affected by changes in China's economic, political and social conditions.

All of our business operations are conducted in China and all of our revenues are derived from our marketing and sales of consumer products in China. Accordingly, our results of operations, financial condition, and future prospects are subject to a significant degree to economic, political and social conditions in China. The Chinese economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the Chinese economy has experienced significant growth in the past three decades, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage foreign investment and sustainable economic growth and to guide the allocation of financial and other resources, which have for the most part had a positive effect on our business and growth. However, we cannot assure you that the PRC government will not repeal or alter these measures or introduce new measures that will not have a negative effect on us. For example, our financial condition and results of operation may be adversely affected by changes in tax regulations applicable to us.

Although the Chinese economy has been transitioning from a planned economy to a more market-oriented economy since the late 1970s, the Chinese government continues to play a significant role in regulating industry development by imposing industrial policies. The Chinese government also exercises significant control over China's economic growth through the allocation of resources, controlling the incurrence and payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Changes in any of these policies, laws and regulations could adversely affect the overall economy in China, which could harm our business.

In particular, our business is primarily dependent upon the economy and the business environment in China. Our growth strategy is based upon the assumption that demand in China for our products will continue to grow with the growth of Chinese economy. However, the growth of the Chinese economy has been uneven across geographic regions and economic sectors, and experienced an economic slowdown in 2009 as a result of the global economic crisis. In addition, while the PRC economy has experienced significant growth in the past three decades, that growth may not continue, at least at the same rate, as evidenced by the slowing of the growth of the Chinese economy since 2012. Any adverse changes in economic conditions in China, in the policies of the Chinese government or in the laws and regulations in China could have a material adverse effect on the overall economic growth of China. Such changes in China's political or social conditions may also adversely affect our operations and financial results and may lead to reduction in demand for our services. In recent years, to encourage economic development, the PRC government has implemented various measures, many of which benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. In addition, future measures to control the pace of economic growth may also cause a decrease in the level of economic activity in China, which in turn could adversely affect our results of operations and financial condition.

The discontinuation of any of the preferential tax treatments and government subsidies available to us in China could materially and adversely affect our results of operations and financial condition.

Under PRC laws and regulations effective until December 31, 2007, our operating subsidiaries, Acorn International Electronic Technology (Shanghai) Co., Ltd., Shanghai HJX Digital Technology Co., Ltd., or Shanghai HJX, Zhuhai Acorn Electronic Technology Co., Ltd., Beijing Acorn Youngleda Technology Co., Ltd., or Beijing Youngleda and Yiyang Yukang Communication Equipment Co., Ltd., or Yiyang Yukang, enjoyed preferential tax benefits afforded to foreign-invested manufacturing enterprises and had been granted a two-year exemption from enterprise income tax beginning from their first profitable year and a 50% reduction of enterprise income tax rate for three years thereafter. The definition of a manufacturing enterprise under PRC law was vague and was subject to discretionary interpretation by the PRC authorities. If we were to be deemed not qualified in the past or if the tax preferential treatments enjoyed by us in accordance with local government rules or policies were deemed in violation of national laws and regulations and were abolished or altered, we would be subject to the standard statutory tax rate, which is 25% for calendar years starting on or after January 1, 2008, and we could be required to repay the income tax for the previous three years at the applicable non-preferential tax rate.

In addition, the new Enterprise Income Tax Law, or the New EIT Law and its implementing rules, which became effective on January 1, 2008, significantly curtails tax incentives granted to foreign-invested enterprises under the previous tax law. The New EIT Law (i) reduces the statutory rate of enterprise income tax from 33% to 25%, (ii) permits companies to continue to enjoy their existing tax incentives, subject to certain transitional phase-out rules, and (iii) introduces new tax incentives, subject to various qualification criteria. Under the phase-out rules, enterprises established before the promulgation date of the New EIT Law and which were granted preferential EIT treatment under the then effective tax laws or regulations may continue to enjoy their preferential tax treatments until their expiration. Additionally, our subsidiaries also received tax holidays and subsidies for certain taxes paid by us, as well as subsidies which formed part of the incentives provided by local government for our investment in local district.

These incentives were granted by local government agencies and may be deemed inappropriate by the central government. Preferential tax treatments and incentives granted to us by PRC governmental authorities are subject to review and may be adjusted or revoked at any time in the future. The discontinuation or revocation of any preferential tax treatments and incentive currently available to us will cause our effective tax rate to increase, which will decrease our net income and materially and adversely affect our financial condition and results of operations. See Item 5.A, “Operating and Financial Review and Prospects—Operating Results—Taxation”.

Under China’s New EIT Law, we may be classified as a “resident enterprise” of China. Such classification could result in unfavorable tax consequences to us and our non-PRC shareholders.

The New EIT Law provides that enterprises established outside China whose “de facto management bodies” are located in China are considered “resident enterprises” and are generally subject to the uniform 25% enterprise income tax rate as to their global income. Under the implementation rules, “de facto management” is defined as substantial and overall management and control over such aspects as the production and business, personnel, accounts and properties of an enterprise. In addition, two tax circulars issued by the State Administration of Taxation, or SAT, on April 22, 2009 and July 27, 2011 respectively regarding the standards used to classify certain Chinese-controlled enterprises established outside of China as “resident enterprises” clarified that dividends and other income paid by such “resident enterprises” will be considered to be PRC source income, subject to PRC withholding tax, currently at a rate of 10%, when recognized by non-PRC enterprise shareholders. These two circulars also subject such “resident enterprises” to various reporting requirements with the PRC tax authorities. Under the implementation rules to the New EIT Law, a “de facto management body” is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and other assets of an enterprise. In addition, the tax circulars mentioned above detail that certain Chinese-controlled enterprises will be classified as “resident enterprises” if the following are located or resident in China: senior management personnel and departments that are responsible for daily production, operation and management; financial and personnel decision making bodies; key properties, accounting books, company seal, and minutes of board meetings and shareholders’ meetings; and half or more of the senior management or directors having voting rights.

Currently, there are no detailed rules or precedents governing the procedures and specific criteria for determining “de facto management bodies” which are applicable to our company or our overseas subsidiary. The above two circulars only apply to offshore enterprises controlled by PRC enterprises or PRC enterprise groups, not those controlled by PRC individuals or foreign corporations like us. In the absence of detailed implementing regulations or other guidance determining that offshore companies controlled by PRC individuals or foreign corporations like us are PRC resident enterprises, we do not currently consider our company or any of our overseas subsidiaries to be a PRC resident enterprise.

However, if the PRC tax authorities determine that our Cayman Islands holding company is a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on offering proceeds and other non-China source income would be subject to PRC enterprise income tax at a rate of 25%, in comparison to no taxation in the Cayman Islands. Second, although under the New EIT Law and its implementation rules dividends paid to us from our PRC subsidiaries would qualify as “tax-exempt income”, we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes but not controlled by PRC enterprise or enterprise group like us. Finally, if our Cayman Islands holding company is deemed to be a PRC tax resident enterprise, a 10% withholding tax shall be imposed on dividends we pay to our non-PRC shareholders and with respect to gains derived from our non-PRC shareholders transferring our shares or ADSs. Similar results would follow if our BVI holding company is considered a PRC “resident enterprise”.

The PRC legal system embodies uncertainties which could limit the available legal protections and expand the government’s power.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation over the past three decades has significantly enhanced the protections afforded to various forms of foreign investment in China. 9 of our 12 PRC operating subsidiaries are foreign invested enterprises incorporated in China. They are subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to foreign-invested enterprises in particular. However, these laws, regulations and legal requirements change frequently, and their interpretation and enforcement involve uncertainties. For example, we may have to resort to administrative and court proceedings to enforce the legal protection that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than in more developed legal systems. In addition, such uncertainties, including the inability to enforce our contracts, could materially and adversely affect our business and operations. Furthermore, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. Furthermore, intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other countries. Accordingly, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the media, ecommerce, education, advertising and retail industries, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us, and our foreign investors, including you.

The PRC legal system is also vague on certain aspects related to the local government's powers, especially the power related to the right to repurchase natural resources for public interest. For example, on December 26, 2008, we executed a State-owned Construction Land Use Right Transfer Contract, or the Land Use Right Contract, with the local government of Qingpu District to obtain a fifty-year land use right of a piece of land located in Qingpu District of Shanghai. Recently we've been contacted by such local government expressing a wish to buy back the land. We have not been offered a specific price and although we are assured by counsel that government cannot force such a buy back, given uncertainties around law and regulation in China we cannot say for certain that such buy back won't occur.

Governmental control of currency conversion may limit our ability to utilize our revenues effectively and affect the value of your investment.

The PRC government imposes controls on the convertibility of the RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and trade and service-related foreign exchange transactions, can be made in foreign currencies without prior SAFE approval by complying with certain procedural requirements. Therefore, after complying with certain procedural requirements, Acorn International's PRC subsidiaries are able to pay dividends in foreign currencies to us without prior approval from SAFE. However, approval from or registration with appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access to foreign currencies for current account transactions in the future. If the foreign exchange control system prevents us from obtaining sufficient foreign currencies to satisfy our foreign currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

Because our revenues are generated in Renminbi and our results are reported in U.S. dollars, ongoing devaluation of the Renminbi could negatively impact our results of operations.

The value of the Renminbi against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. The conversion of Renminbi into foreign currencies, including U.S. dollars, is based on rates set by the People's Bank of China. The PRC government allowed the Renminbi to appreciate more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. From June 2010 through January 2014, the PRC government allowed the Renminbi to appreciate slowly against the U.S. dollar again, though there were periods during that time when the U.S. dollar appreciated against the Renminbi as well. In April 2012, the PRC government announced that it would allow more RMB exchange rate fluctuation. However, it remains unclear how this announcement might be implemented. There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in greater fluctuation of the RMB against the U.S. dollar. From June 2010 to January 2014, the RMB has appreciated against the U.S. dollar from approximately RMB6.82 per U.S. dollar to RMB6.05 per U.S. dollar, reaching a new historical height, followed by the RMB depreciating against the U.S. dollar to RMB6.48 per U.S. dollar on December 31, 2015, with further depreciation to RMB6.94 per U.S. dollar by December 31, 2016. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the

Renminbi and the U.S. dollar in the future.

There remains significant international pressure on the Chinese government to adopt a flexible currency policy to allow the Renminbi to appreciate against the U.S. dollar. Significant revaluation of the Renminbi may have a material adverse effect on your investment. Substantially all of our revenues and costs are denominated in Renminbi. Any significant devaluation of Renminbi may materially and adversely affect our revenues, earnings and financial position, and the value of, and any dividends payable on, our ADSs in U.S. dollars. To the extent that we need to convert U.S. dollars into RMB for capital expenditures and working capital and other business purposes, appreciation of the RMB against the U.S. dollar would have an adverse effect on the RMB amount we would receive from the conversion. Conversely, a significant depreciation of the Renminbi against the U.S. dollar may significantly reduce the U.S. dollar equivalent of our earnings, which in turn could adversely affect the price of our ADSs, and if we decide to convert RMB into U.S. dollars for the purpose of making payments for dividends on our common shares or ADSs, strategic acquisitions or investments or other business purposes, appreciation of the U.S. dollar against the RMB would have a negative effect on the U.S. dollar amount available to us.

Very limited hedging options are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to adequately hedge our exposure or at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency. As a result, fluctuations in exchange rates may have a material adverse effect on your investment.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us, our management or the experts named in the annual report.

We conduct all of our operations in China and substantially all of our assets are located in China. In addition, almost all of our directors and executive officers reside within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside China upon some of our directors and senior executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. Moreover, we understand that the PRC currently does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts.

Regulations relating to offshore investment activities by PRC residents may increase the administrative burden we face and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by our shareholders who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose our PRC resident shareholders to liability under PRC law.

On July 4, 2014, the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, was promulgated by SAFE, which replaced the former circular commonly known as "Notice 75" promulgated by SAFE on October 21, 2005 and requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle." SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiary of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls. Pursuant to the Circular on Further Simplifying and Improving the Direct Investment-related Foreign Exchange Administration Policies, or SAFE Circular 13, promulgated by SAFE, starting from June 1, 2015, the registration (including initial registration and amendment registration) under SAFE Circular 37 will be directly reviewed and handled by local banks.

We have already notified our shareholders and the shareholders of the offshore entities in our corporate group, who are PRC residents known by us to urge them to make the necessary applications and filings, as required under SAFE Circular 37. We understand that the relevant shareholders have registered their offshore investments in us with Shanghai SAFE, where most of our PRC subsidiaries are located. We are committed to complying, and to ensuring that our shareholders who are subject to the regulation comply, with the relevant rules. However, we cannot assure you that all of our shareholders who are PRC residents will comply with our request to make or obtain any applicable registrations or approvals required by SAFE Circular 37 and SAFE Circular 13. In addition, SAFE Circular 37 and SAFE Circular 13 were recently promulgated, and it is unclear how these regulations and relevant rules will be interpreted, amended and implemented by the relevant PRC government authorities. The failure or inability of our PRC resident shareholders to receive any required approvals or make any required registrations may limit our PRC subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, as a result of which our acquisition strategy and business operations and our ability to distribute profits to you could be materially and adversely affected.

Upon the completion of our acquisition of Yiyang Yukang in December 2008, shareholders of Yiyang Yukang became our shareholders. To our knowledge, some of the prior shareholders of Yiyang Yukang did not file applications for SAFE registration, which may adversely affect our ability to distribute dividends to our shareholders as stated above. To our knowledge, a separate registration in respect of Notice 75 which was effective at the moment of the above acquisition is not applicable to our acquisition of Yiyang Yukang.

A failure by us and PRC individuals who hold shares or share options granted pursuant to an employee share option or share incentive plan to comply with relevant PRC laws and regulations related to share option could expose us and our PRC individual option holders to liability under PRC law.

On March 28, 2007, SAFE issued the Operating Rules for Administration of Foreign Exchange for Domestic Individuals' Participation in Employee Stock Ownership Plans and Stock Option Plans of Overseas Listed Companies, or Circular 78. On February 15, 2012, SAFE promulgated the Circular on Relevant Issues Concerning Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Listed Companies, or Circular 7, in replacement of Circular 78. According to Circular 7, individuals in the PRC (including PRC citizens and foreign individuals who have lived in China over one year) who intend to participate in the stock incentive plan of an overseas listed company shall jointly appoint a qualified PRC domestic agent or a PRC subsidiary of such overseas listed company ("a PRC Agency") to conduct foreign exchange registration with SAFE, open bank accounts and transfer and exchange funds. In addition, an overseas entity shall be appointed to conduct the exercise of options, buying and selling of relevant stocks or equities and transfer of relevant funds. After such individuals' foreign exchange income from participation in the stock incentive plan is remitted to the PRC, relevant banks shall distribute the above funds from the account opened and managed by the PRC Agency to such individuals' foreign exchange accounts. We and our employees within PRC who have been granted share options, or PRC option holders, are subject to Circular 7 upon the listing of our ADSs on NYSE. If we or our PRC option holders fail to comply with these regulations, we or our PRC option/stock appreciation right holders may be subject to fines and other legal or administrative sanctions. Furthermore, pursuant to the Notice on Relevant Issues Concerning Collection of Individual Income Tax Related to Income from Share Option issued by the Ministry of Finance and the SAT on March 28, 2005 and the Notice on Issues of Individual Income Tax Concerning Share Incentive Plan issued by the SAT on August 24, 2009, as to an overseas listed company's share option plan, the difference obtained by a PRC individual who has been granted share options between the exercise price below the fair market price of such share on the day when such individual exercises his option shall be imposed individual income tax which shall be withheld by domestic entities of such overseas listed company. If we or our PRC employees fail to comply with the above regulations, we or our PRC option holders may be subject to failure of share option plan or/and a fine, and, in the serious case, may constitute a crime.

The enforcement of the PRC Labor Contract Law and other labor-related regulations in the PRC may adversely affect our business and our results of operations.

The PRC Labor Contract Law, which became effective on January 1, 2008, and its implementing rules impose requirements concerning contracts entered into between a PRC employer and its employees and establish time limits for probationary periods. Because the Labor Contract Law and its implementing rules lack clarity with respect to their implementation and potential penalties and fines, there may be a risk that certain of our employment policies and practices could be determined by relevant PRC authorities as being in violation of the Labor Contract Law or its implementing rules, which could result in penalties, fines or other sanctions. If we are subject to large penalties or fees related to the Labor Contract Law or its implementing rules, our business, financial condition and results of operations may be materially and adversely affected. In addition, according to the Labor Contract Law and its implementing rules, under certain cases an employee who is terminated by us is entitled to receive a severance payment equal to his or her average monthly salary during the 12-month period immediately preceding to the termination for each year of service up to the date of termination. If we terminate a labor contract in any circumstance other than those specified under the PRC Labor Contract Law and its implementing rules, including termination without cause, we must either reinstate and continue to perform the employee's employment contract or pay the employee damages calculated at twice the rate for calculating the severance payment, subject to the employee's own request. Due to our cost controls and internal business restructuring, we are in the process of termination of our employees' labor contracts on a large scale and we have to pay to terminated employees a large amount of severance payment or damages. As such, our business, financial condition and results of operations may be materially and adversely affected. Furthermore, the PRC Labor Contract Law and subsequently passed rules and regulations have tended to provide greater rights to employees and impose more onerous requirements on employers in China. As a result of regulations designed to enhance labor protection, our labor costs in China may increase in the future.

On December 28, 2012, the Labor Contract Law was amended to impose more stringent requirements on labor dispatch which became effective on July 1, 2013. For example, an employer shall strictly control the number of dispatched employees not to exceed certain percentage of its total number of employees. Moreover, the Interim Provisions on Labor Dispatch, or the Dispatch Rule, effective on March 1, 2014, provides that dispatched employees are only be allowed to work in temporary, ancillary and replaceable positions. The number of dispatched employees hired by an employer may not exceed 10% of its total labor force and the employer has a two-year transition period to comply with such requirement. Pursuant to the current Labor Contract Law, a labor-dispatching enterprise or an employer using dispatched workers who violates requirements of labor dispatching under the Labor Contract Law may be subject to fine by competent labor administrative authority and, if losses are caused to any dispatched employee, such labor-dispatching enterprise and employer shall assume liabilities jointly and severally. Currently, a majority of our call center employees are recruited as dispatched employees and such employees are not working in said temporary, ancillary and replaceable positions. Besides, the number of dispatched workers in certain of our PRC subsidiaries has exceeded 10% of their respective total number of employees as required by the Dispatch Rule. Therefore, we have to reduce the number of our dispatched workers to comply with the percentage limitation as required, which may result in an increase in our labor costs. If we fail to decrease the number of our dispatched workers, we may be subject to penalties by competent labor administrative authority. In addition, if our dispatched employees suffer losses arising from relevant labor-dispatching agency's violation of the Labor Contract Law, we, as the enterprise engaging such employees, may be required by such dispatched employees to assume liabilities. We cannot assure you that, after assumption of such liability, we will successfully obtain reimbursement from relevant labor-dispatching agency.

If the custodians or authorized users of controlling non-tangible assets of our company, including our corporate chops and seals, fail to fulfill their responsibilities, or misappropriate or misuse these assets, our business and operations could be materially and adversely affected.

Under PRC law, legal documents for corporate transactions are executed using the chops or seals of the signing entity or with the signature of a legal representative whose designation is registered and filed with the relevant branch of the Administration of Industry and Commerce.

Although we usually utilize chops to enter into contracts, the designated legal representatives of each of our PRC subsidiaries and consolidated affiliated entities have the apparent authority to enter into contracts on behalf of such entities without chops and bind such entities. All designated legal representatives of our PRC subsidiaries and consolidated affiliated entities are members of our senior management team who have signed employment agreements with us or our PRC subsidiaries and consolidated affiliated entities under which they agree to abide by various duties they owe to us. In order to maintain the physical security of our chops of our PRC entities, we generally store these items in secured locations accessible only by the authorized personnel in the legal or finance department of each of our subsidiaries and consolidated affiliated entities. Although we monitor such authorized personnel, there is no assurance that such procedures will prevent all instances of abuse or negligence. Accordingly, if any of our authorized personnel misuse or misappropriate our corporate chops or seals, we could encounter difficulties in maintaining control over the relevant entities and experience significant disruption to our operations. If a designated legal representative obtains control of the chops in an effort to obtain control over any of our PRC subsidiaries or consolidated affiliated entities, we or our PRC subsidiary and consolidated affiliated entity would need to pass a new shareholder or board resolution to designate a new legal representative and we would need to take legal action to seek the return of the chops, apply for new chops with the relevant authorities, or otherwise seek legal redress for the violation of the representative's fiduciary duties to us, which could involve significant time and resources and divert management attention away from our regular business. In addition, the affected entity may not be able to recover corporate assets that are sold or transferred out of our control in the event of such a misappropriation if a transferee relies on the apparent authority of the representative and acts in good faith.

Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the SEC, as auditors of companies that are traded publicly in the United States and a firm registered with the PCAOB, is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditors are located in the Peoples' Republic of China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, our auditors are not currently inspected by the PCAOB. In May 2013, the PCAOB announced that it had entered into a Memorandum of Understanding on Enforcement Cooperation with the CSRC and

the Ministry of Finance, which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations undertaken by the PCAOB, the China Securities Regulatory Commission, or the CSRC, or the Ministry of Finance in the United States and China, respectively. The PCAOB continues to be in discussions with the CSRC and the Ministry of Finance to permit joint inspections in China of audit firms that are registered with the PCAOB and audit Chinese companies that trade on U.S. exchanges.

Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections, and to the extent that such inspections might have facilitated improvements in our auditor's audit procedures and quality control procedures, investors may be deprived of such benefits. In addition, investors may lose confidence in our reported financial information and procedures and the quality of our financial statements, which may have a material adverse effect on our ADS price.

If additional remedial measures are imposed on the Chinese affiliates of the five of the largest global public accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, with respect to requests for the production of documents, we could be unable to timely file future financial statements in compliance with the requirements of the Securities Exchange Act of 1934.

Starting in 2011 the Chinese affiliates of the five of the largest global public accounting firms, (including our independent registered public accounting firm) were affected by a conflict between US and Chinese law. Specifically, for certain US listed companies operating and audited in mainland China, the SEC and the PCAOB sought to obtain from the Chinese firms access to their audit work papers and related documents. The firms were, however, advised and directed that under China law they could not respond directly to the US regulators on those requests, and that requests by foreign regulators for access to such papers in China had to be channeled through the CSRC.

In late 2012 this impasse led the SEC to commence administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the Chinese accounting firms, (including our independent registered public accounting firm). A first instance trial of the proceedings in July 2013 in the SEC's internal administrative court resulted in an adverse judgment against the firms. The administrative law judge proposed penalties on the firms including a temporary suspension of their right to practice before the SEC, although that proposed penalty did not take effect pending review by the Commissioners of the SEC. On February 6, 2015, before a review by the Commissioner had taken place, the firms reached a settlement with the SEC. Under the settlement, the SEC accepts that future requests by the SEC for the production of documents will normally be made to the CSRC. The firms will receive matching Section 106 requests, and are required to abide by a detailed set of procedures with respect to such requests, which in substance require them to facilitate production via the CSRC. If they fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. Remedies for any future noncompliance could include, as appropriate, an automatic six-month bar on a single firm's performance of certain audit work, commencement of a new proceeding against a firm, or in extreme cases the resumption of the current proceeding against all four firms.

In the event that the SEC restarts the administrative proceedings, depending upon the final outcome, listed companies in the United States with major PRC operations may find it difficult or impossible to retain auditors in respect of their operations in the PRC, which could result in financial statements being determined to not be in compliance with the requirements of the Exchange Act, including possible delisting. Moreover, any negative news about any such future proceedings against these audit firms may cause investor uncertainty regarding PRC-based, United States-listed companies and the market price of our ADSs may be adversely affected.

If our independent registered public accounting firm were denied, even temporarily, the ability to practice before the SEC and we were unable to timely find another registered public accounting firm to audit and issue an opinion on our financial statements, our financial statements could be determined not to be in compliance with the requirements of the Exchange Act of 1934, as amended. Such a determination could ultimately lead to the delisting of our ADSs from the NYSE or deregistration from the SEC, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

We face risks related to natural disasters, health epidemics and other outbreaks, which could significantly disrupt our operations.

On May 12, 2008 and April 14, 2010, severe earthquakes hit part of Sichuan province in southeastern China and part of Qinghai province in western China, respectively, resulting in significant casualties and property damage. While we did not suffer any loss or experience any significant increase in cost resulting from these earthquakes, if a similar disaster were to occur in the future that affected Shanghai or another city where we have major operations, our operations could be materially and adversely affected due to loss of personnel and damages to property. In addition, a similar disaster affecting a larger, more developed area could also cause an increase in our costs resulting from the efforts to resurvey the affected area. Even if we are not directly affected, such a disaster could affect the operations or

financial condition of our customers and suppliers, which could harm our results of operations.

In addition, our business could be materially and adversely affected by natural disasters or public health emergencies, such as the outbreak of avian influenza, severe acute respiratory syndrome, or SARS, Ebola virus, Zika, or another epidemic. In April 2009, a new strain of influenza A virus subtype H1N1, commonly referred to as “swine flu,” was first discovered in North America and quickly spread to other parts of the world, including China. In early June 2009, the World Health Organization, or the WHO, declared the outbreak to be a pandemic, while noting that most of the illnesses were of moderate severity. The PRC Ministry of Health has reported several hundred deaths caused by influenza A (H1N1). In March 2013, a new virus subtype H7N9, commonly known as “bird flu” or “avian flu,” was discovered in eastern China. In April 2013, the WHO has identified H7N9 as “an unusually dangerous virus for humans” but the number of cases detected after April 2013 fell abruptly. Any outbreak of avian flu, SARS, influenza A (H1N1), or their variations, or other adverse public health epidemic in China may have a material and adverse effect on our business operations. These occurrences could require the temporary closure of our offices or prevent our staff from traveling to our customers’ offices to provide on-site services. Such closures could severely disrupt our business operations and adversely affect our results of operations.

Risks Relating to Our ADSs.

Our ADSs may be delisted from the New York Stock Exchange which would adversely impact our public float and the trading price for our ADSs.

We must comply with various listing standards to maintain our continued NYSE listing. For example, the average closing price for our ADSs is not permitted to fall below \$1.00 over a 30 trading-day period. On two recent occasions we were notified by the NYSE that we were in violation of this listing standard.

On March 19, 2015, the NYSE notified us that the closing price of our ADSs for the consecutive 30 trading-day period ended on March 13, 2015 was \$0.99 and therefore below the NYSE’s continued listing standard relating to minimum average closing share price. Subsequent increases in the closing prices of our ADSs allowed us to regain compliance with the minimum share price rule by April 2015 but on September 15, 2015, the NYSE again notified us that we were below the NYSE’s continued listing criteria because the average per share closing price of our ADS for the consecutive 30 trading-day period ended on September 11, 2015 had fallen below \$1.00. We regained compliance with the NYSE continued listing criteria after we changed the ratio of ordinary shares per one ADS from 1 ADS representing three ordinary shares to one ADS representing twenty ordinary shares (equivalent to a three-for-twenty reverse ADS split).

Our efforts to maintain our ADS average closing price at or above \$1.00 to satisfy the relevant continued listing requirements may not succeed. We also have no assurance that we will continue to be in compliance with other NYSE listing standards. In addition, we would be subject to immediate suspension and de-listing from the NYSE if our average market capitalization is less than \$15 million over a consecutive 30 trading-day period. As of April 30, 2017,

our market capitalization was approximately \$40.45 million. Furthermore, if our shareholders' equity falls below \$50 million during any time when our average market capitalization over the previous consecutive 30 trading-day period is less than \$50 million, the NYSE could take actions to delist our ADSs. As of December 31, 2016, we had shareholders' equity of \$99.5 million.

We may be classified as a passive foreign investment company or “PFIC” for U.S. federal income tax purposes for a given taxable year pursuant to an annual factual determination made after the close of that year; pursuant to a determination made in 2017 we believe we were classified as a PFIC for the 2016 taxable year.

Depending upon the value of our ADSs or ordinary shares and the nature of our assets and income over time, we could be classified as a PFIC for U.S. federal income tax purposes. We will be classified as a PFIC in any taxable year if either: (a) the average quarterly value of our gross assets that produce passive income or are held for the production of passive income is at least 50% of the average quarterly value of our total gross assets or (b) 75% or more of our gross income for the taxable year is passive income. According to these technical rules, we would likely become a PFIC for a given taxable year if our market capitalization were to decrease significantly while we hold substantial cash and cash equivalents in that year.

If we are classified as a PFIC in any taxable year in which you hold our ADSs or ordinary shares and you are a U.S. investor, subject to certain exceptions described in Item 10.E, “Additional Information—Taxation—U.S. Federal Income Taxation—Passive Foreign Investment Company,” you would generally be taxed at higher ordinary income rates, rather than lower capital gain rates, if you dispose of ADSs or ordinary shares for a gain in a later year, even if we are no longer a PFIC in that year. In addition, a portion of the tax imposed on your gain would be increased by an interest charge. Moreover, if we were classified as a PFIC in any taxable year, you would not be able to benefit from any preferential tax rate with respect to any dividend distribution that you may receive from us in that year or in the following year. Finally, you would also be subject to special U.S. tax reporting requirements.

Our PFIC status for the current taxable year 2017 will not be determinable until after the close of the taxable year ending December 31, 2017. Because we currently hold, and expect to continue to hold, a substantial amount of cash and other passive assets and, because the value of our assets is likely to be determined in large part by reference to the market prices of our ADSs or ordinary shares, which are likely to fluctuate, there can be no assurance that we will not be classified as a PFIC in 2017 and any future taxable year. Based on a determination made in 2017 with respect to the 2016 taxable year, we believe we were classified as a PFIC for the 2016 taxable year. U.S. investors are urged to consult their independent tax advisors about the application of the PFIC rules and certain elections that may help them relieve any adverse U.S. federal income tax consequences for their particular circumstances for the 2016 taxable year. For more information regarding such elections, please consult Item 10.E, “Additional Information—Taxation—U.S. Federal Income Taxation—Passive Foreign Investment Company” and your independent tax advisor.

The sale, deposit, cancellation and transfer of the ADSs issued after an exercise of rights may be restricted under applicable U.S. securities laws.

If we offer holders of our ordinary shares any rights to subscribe for additional shares or any other rights, the depositary may make these rights available to holders of our ADSs if it is lawful and reasonably practicable to do so.

However, the depositary may allow rights that are not distributed or sold to lapse. In that case, holders of our ADSs will receive no value for them. In addition, U.S. securities laws may restrict the sale, deposit, cancellation and transfer of the ADSs issued after exercise of rights. Under the deposit agreement, the depositary will not distribute rights to holders of ADSs unless the distribution and sale of rights and the securities to which these rights relate are either exempt from registration under the Securities Act with respect to holders of ADSs, or are registered under the provisions of the Securities Act. We can give no assurance that we can establish an exemption from registration under the Securities Act, and we are under no obligation to file a registration statement with respect to these rights or underlying securities or to endeavor to have a registration statement declared effective. Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

The trading prices of our ADSs may be volatile, which could result in substantial losses to investors.

The daily closing trading prices of our ADSs ranged from US\$2.4695 to \$19.2000 in 2015 (adjusted to reflect the November 2015 increase in our ordinary shares to 1 ADS ratio to 20:1), and from \$4.0100 to \$12.3500 in 2016. The trading price of our ADSs is likely to be volatile and could fluctuate widely due to factors beyond our control. This may happen because of broad market and industry factors, like the performance and fluctuation in the market prices or the underperformance or deteriorating financial results of other similarly situated companies in China that have listed their securities in the United States in recent years. The securities of some of these companies have experienced significant volatility since their initial public offerings, including, in some cases, substantial price declines in the trading prices of their securities. The trading performances of these Chinese companies' securities after their offerings may affect the attitudes of investors toward Chinese companies listed in the United States, which consequently may impact the trading performance of our ADSs, regardless of our actual operating performance. In addition, any negative news or perceptions about inadequate corporate governance practices or fraudulent accounting or other practices at other Chinese companies may also negatively affect the attitudes of investors towards Chinese companies in general, including us, regardless of whether we have engaged in such practices. Furthermore, securities markets may from time to time experience significant price and volume fluctuations that are not related to our operating performance, which may have a material adverse effect on the market price of our ADSs.

In addition to market and industry factors, the price and trading volume for our ADSs may be highly volatile due to specific factors, including the following:

- variations in our net revenues, earnings and cash flow;
- announcements of new investments, acquisitions, strategic partnerships, or joint ventures;
- announcements of new services and expansions by us or our competitors;

• changes in financial estimates by securities analysts;

• failure on our part to realize monetization opportunities as expected;

• additions or departures of key personnel or directors;

• any announcement regarding the NYSE listing status of our ADSs and actions proposed to be taken to preserve our NYSE listing;

• detrimental negative publicity about us, our competitors or our industry; and

• potential litigation or regulatory proceedings or changes.

Any of these factors may result in large and sudden changes in the volume and price at which our ADSs will trade.

If securities or industry analysts do not publish research or reports about our business, or if they adversely change their recommendations regarding our ADSs, the market price for our ADSs and trading volume could decline.

The trading market for our ADSs will be influenced by research or reports that industry or securities analysts publish about our business. If one or more analysts who cover us downgrade our ADSs, the market price for our ADSs would likely decline. If one or more of these analysts cease to cover us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which, in turn, could cause the market price or trading volume for our ADSs to decline.

Anti-takeover provisions in our charter documents may discourage a third party from acquiring us, which could limit our shareholders' opportunities to sell their shares at a premium.

Our amended and restated memorandum and articles of association include provisions that could limit the ability of others to acquire control of us, modify our structure or cause us to engage in change-of-control transactions. These provisions could have the effect of depriving our shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of us in a tender offer or similar transaction.

For example, our board of directors has the authority, without further action by our shareholders, to issue preferred shares in one or more series and to fix the powers and rights of these shares, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, any or all of which may be greater than the rights associated with our ordinary shares. Preferred shares could thus be issued quickly with terms calculated to delay or prevent a change in control or make removal of management more difficult. In addition, if our board of directors issues preferred shares, the market price of our ordinary shares may fall and the voting and other rights of the holders of our ordinary shares may be adversely affected.

We are a Cayman Islands company and, because judicial precedent regarding the rights of shareholders is more limited under Cayman Islands law than under U.S. law, our shareholders may have less protection of their shareholder rights than they would under U.S. law.

Our corporate affairs are governed by our amended and restated memorandum and articles of association, the Cayman Islands Companies Law and the common law of the Cayman Islands. The rights of shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands, as well as from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedent in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities laws than the United States. In addition, some states, such as Delaware, have more fully developed and judicially interpreted bodies of corporate law than the Cayman Islands.

Unlike many jurisdictions in the United States, Cayman Islands law does not generally provide for shareholder appraisal rights on an approved arrangement and reconstruction of a company. This may make it more difficult for you to assess the value of any consideration you may receive in a merger or consolidation or to require that the offer or give you additional consideration if you believe the consideration offered is insufficient. Moreover, holders of our ADSs are not entitled to appraisal rights under Cayman Islands law. ADS holders that wish to exercise their appraisal or dissenter's rights must convert their ADSs into ordinary shares by surrendering their ADSs to the depositary and paying the ADS depositary fee.

Shareholders of Cayman Islands exempted companies like us have no general rights under Cayman Islands law to inspect corporate records or to obtain copies of lists of shareholders of these companies. Our directors have discretion under our existing articles of association to determine whether or not, and under what conditions, our corporate records may be inspected by our shareholders, but are not obliged to make them available to our shareholders. This may make it more difficult for you to obtain the information needed to establish any facts necessary for a shareholder motion or to solicit proxies from other shareholders in connection with a proxy contest.

As a result of all of the above, public shareholders may have more difficulty in protecting their interests in the face of actions taken by management, members of the board of directors or controlling shareholders than they would as public shareholders of a company incorporated in the United States.

Judgments obtained against us by our shareholders may not be enforceable in our home jurisdiction.

We are incorporated in the Cayman Islands, and conduct substantially all of our operations in China through our subsidiaries established in China. Most of our directors and officers reside outside the United States and substantially all of the assets of those persons are located outside the United States. As a result, it may be difficult or impossible for our shareholders to bring an action against us or against these individuals in the Cayman Islands or in China in the event that our shareholders believe that their rights have been infringed under the applicable securities laws or otherwise. Even if our shareholders are successful in bringing an action of this kind, the laws of the Cayman Islands and of China may render them unable to enforce a judgment against our assets or the assets of our directors and officers.

There are uncertainties as to whether Cayman Islands courts would:

• recognize or enforce judgments of U.S. courts obtained against us or our directors or officers predicated upon the civil liability provisions of the securities laws of the United States or any state in the United States; or

• entertain original actions brought against us or our directors or officers predicated upon the securities laws of the United States or any state in the United States.

There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the Cayman Islands will generally recognize as a valid judgment, a final and conclusive judgment *in personam* obtained in the federal or state courts in the United States under which a sum of money is payable (other than a sum of money payable in respect of multiple damages, taxes or other charges of a like nature or in respect of a fine or other penalty) and would give a judgment based thereon, provided that (i) such courts had proper jurisdiction over the parties subject

to such judgment, (ii) such courts did not contravene the rules of natural justice of the Cayman Islands, (iii) such judgment was not obtained by fraud, (iv) the enforcement of the judgment would not be contrary to the public policy of the Cayman Islands, (v) no new admissible evidence relevant to the action is submitted prior to the rendering of the judgment by the courts of the Cayman Islands, and (vi) there is due compliance with the correct procedures under the laws of the Cayman Islands.

The ability for shareholders to protect their rights as shareholders through the U.S. federal courts may be limited because we are incorporated under Cayman Islands law.

Cayman Islands companies may not have standing to initiate a derivative action in a federal court of the United States. As a result, our shareholders' ability to protect their interests if they are harmed in a manner that would otherwise enable them to sue in a U.S. federal court may be limited.

The voting rights of holders of ADSs are limited in several significant ways by the terms of the deposit agreement.

Holders of our ADSs may only exercise their voting rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Under the deposit agreement, you must vote by giving voting instructions to the depository. Upon receipt of voting instructions from a holder of ADSs in the manner set forth in the deposit agreement, the depository will endeavor to vote the underlying ordinary shares in accordance with these instructions.

You will not be able to directly exercise your right to vote with respect to the underlying ordinary shares unless you withdraw the ordinary shares by surrendering your ADSs to the depository and paying the ADS depository fee. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting of shareholders is ten days. When a general meeting is convened, holders of our ADSs may not receive sufficient notice of the meeting to permit the holders to withdraw their ordinary shares to allow them to cast their vote with respect to any specific matter at the meeting. In addition, the depository and its agents may not be able to send voting instructions to holders of our ADSs or carry out the holders' voting instructions in a timely manner. We make all reasonable efforts to cause the depository to extend voting rights to holders of our ADSs in a timely manner, but we cannot assure holders of our ADSs that they will receive the voting materials in time to ensure that they can instruct the depository to vote their shares. Furthermore, the depository and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast or for the effect of any such vote. As a result, holders of our ADSs may not be able to exercise their right to vote and may lack recourse if their ordinary shares are not voted as requested.

The depository of our ADSs, except in limited circumstances, grants to us a discretionary proxy to vote the ordinary shares underlying the ADSs if holders of our ADSs do not vote at shareholders' meetings, which could adversely affect the interests and the ability of our shareholders as a group to influence the management of our company.

Under the deposit agreement for the ADSs, the depositary gives us a discretionary proxy to vote our ordinary shares underlying the ADSs at shareholders' meetings if holders of our ADSs do not vote, unless:

- we have failed to timely provide the depositary with our notice of meeting and related voting materials;
- we have instructed the depositary that we do not wish a discretionary proxy to be given;
- we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;
- a matter to be voted on at the meeting would have a material adverse impact on shareholders; or
- voting at the meeting is made on a show of hands.

The effect of this discretionary proxy is that holders of our ADSs cannot prevent our ordinary shares underlying ADSs from being voted, absent the situations described above, and it may make it more difficult for shareholders to influence the management of our company. Holders of our ordinary shares are not subject to this discretionary proxy.

Holders of ADSs may not receive distributions on our ordinary shares or any value for them if it is illegal or impractical for us to make them available.

The depositary of our ADSs pays holders of our ADSs the cash dividends or other distributions it or the custodian for our ADSs receives on our ordinary shares or other deposited securities after deducting its fees and expenses. Holders of our ADSs receive these distributions in proportion to the number of our ordinary shares their ADSs represent. However, the depositary is not responsible if it is unlawful or impractical to make a distribution available to any holders of ADSs. For example, it would be unlawful to make a distribution to a holder of ADSs if it consists of securities that require registration under the Securities Act but that are not properly registered or distributed pursuant to an applicable exemption from registration. The depositary is not responsible for making a distribution available to any holders of ADSs if any government approval or registration is required for such distribution. We have no obligation to take any other action to permit the distribution of our ADSs, ordinary shares, rights or anything else to holders of our ADSs. This means that holders of our ADSs may not receive the distributions we make on our ordinary shares or any value for them if it is illegal or impractical for us to make them available. These restrictions may have a material and adverse effect on the value of the holders' ADSs.

Holders of our ADSs may be subject to limitations on transfer of their ADSs.

ADSs, represented by American depositary receipts, are transferable on the books of the depositary. However, the depositary may close its books at any time or from time to time when it deems expedient in connection with the performance of its duties. The depositary may close its books for a number of reasons, including in connection with corporate events such as a rights offering, during which time the depositary needs to maintain an exact number of ADS holders on its books for a specified period. The depositary may also close its books in emergencies, and on weekends and public holidays. The depositary may refuse to deliver, transfer or register transfers of our ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary thinks it is necessary or advisable to do so in connection with the performance of its duty under the deposit agreement, including due to any requirement of law or any government or governmental body, or under any provision of the deposit agreement. As a result, you may be unable to transfer your ADSs when you wish to do so.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

We commenced operations in 1998 through Beijing Acorn Trade Co., Ltd., or Beijing Acorn, and in 2000, two other operating companies, Shanghai Network, and Shanghai Acorn Trade and Development Co., Ltd., or Shanghai Trade, were established and commenced business operations. Prior to January 1, 2005, our business was operated through Beijing Acorn, Shanghai Network and Shanghai Trade, including their subsidiaries. To enable us to raise equity capital from investors outside of China, we established a holding company structure by incorporating China DRTV Inc., or China DRTV, in the British Virgin Islands on March 4, 2004. Commencing on January 1, 2005, our business was conducted through China DRTV and its subsidiaries and affiliated entities. In connection with our initial public offering, we incorporated Acorn International in the Cayman Islands on December 20, 2005 as our listing vehicle. On March 31, 2006, Acorn International became our ultimate holding company when it issued shares to the existing shareholders of China DRTV in exchange for all of the shares that these shareholders held in China DRTV. For additional information on our organizational structure, see Item 4.C, “Information on the Company— Organizational Structure”.

In May 2007, we completed our initial public offering, which involved the sale by us and certain of our shareholders of 8,855,000 ADSs, representing 26,565,000 ordinary shares. On November 30, 2015, we changed the ratio of our ADSs to ordinary shares from 1:3 to 1:20, which we believe was in the best interests of our shareholders as it assisted our Company in regaining compliance with the minimum average closing price continued listing standard of the NYSE.

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Our principal executive offices are located at 19/F, 20th Building, 487 Tianlin Road, Shanghai 200233, People's Republic of China, and our telephone number is (86 21) 5151-8888. Our website address is www.acorninternationalir.com. The information on our website does not form a part of this annual report. Our agent for service of process in the United States is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011.

B. Business Overview

Overview

We are a marketing and branding company in China with a proven track record of developing, promoting and selling a diverse portfolio of our proprietary-branded products, as well as well-established and promising new products from third parties. Our current primary business includes selling merchandise to consumers in China.

Under Mr. Roche's stewardship since May 2015, we have reduced operating expenses and reduced cash outflow, focusing primarily on cost reduction and streamlining business operations of our Company. In addition, our cost reduction has been part of a broader restructuring in response to rationalizing our business model in light of the evolution of the business environment and competitive landscape in China. The business landscape in China has evolved in recent years and as a result, in addition to the desire to generate cash for the business, we are liquidating certain non-core assets and downsizing related business areas, such as warehousing, manufacturing and logistics, with an aim to enhance operational efficiency. Going forward, our management will continue to turn its attention to growing revenues. We plan to devote more resources to increasing our e-commerce sales.

Our direct sales business involves marketing and selling products directly to consumers in China through e-commerce as well as our call center. Our call center operations directly market consumer products to individual customers in China, the majority of whom were previous TV direct sales purchasers who placed orders with us or made calls to our call center through 1998 to early 2015. We also conduct our Internet sales business primarily through the platforms of China's leading e-commerce companies. We expect our Internet sales to have an increasing importance to our business in the future and are in the process of re-launching our official website. Through our nationwide distribution network we distribute a select number of our products promoted by our direct sales platforms. We have developed several leading proprietary-branded product lines in China, including Ozing electronic learning products and Babaka posture-correction. As of the date of this annual report, we are in the process of negotiating with potential investors to restructure our business related to the Ozing electronic learning products.

On May 4, 2015, Mr. Roche returned as our Chief Executive Officer to focus on restructuring and turning around the business, after his improper removal on August 26, 2014. Our total net revenues declined from \$94.8 million in 2014, \$47.5 million in 2015 and further decreased to \$24.5 million in 2016 with operation losses totaling \$44.9 million in 2014, \$40.9 million in 2015 and \$9.3 million in 2016. Among other factors, these results reflect primarily the adverse impact of the following events:

- increasingly restrictive government regulations on TV infomercials which drove a substantial reduction in our purchase of TV advertising time in 2014 and the termination of our TV direct sales operations in the first quarter of

2015. These actions, in turn, resulted in significantly lower direct sales and lower distribution sales (distribution sales often benefit from TV advertising exposure);

the legal dispute between two groups of our shareholders relating to the management and direction of our company and the related diversion of our management's attention from our business and litigation-related prohibitions on our pursuing transactions outside our ordinary course of business. This dispute resulted in a court case that was adjudicated and resulted in the following by May 2015 (i) a Cayman Islands court issued a final order in connection with the dispute, (ii) Robert Roche, our co-founder, Chairman and controlling shareholder, returned as our CEO and chairman; (iii) we held an extraordinary general meeting (EGM) of our shareholders at which a significant change in the composition of our board of directors was approved by our shareholders and effected and (iv) a business operations and sales team headed by our former co-founder Mr. Don Dongjie Yang left the company in 2015; and

continuous internal restructuring, transition, and efforts to reduce costs at the expense of revenue, cutting back on distributor incentives and the industry wide impact on sales of significant shifts in the market for electronic learning devices.

In 2016, as the result of the restructuring of our business, our intense focus on cost reduction measures, and sales of non-core assets, we achieved net income of \$3.4 million.

Our Complementary Direct Sales Platforms

We have established and maintained complementary direct sales platforms, which currently consist mainly of outbound marketing and Internet sales. Through our direct sales platforms, we sell and market our proprietary products as well as certain third-party products. Approximately 47.7%, 40.8% and 56.4% of our total net revenues in 2014, 2015 and 2016, respectively, were generated from our direct sales platforms.

Historically, the core focus of our direct sales was our TV direct sales platform. Our TV direct sales platform primarily consisted of procuring TV airtime from both national and local TV channels in China to play three to ten minute infomercials demonstrating and explaining our product in an entertaining and appealing manner, and providing phone numbers for customers to call to make further inquiries or to purchase the product. However, a series of increasingly more restrictive regulations and rules on TV advertising in China and rising media costs significantly reduced our ability to effectively access TV airtime. As a result, we significantly reduced our purchases of airtime for our TV infomercials beginning in 2014 and by early 2015 we suspended the procurement of new TV time altogether. As a result, as a percentage of our total gross revenues, gross revenues generated by TV direct sales declines from 30.4% and 6.0% in 2013 and 2014, respectively, to approximately 0.7% in 2015 and 0% in 2016.

Outbound Marketing. As of December 31, 2016, our database contained approximately 12 million names of individual customers, the majority of whom have placed orders to us or made calls to our call center from 1998 through early 2015. As of December 31, 2016, our 61 specialized outbound marketing representatives utilize our customer database to target calls and text messages at customer subgroups identified as likely purchasers of particular products. We currently operate one call center in Wuxi which processes telephone orders generated by our direct sales platforms and gathers real-time data to help determine how we shall adjust our business operations and product offerings. Our outbound marketing sales accounted for approximately 14.5% of our total net revenues in 2016.

Internet Website. We maintain e-shops on various e-commerce platforms in China, including T-mall.com, Taobao, JD.com, and Amazon to provide products and services to our end-customers. Our Internet website sales accounted for approximately 41.9% of our total net revenues in 2016. We expect that our Internet sales will continue to grow and will be of increasing importance to our business in the future.

Our Nationwide Distribution Network

In addition, our nationwide distribution network, coupled with local marketing and promotional efforts, helps us to further enhance the awareness of and demand for certain of our products, thereby broadening our customer reach and enhancing the penetration of those products on a nationwide basis.

We use our nationwide distribution network to distribute a selected number of our products promoted through our direct sales platforms. Our distribution network broadens our customer reach and enhances the penetration of those products on a nationwide basis. Our network covers all provinces in China through 23 distributors, which allows us to reach over 900 retail outlets across China. These retail outlets include bookstores, supermarkets, specialty retail chains and department stores. In addition to our ground distribution network, starting from 2013, we also engaged distributors on China's leading e-commerce platforms to promote and market our products. In 2014, 2015 and 2016, sales generated through our nationwide distribution network accounted for 52.3%, 59.2% and 43.6% of our net revenues, respectively. We typically provide our distributors (other than distributors on the e-commerce websites) with the exclusive right to distribute selected products in their respective territories. In 2014, 2015 and 2016, sales generated by our top five distributors accounted for 13.8%, 25.6% and 15.1% of our gross revenues, respectively.

Our distribution agreements with ground distributors are typically negotiated and entered into on an annual basis and are designed to provide incentives for our distributors to improve their sales performance, encourage them to promote our brands, and protect the value of those brands. For example, our distributors are required to meet the monthly and annual sales volume target for our selected featured products and, in the case of electronic learning products distribution, we provide sales incentives in the form of cash rebates to the distributors that meet or exceed our sales targets. We also require our distributors to ensure that the retail prices of our products sold through their retail outlets are not lower than the retail prices for the same products sold through our direct sales platforms, or the minimum retail prices set by us. Furthermore, distributors of our electronic learning products must also incur minimum marketing expenditures provided in our distribution agreements. We regularly monitor and review our distributors' sales performance and their compliance with the terms of our agreements.

Our Products

We currently offer over 250 products which are sold primarily through our outbound marketing and online stores, as well as our nationwide distribution network. Our recently featured product categories include electronic learning products, collectibles products, health products, and mobile phone products, all of which are primarily sold through our comprehensive and complimentary direct sales platform, nationwide distribution network, or both. We periodically develop and introduce new and upgraded products under the same product brand to develop such brand into a product line.

In addition, to further expand our product offerings, we entered into an Insurance Business Cooperation Agreement with Sino- US United MetLife Insurance Co., Ltd., or MetLife, a joint venture company established by certain wholly-owned subsidiaries of MetLife Inc. and Shanghai Alliance Investment Ltd. Pursuant to the cooperation agreement effective on August 29, 2012, we, as a concurrent-business insurance agent of Metlife, are jointly marketing and selling short-term accident and health insurance products with Metlife through various channels under our other direct sales platform. Pursuant to our cooperation with Metlife, we received a service fee/commission of approximately \$0.5 million from Metlife in 2016 and expect to further expand our insurance product operations going forward.

Recent Featured Product Categories

In 2016, we featured products in the following categories and under the following proprietary and third-party brands:

Electronic Learning Products featuring the Ozing branded electronic learning device incorporating mobile internet interactive features, such as online tutoring services. Electronic learning products accounted for 46.5%, 51.7% and 32.8% of our total gross revenues in 2014, 2015 and 2016, respectively. Our primary Ozing branded product is a multi-functional handheld electronic device with a screen display that provides lessons for independent English learners. The retail prices for our electronic learning products ranged from RMB188 to RMB1,761 per unit in 2014, RMB23 to RMB3,321 (or approximately \$4 to \$551) per unit in 2015 and RMB78 to RMB3,075 per unit in 2016.

Health Products featuring Babaka posture correction products. Health products accounted for 10.4%, 17.0% and 47.9% of our total gross revenues in 2014, 2015 and 2016, respectively. The retail prices for our health products ranged from RMB25 to RMB2,127 per unit in 2014, RMB164 to RMB316 (or approximately \$29 to \$57) per unit in 2015 and RMB73 to RMB390 per unit in 2016.

Collectibles Products Collectibles products accounted for 16.2%, 11.8% and 6.4% of our total gross revenues in 2014, 2015 and 2016, respectively. The retail prices for our collectibles products ranged from RMB25 to RMB65,999 per unit in 2014, and RMB4 to RMB67,521 (or approximately \$1 to \$12,166) per unit in 2015 and RMB22 to RMB27,461 per unit in 2016.

Mobile Phone Products Mobile phone products accounted for 6.3%, 10.6% and 7.0% of our total gross revenues in 2014, 2015 and 2016, respectively. The retail prices for the mobile phone products that we market ranged from RMB129 to RMB5,942 per unit in 2014, RMB82 to RMB2,382 (or approximately \$13 to \$367) per unit in 2015 and RMB10 to RMB1,866 per unit in 2016.

Kitchen and Household Kitchen and household accounted for 10.3%, 3.3% and 1.6% of our total gross revenues in 2014, 2015 and 2016, respectively. The retail prices for the kitchen and household products that we market ranged from RMB1.2 to RMB692 per unit in 2014, RMB4 to RMB448 (or approximately \$1 to \$69) per unit in 2015 and RMB1 to RMB815 per unit in 2016.

Our five best-selling products and product lines in 2014, 2015 and 2016 are set forth below:

Product	Brand	2014		2015		2016		Rank
		Revenues	% of gross	Rank	Revenues	% of gross	Rank	

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		revenues			revenues			revenues					
		(in thousands, except percentages and ranks)											
Health products	Babaka, Zehom	9,876	10.4	%	3	8,102	17.0	%	2	11,777	47.9	%	1
Electronic learning products	Ozing	\$44,138	46.5	%	1	\$24,638	51.7	%	1	\$8,071	32.8	%	2
Mobile phone products	Gionee, K-touch, U-king, Lenovo, Nokia and Konka	6,000	6.3	%	5	5,032	10.6	%	4	1,723	7.0	%	3
Collectibles products		15,414	16.2	%	2	5,646	11.8	%	3	1,574	6.4	%	4
Kitchen and Household products	Rose, True	9,810	10.3	%	4	1,591	3.3	%	5	398	1.6	%	5
Total top five		\$85,238	89.7	%		\$45,009	94.4	%		\$23,542	95.7	%	
Other products revenues		\$9,716	10.3	%		\$2,644	5.6	%		\$1,061	4.3	%	
Total gross revenues		\$94,954	100.0	%		\$47,653	100.0	%		\$24,603	100.0	%	
Total sales tax		\$(199)				\$(107)				\$(75)			
Total revenues, net		\$94,755				\$47,546				\$24,528			

Product Development

We employ a rigorous and systematic approach to identifying and developing products. Historically, our product development process comprised of product identification, pre-testing preparation and test-marketing through our TV direct sales platform. Under this process, we generally tested the market potential and customer appeal of our products by broadcasting our TV direct sales programs on specific channels for a designated period of time, and then closely evaluate customer feedback and sales of the relevant product through our call center.

In connection with discontinuing our TV direct sales platform, we have focused on other means of product identification and development, such as working with third parties to gauge consumer responsiveness to various products.

Call Center Operations

Our sales operations and media purchase activities are supported by our call center located in Wuxi, which began operation in 2009. Sales representatives in our call center places outbound marketing calls to selected customers to market our products and are trained to identify, promote and act upon cross-selling and up-selling opportunities while processing customer orders. We regularly track and analyze real-time data generated through our call center operations to ensure the cost-effectiveness of our media purchases. We use call center-generated real time data to adjust our product mix and to maximize the profitability of our direct sales operations. As of December 31, 2016, we had 61 dedicated sales representatives and 18 customer service representatives. In 2014, 2015 and 2016, our call center processed an average of approximately 3,298, 252 and 364 incoming calls per day, respectively, with the decline in calls processed in 2014 and 2015 primarily attributable to the substantial reduction in our TV media spending as we wound down our TV direct sales platform and our closure of call centers in Shanghai and Beijing in August 2014 and June 2015, respectively.

Order Fulfillment

Many of the products sold through our various sales centers are delivered to our customers throughout China by EMS, the largest national express mail service operated by the China Post Office, and local delivery companies. We generally guarantee our products will be delivered to our customers within two to ten days of the date of receiving the order. In 2014, 2015 and 2016, of the total attempted product deliveries by EMS and local delivery companies on a cash-on-delivery, or COD, basis, approximately 68%, 54% and 45% were successful, respectively. Reasons for delivery failure primarily include customers' refusal to accept a product upon delivery, which tend to occur more frequently with products that have higher average selling prices, or failure to successfully locate the delivery address. We are responsible for delivery and handling fees regardless of whether the delivery is successful. We have found that, in general, the shorter the delivery time, the lower the likelihood that the customer will refuse to accept the product upon delivery. As a result, local delivery companies enjoy higher delivery success rate than EMS due to a faster delivery time and better service quality. EMS and local delivery companies are responsible for returning to us any undelivered products. It generally takes EMS two to three weeks, and local delivery companies approximately seven days, to return undelivered products to us.

In 2014, 2015 and 2016, approximately 85%, 38.0% and 25.5% of our direct sales were settled on a COD basis by our customers. We recognize non-COD sales revenues when products are delivered to and accepted by our customer (e.g. FOB destination). For customers settling through COD, either EMS or the local delivery company is responsible for collecting and wiring to us these cash amounts on a periodic basis once collected. EMS and local delivery companies generally charge us delivery fees based upon weight of the products and distance of delivery. Additionally, EMS charges a processing fee based upon the sales price. One of our local delivery companies charge a lower processing fee based upon the sales price, while the other companies do not charge us such fee. It typically takes two to three weeks for us to receive payments from EMS compared to approximately seven days from local delivery companies. And as of December 31, 2015 and 2016, no accounts receivables from a single delivery company were more than 10%

of our total accounts receivables.

In 2014, 2015 and 2016, approximately 11.3%, 16.4% and 16.3% of our net revenues resulted from products delivered by EMS, respectively, and approximately 36.4%, 24.4% and 40.1% of our net revenues resulted from products delivered by local delivery companies, respectively.

Customer Service, Product Warranties and Return Policies

We believe emphasizing customer service will enhance our products brand image, facilitate cross-selling opportunities and generate customer loyalty and repeat purchasing behavior. Our customer service center within our Wuxi call center is currently staffed with approximately 18 customer service representatives. In addition, most of our distributors generally provide their own customer service in their respective territories.

Our customer service representatives are primarily responsible for answering our customers' product-related inquiries, providing product information and handling product returns and customer complaints. To ensure superior customer service, we place significant emphasis on personnel selection and training. Our customer service representatives undergo product-specific training to allow them to answer product-related questions, proactively educate potential customers about the benefits of our products and promptly resolve customer problems. We also provide customer service training to some of our distributors for products sold through our nationwide distribution network.

Under our policies, our customers generally may return products to us within seven days after delivery if there is a quality defect or if a product fails to meet its specifications. In most cases, product exchanges are allowed within a month of delivery. Our warranties generally provide for repair of product defects within one year at no cost to the customers. Product returns from our multiple sales platforms were insignificant in 2014, 2015 and 2016. To the extent that the manufacturer of the defective product is a third party, the manufacturer is obligated to either repair the defective product or reimburse us for any related expenses. Our distributors are allowed to exchange any defective products they receive from us. The number of products exchanged by our distributors due to defects was insignificant in 2014, 2015 and 2016.

Supply and Inventory

Supply

We rely outsourced product manufacturers to produce our proprietary products (including our electronic learning products, oxygen generating devices and posture-correction products) and on third-party suppliers for our other products.

We historically manufactured a substantial portion of our proprietary products. However, beginning in 2015, we began to discontinue our manufacturing operations. As of the date of this annual report, we have outsourced the

manufacture of our key proprietary products to four manufacturers who manufacture our products based on our design and to our specifications.

Although we believe we could replace our contract manufacturers with qualified manufacturers on commercially reasonable terms within a reasonable period of time, any disruption of these arrangements could adversely impact our business.

Inventory Control

We closely monitor our inventory and sales levels at all of our sales and marketing platforms. In general, before or during our test-marketing stage, we do not acquire any sizable inventory position in a product. We adjust our inventory levels based on the weekly sales forecasts we develop.

Majority-Owned Subsidiaries

To acquire managerial expertise and additional complementary distribution network infrastructure or secure exclusive product distribution rights, we have formed certain majority-owned subsidiaries. We currently have two majority-owned PRC operating subsidiaries. We may form other majority-owned subsidiaries in the future.

Competition

Because of our integrated vertical business model, we face competition from the following companies operating in our value chain:

numerous domestic and international sellers of consumer branded products that sell their products in China and which compete with our products, such as our Ozing electronic learning products which compete with electronic learning products from BBG, Noah, Readboy, and other brands, and our mobile phone products which compete with similar products sold by local and international mobile phone manufacturers; and

other Internet and e-commerce companies in China that offer consumer products online via an Internet platform, such as Dang Dang Wang, Yihaodian, Tmall and JD.COM.

We also compete with companies that make imitations of our products at substantially lower prices, such as our Babaka branded posture-correction products, which are often sold in department stores, pharmacies and general merchandise stores. See Item 3.D, “Key Information—Risk Factors—Risks Relating to Our Business—We may not be able to prevent others from unauthorized use of our intellectual property, which could harm our product brand, reputation and competitive position. In addition, we may have to enforce our intellectual property rights through litigation. Such litigation may result in substantial costs and diversion of resources and management attention.”

We believe we compete primarily on the basis of the effectiveness of our sales and distribution channels in reaching customers and generating customer appeal for our products. In addition, we believe we also compete primarily on the basis of our ability to identify and develop product brands, which helps to attract new product proposals from independent third parties and product suppliers who otherwise often lack the marketing or distribution capabilities and/or resources required to effectively market and sell their products or develop their own product brands. We also compete on the basis of product quality, price, and quality of our customer service, retail outlet coverage of our nationwide distribution network and speed of delivery. Many of our current or future competitors may have longer operating histories, better brand recognition, greater levels of consumer trust, stronger media management capabilities, better media and supplier relationships, a larger technical staff and sales force and/or greater financial, technical or marketing resources than we do.

Seasonality

Certain of our products are subject to seasonality, such as our electronic learning products. Sales for these products are typically higher around our first and third fiscal quarters which correspond to the end and beginning of school semesters in China, respectively. Other than seasonality related to these and certain of our other products, our business generally has not been seasonal.

Intellectual Property

We rely on a combination of copyright, trademark, patent, unfair competition laws, as well as non-disclosure agreements and other methods to protect our intellectual property rights. We currently maintain 624 trademark registrations and are in the process of applying for registrations or transfer for approximately 182 trademarks in China. We own 17 invention, utilities and packaging design patents in China pertaining to our posture-correction products, kitchen and household products, fitness products, and oxygen generating device.

The legal regime in China for the protection of intellectual property rights is still at a relatively early stage of development. Despite many laws and regulations promulgated and other efforts made by China over the years to enhance its regulation and protection of intellectual property rights, private parties may not enjoy intellectual property rights in China to the same extent as they would in many western countries, including the United States, and enforcement of such laws and regulations in China have not achieved the levels reached in those countries. Therefore, it is difficult and expensive to police and enforce against infringement of intellectual property rights in China. Imitation or counterfeiting of our products or other infringement of our intellectual property rights, including our trademarks, could diminish the value of our various brands or otherwise adversely affect our net revenues. See Item 3.D, “Key Information—Risk Factors—Risks Relating to Our Business—We may not be able to prevent others from unauthorized use of our intellectual property, which could harm our product brand, reputation and competitive position. In addition, we may have to enforce our intellectual property rights through litigation. Such litigation may

result in substantial costs and diversion of resources and management attention.”

We have in the past been, and in the future may again be, the subject of claims for infringement, invalidity, or indemnification relating to other parties’ proprietary rights.

Management Information System

Our management information system and technology infrastructure is designed to support our key operations. Full redundancy design and data backup are built into our systems. We also have an uninterruptible power supply that can provide up to two hours of power in case of power outage to allow full functioning of our call center and customer services operations during that period.

Our major system modules and functions, which facilitate various aspects of our business, include the following:

call center business management system, which facilitates automatic incoming call connection to available sales representatives or customer service representatives, data collection and organization of information received through call center representatives’ caller interactions, processing of after-sales service issues and monitoring of call center representatives for training and quality assurance purposes;

• outbound marketing management system, which facilitates automatic outgoing dialing processes from a predetermined subgroup derived from our database and matches calls with available representatives;

• database management system, which facilitates the collection and updating of customer information;

• supply chain management system, or SCM, which aims to manage complex and dynamic supply and demand networks including our various suppliers and merchandise;

• short message service, or SMS, system, which supports SMS product order confirmation and advertising; and

• database backup.

We believe our information technology system is one of the key tools with which we are able to identify market trends and demands early.

Chinese Government Regulations

The PRC government extensively regulates the industries in which we operate our business. We operate our direct sales and advertising businesses in China under a legal regime consisting of the State Council, which is the highest authority of the executive branch of the PRC central government, and several ministries and agencies under its authority including, among others, the State Administration for Industry and Commerce, or SAIC, the Ministry of Commerce, or MOFCOM, the SAPPRFT, the State Administration for Food and Drug, or SAFD and the Ministry of Industry and Information Technology, or MIIT. Meanwhile, we operate our Concurrent-Business Insurance Agency business under the regulations promulgated by the China Insurance Regulatory Commission, or the CIRC.

Except as disclosed in Item 3.D, “Key Information—Risk Factors—Risks Related to the Regulation of Our Business and Industry— If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising under Guideline Catalog of Foreign Investment Industries (2004 Revision), we could be subject to penalties.”, and as disclosed in Item 3.D, “Key Information—Risk Factors—Risks Related to the Regulation of Our Business and Industry— If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising under Guideline Catalog of Foreign Investment Industries (2004 Revision), we could be subject to penalties.”, we understand that (1) the ownership structures of our directly owned PRC subsidiaries comply with existing PRC laws and regulations; and (2) the ownership structure of our affiliated entities and our contractual arrangements with our affiliated entities and their shareholders are valid, binding and enforceable, and do not and will not result in a violation of existing PRC laws and regulations.

There are substantial uncertainties regarding the interpretation and application of existing or proposed PRC laws and regulations. We cannot assure you that the PRC regulatory authorities would find that our corporate structure and our business operations comply with PRC laws and regulations. If the PRC government finds us to be in violation of PRC laws and regulations, we may be required to pay fines and penalties, obtain certain licenses, approvals, or permits and change, suspend or discontinue our business operations until we comply with applicable laws.

The following discussion sets forth a summary of what we believe are the most significant regulations or requirements that affect our business activities in China and our shareholders' right to receive dividends and other distributions from us.

Regulatory Requirements for Foreign Participation

Direct Sales and Wholesale Distribution Businesses

Prior to late 2016, foreign investments in direct sales and wholesale businesses were both principally governed by the Administrative Measures on Foreign Investment in Commercial Sector promulgated by the MOFCOM, or the Commercial Sector Measures on April 16, 2004 as supplemented. The Commercial Sector Measures lowered the previous thresholds for foreign investors to enter the commercial sector in China and completely removed the previous restrictions on the location of and maximum foreign shareholding percentage in foreign-invested commercial enterprises as of December 11, 2004. Under the Commercial Sector Measures, the establishment of a foreign-invested direct sales (including direct sales via TV, telephones, mail and Internet) or wholesale distribution enterprise must obtain approval from MOFCOM or its authorized local counterparts. However, on November 3, 2016, the Commercial Sector Measures were revoked, and an anonymous consultation with the Shanghai Municipal Commission of Commerce indicated that the establishment of a foreign-invested enterprise engaging in direct sales via the Internet requires only registration with the local district counterpart of MOFCOM, rather than requiring approval.

Under the PRC Law on Sino-foreign Equity Joint Venture Enterprises (revised in 2016), the PRC Law on Sino-foreign Cooperative Joint Venture Enterprises (revised in 2016), and the PRC Law on Wholly Foreign-owned Enterprises (revised in 2016), a foreign-invested enterprise is allowed to sell its self-produced products. Our distribution of our proprietary branded products is primarily conducted by our indirect subsidiaries which manufacture these proprietary branded products and sell such products as their self-produced products.

Under the PRC laws, sellers of special products, such as medicine, medical devices and health protection products, are required to review the necessary manufacturing permits provided by the manufacturers.

Advertising Services

The advertising industry used to be a restricted industry for foreign investment under the Guideline Catalog of Foreign Investment Industries (2004 Revision). However, on October 31, 2007, the NDRC and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2007 Revision) that identified the advertising industry as permitted industry for foreign investment. On December 24, 2011 the NDRC and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2011 Revision) as amended on March 10, 2015, under which the advertising industry continues to remain as permitted industry. As a permitted industry, approval of MOFCOM or its local counterpart is no longer required for a foreign invested enterprise or its domestic subsidiary to invest in advertising unless required by other specific PRC laws and regulations.

Previously, direct investment by foreign investors in the advertising industry in China was further subject to the Administrative Regulation on Foreign-Invested Advertising Enterprises jointly promulgated by MOFCOM and SAIC on March 2, 2004 and further revised on October 1, 2008. Under this advertising regulation, foreign investors were required to have had at least three years of experience in directly operating an advertising business outside of China before they may receive approval to own 100% of an advertising business in China. Furthermore, all foreign invested advertising companies must obtain approval from SAIC or MOFCOM or their local counterparts. On June 29, 2015, the Administrative Regulation on Foreign-Invested Advertising Enterprise was revoked. Today, foreign investors are allowed to own 100% of an advertising agency in China subject to certain qualification requirements. However, for those advertising agencies that provide online advertising services, foreign ownership restrictions on the value-added telecommunications business as discussed herein are still applicable.

Our Direct Sales Operations

Due to the complicated and lengthy approval process and MOFCOM's uncertain position towards approving investment in direct sale business by foreign investors under the Commercial Sector Measures, our direct sales business (other than direct sales of our Ozing electronic learning products) is currently conducted by our consolidated affiliated enterprises owned by Kuan Song and Pan Zong —Shanghai Network and Beijing Acorn. Furthermore, due to the aforesaid reason as well as certain restrictions or prohibitions on foreign ownership of companies that engage in internet and other related businesses imposed by current PRC laws and regulations, including the provision of internet content, we have set up another new consolidated affiliated enterprise, Beijing HJX Technology, and conducted internet interactive service through Beijing HJX Technology which held an ICP License. However, due to

management changes and our improper management of the original ICP License of Beijing HJX Technology, Beijing HJX Technology had not yet been able to complete its annual inspection on such license as of the date of this filing. We are currently in the process of preparing application documents for a new ICP License under the name of our subsidiary Shanghai Network to support of our shifting of core business from Beijing to Shanghai. The new consolidated affiliated enterprise is also owned by Kuan Song and Pan Zong. As domestic companies, these three companies are not subject to the PRC regulations on foreign investment into provision of internet content business, but they are controlled by us through a set of contractual arrangements. To our knowledge:

The ownership structures of (i) Acorn Information, Shanghai Network and Beijing Acorn and (ii) Beijing HJX Technology and Acorn Trade (Shanghai) are in compliance with existing PRC laws and regulations; and

Our contractual arrangements among (i) Acorn Information, Shanghai Network and Beijing Acorn and their respective shareholders, and (ii) Acorn Trade (Shanghai) and Beijing HJX Technology and their shareholders are valid, binding and enforceable, and do not and will not result in a violation of existing PRC laws and regulations.

However, there are uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Accordingly, there can be no assurance that the PRC regulatory authorities, in particular MIIT, SAIC and MOFCOM, which regulate foreign investment in internet and direct sales businesses, will not in the future take a view that is contrary to the above opinions of our PRC legal counsel. If the current agreements that establish the above structure were found to be in violation of existing or future PRC laws or regulations, we may be required to restructure our ownership structure and direct sales and internet interactive service operations in China or to carry out other actions required by relevant PRC government authorities to comply with PRC laws and regulations, or we could be subject to severe penalties. See Item 3.D, “Key Information—Risk Factors—Risks Related to the Regulation of Our Business and Industry—If the PRC government takes the view that the agreements that establish the structure for operating our TV and direct sales business and internet interactive service in China do not comply with PRC governmental restrictions on foreign investment in these areas, we could be subject to severe penalties”.

Our Advertising Operations

On September 24, 2007, we acquired 100% of the legal ownership of Shanghai Advertising, which had been one of our affiliated entities, through Shanghai Acorn Enterprise Management Consulting Co., Ltd., or Acorn Consulting. At the time of our acquisition, the advertising industry was still a restricted industry for foreign investment under the Guideline Catalog of Foreign Investment Industries (2004 Revision), and required the approval of Shanghai Foreign Investment Commission, or SFIC, MOFCOM's local counterpart in Shanghai. However, we completed the registration of such acquisition with Pudong Administration of Industry and Commerce in Shanghai on September 24, 2007 without SFIC's approval based on SFIC's advice that this acquisition was a purely domestic acquisition without any foreign related issues. To our knowledge, it is unlikely that we would be required by the PRC regulatory authorities, in particular SAIC and MOFCOM, both as regulators of foreign investment, to seek such approval to make up for our deficiency or any penalties would be imposed upon us for failure to obtain such approval. However, we cannot assure you that SAIC or MOFCOM will not take a different view from ours. See Item 3.D, "Key Information—Risk Factors—Risks Related to the Regulation of Our Business and Industry— If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising under Guideline Catalog of Foreign Investment Industries (2004 Revision), we could be subject to penalties."

According to an anonymous consultation with SFIC, because our acquisition of Shanghai Advertising was completed through Acorn Consulting, a domestic subsidiary of foreign invested enterprises, the acquisition was not subject to the requirement that foreign investors have the requisite years of operating experience in an advertising business outside of China. Similarly, Pudong Administration of Industry and Commerce in Shanghai did not require us to show that Acorn Consulting had the requisite years of operating experience either before or after it accepted the registration of the acquisition and issued a new business license to Shanghai Advertising on September 24, 2007. However, we cannot assure you that the PRC government will not take a different view from ours. Since our acquisition of Shanghai Advertising occurred prior to the revocation of Administrative Regulation on Foreign-Invested Advertising Enterprises, if the PRC government determines that we did not obtain the requisite approval or that this acquisition violated the then-effective requirements on foreign investment or re-investment in advertising businesses in China, we may be subject to severe penalties including, among others, the revocation of the business licenses of our related subsidiaries, discontinuation of our advertising operations, the imposition of conditions with which we or our PRC subsidiaries may be unable to comply, and the restructuring of Shanghai Advertising. The imposition of any of these penalties could result in a material adverse effect on our ability to conduct our business. See Item 3.D, "Key Information—Risk Factors—Risks Related to the Regulation of Our Business and Industry—If the PRC government takes the view that our acquisition of Shanghai Advertising does not comply with PRC governmental restrictions on foreign investment in advertising, we could be subject to severe penalties."

Our Wholesale Distribution Operations

Historically, our wholesale distribution business was conducted through our two affiliated entities, Shanghai Network and Beijing Acorn due to the complicated approval process and MOFCOM's uncertain position toward approving

investment in wholesale distribution business by foreign investors. On December 5, 2007, we received approval from Shanghai Qingpu People's government approving our setup of Acorn Trade (Shanghai) Co. Ltd., or Acorn Trade, a PRC subsidiary wholly-owned by China DRTV, to conduct our wholesale distribution business. A valid business license was issued by Shanghai Administration of Industry and Commerce on December 13, 2007.

Regulation of Manufacturing and Sale of Special Consumer Products

Some of the products we offer through our direct sales platforms and some of the proprietary branded products we manufacture and sell are categorized as medical devices. Therefore, we are required to comply with relevant PRC laws and regulations regarding the manufacture and sale of medical devices.

In the PRC, medical devices are classified into three different categories for regulation and supervision by SAFD, depending on the degree of risk associated with each medical device and the extent of regulation needed to ensure safety and proper operation of the product. Class I includes medical devices posing a low risk whose safety and effectiveness can be guaranteed through routine administration. Class II includes those with medium risk whose safety and effectiveness should be ensured by strict control and administration. Class III includes those devices that pose a relatively high risk whose safety and effectiveness should be ensured by taking special measures to conduct strict control and administration. All the medical devices that we manufacture belong to Class II above. Under the Administrative Measures on Supervision over Manufacture of Medical Device as amended in July 2014, manufacturers of Class II medical devices must apply to the provincial-level SAFD for a valid Medical Device Manufacturing Enterprise License. Such Medical Device Manufacturing Enterprise License is valid for a period of five years. Under the Administrative Measures on Supervision over Operation of Medical Device which replaced the Administrative Measures on Medical Device Operation Enterprise License, or Medical Device Operation Enterprise License Measures, Class II medical device operators no longer need to apply for a Medical Device Operation Enterprise License under Medical Device Operation Enterprise License Measures, but instead, must make a filing with local branches of SAFD. In addition, manufacturers of Class II medical devices must register their manufactured Class II medical devices with SAFD at the provincial level and obtain a Medical Device Registration Certificate. Such Medical Device Registration Certificate is valid for a period of five years. Violation of these provisions may result in fines, termination of operations, confiscation of illegal income, or in the most serious cases, criminal prosecution.

One of our subsidiaries, Shanghai HJX, and one of our affiliated entities, Shanghai Network, have made filing with competent branches of SAFD on March 11, 2015 in connection with their operation of Class II medical device, and have completed subsequent update of filing information on April 27, 2016. Another of our subsidiaries, Acorn Trade (Shanghai) Co., Ltd., holds valid Medical Device Operation Enterprise Licenses that will expire on March 20, 2018, which we obtained as required by Medical Device Operation Enterprise License Measures and have completed the filing update of sale license in May, 2015. In addition, Zhuhai Acorn Electronic Technology Co., Ltd., or Zhuhai Acorn, holds a Medical Device Manufacturing License expiring on November 3, 2020 and a Medical Device Registration Certificate for an oxygen generating device that will expire on January 25, 2020. We are also in the process of renewing other expired licenses and certificates that are required for our operation and products. Although we continue to maintain sufficient outsourced employees to operate the Zhuhai Acorn manufacturing facilities, due to the scope of the operations at Zhuhai Acorn as well as for cost considerations, we do not have any senior employees based in Zhuhai Acorn, nor do we send senior employees to Zhuhai Acorn, to manage the manufacturing process.

On 27 March 2017, SAFD released a draft Measures for Punishments against Illegal Acts of Online Medical Device Operation, or the Online Medical Device Operation Regulation, to solicit public comments. The Online Medical Device Operation Regulation imposes more stringent requirements for the online medical device operators (*i.e.* enterprises engage in the operation of medical devices), including:

(1) the online medical device operators shall set up quality and safety management system for the online transactions and provide relevant data to SAFD or its counterparts;

(2) the online medical device operators shall publish the detailed information of the medical device for sale online on its website so as to be consistent with the registration or filing, including its name, type, size, registration certificate, registration holder, number of the Medical Device Manufacturing Enterprise License, product number, contraindications; and

(3) the online medical device operators shall record and maintain the information of the medical device sold not less than the expiration period of such medical devices or two years after the expiration date of such medical device. In the event that the medical device sold does not have the explicit expiration period or expiration date, the information of the medical device shall be maintained for not less than five years.

As this regulation is only in draft form, there are substantial uncertainties as to its enactment timetable, final content, likely interpretation and ultimate implementation of the Online Medical Device Operation Regulation. The draft Online Medical Device Operation Regulation, if enacted as proposed, could cause us to incur substantial costs or require us to change our business practices in a manner materially adverse to our business.

We have obtained a new Food Circulation License to sell pre-packaged food (including refrigerated foods and frozen foods) online under the name of Shanghai Network on April 28, 2016.

For the purposes of strengthening the supervision and management of medical devices and protecting human health and life safety, on January 25, 2017, SAJD promulgated the Administrative Measures for the Recall of Medical Devices, or Recall Measures, to become effective from May 1, 2017, which provides that medical device manufacturing enterprises shall eliminate defects of products of certain types, models or batches that have already been launched into the market for sale by way of warning, examination, repair, re-labelling, revision and amendment of the instruction manual, software upgrade, exchange, withdrawal or destruction according to the prescribed procedures. The recall is classified into two categories, that is, voluntary recall and compelled recall. If a medical device manufacturing enterprise discovers that a medical device is defective after conducting investigation and evaluation, it shall immediately decide to recall such device. If, upon investigation and evaluation, the drug regulatory department finds any defect in medical device that manufacturing enterprise should have voluntarily recalled, the drug regulatory department shall compel the concerned enterprise to recall the concerned medical devices. If medical device manufactured by us is found any defects prescribed in Recall Measures, we shall be subject to recall of the defective medical device.

Regulation of Internet Content Providers

We currently operate *www.xiangguo.com* (redirected from *www.chinadrtv.com*) and *www.hjx.com* through which our customers can familiarize themselves with our products. We are required to comply with the Telecommunications Regulations promulgated by the State Council on September 25, 2000 and revised on July 29, 2014 and again on February 6, 2016, the Administrative Measures on Internet Content Services issued by the State Council on September 25, 2000, the Administrative Measures on Telecommunications Business Operating Licenses promulgated by the MIIT in 2001 and revised in 2009, Measures for the Archival Administration of Non-operational Internet Content Services issued by the Ministry of Information Industry (now the Ministry of Industry and Information Technology) on February 8, 2005 and the Administrative Measures on Internet Pharmaceuticals Information Services issued by SAJD on July 8, 2004 in our operation of the website.

Under the above regulations internet content providers must apply for a Telecommunications and Information Services Operating License, or ICP License, a Value-added Telecommunications Business Permit for Internet Information Service if they are deemed to be “operating business”. Internet content providers not deemed to be operating businesses are only required to file a registration with the relevant information industry authorities. The online dissemination of information regarding medical devices must also be approved by SAJD at the provincial level and validated by an Internet Pharmaceuticals Information Service Qualification Certificate issued by SAJD. Violation of these provisions will result in a warning, an order to rectify within a certain period, a fine, or the closing of the website.

As internet information service in the websites of *www.chinadrvtv.com* and *www.xiangguo.com* are not deemed as an operating business, we only need to file with the relevant information industry authorities for record, which we have finished. Furthermore, as internet information service in the website of *http://www.hjx.com* is deemed as operating business, we need to obtain an ICP License from the relevant information industry authorities. On January 17, 2014, Beijing HJX Technology, one of our affiliated entities, obtained an ICP License with a validity period of five years. Due to management changes and our improper management of the original ICP License, Beijing HJX Technology was not able to complete its annual inspection on such license, which may subject us to potential penalties. As of the date of this annual report, Beijing HJX Technology has not successfully renewed its ICP License, though it has very limited business that may require utilization of such license. We are in the process of preparing application documents for a new ICP License under the name of Shanghai Network to rectify the status.

Pursuant to Administrative Provisions for the Internet Audio-Video Program Service promulgated by SAPPRFT and MIIT on December 20, 2007, as revised on August 28, 2015, an entity shall obtain the Permit for Audio-Video Programs Transmitted through Information Network before providing service of production, edition and integration of audio-video programs, the supply of audio-video programs to the public via the Internet.

The internet publication service is classified as a prohibited industry for foreign investment under the Guideline Catalog of Foreign Investment Industries (2015 Revision). Pursuant to Administrative Provisions on Internet Publication Service jointly promulgated by MIIT and SAPPRFT on February 4, 2016, effective from March 10, 2016, any engagement in internet publication activities shall be subject to approval by SAPPRFT and internet publication providers shall acquire the Internet Publication Service License. The internet publication service refers to the provision of digitized works with characteristics of publication, such as editing, production or processing, to the public through information networks. Digitized works include (i) original digitized works such as knowledgeable and thoughtful texts, pictures, maps, games, animation, audio and video readings in literature, art, science and other fields; (ii) the works whose contents are consistent with those in published books, newspaper, periodicals, audio and video products, and electronic publications; (iii) the works such as online literature databases formed by way of selecting, compiling or collecting the above works, and (iv) other types of digitized works identified by the SAPPRFT. The Provisions further restricts the cooperation of internet publication providers and foreign invested enterprises, requiring the approval by the SAPPRFT in advance regarding the internet publication cooperation.

Regulation of Internet Shopping

On June 24, 2010 MOFCOM promulgated the Outline of Promoting Healthy Development of Internet Shopping which requires relevant authorities to encourage enterprises to develop internet sales, expand internet shopping field, attach importance to rural internet shopping market, improve support service, protect legal interests of consumers and standardize internet market order.

On December 28, 2010 MOFCOM, MITT and other departments jointly issued the Notice on Implementing Scheme of Cracking Down Infringement on Intellectual Properties and Manufacture and Sale of Fake Commodity in Internet Shopping which, among other things, requires to strengthen supervision and control over internet shopping platform and transaction parties, set up access system for tradable commodity and intensify the fight against infringement on intellectual properties and manufacture and sale of fake commodity in internet shopping.

On January 5, 2011 the MOFCOM issued the Notice on Regulation of Promotion Activities in Internet Shopping, pursuant to which, among other things, (1) internet shopping enterprises shall ensure the quality of promotional commodity; (2) price fraud and false promotion is strictly forbidden; and (3) infringement on intellectual properties and manufacture and sale of fake commodity in promotion will be severely cracked down.

On January 26, 2014 SAIC promulgated Measures on the Administration of Internet Transactions which provide rules for internet product transactions and relevant services. Pursuant to these measures, except for several specified products, a consumer is entitled to return products sold by an internet product business operator within seven days upon the receipt of such products and is not required to provide any reason for such return. However, the products returned by a consumer shall be intact and in good condition.

Law on the Protection of Consumer Rights and Interests was amended by Standing Committee of the National People's Congress and took effect on March 15, 2014. Pursuant to the newly amended law, upon discovery of any defects in the goods or services that are likely to impact personal or property safety, enterprises or service providers shall take necessary actions such as recall of goods, and shall bear the necessary expenses incurred by such recall. Where enterprises sell goods via the Internet, or by television, phone, mail order, except for certain specified goods, consumers are entitled to return the goods delivered within seven days upon receipt of goods without providing any reason, provided that goods returned by a consumer shall be intact and in good condition. In addition, enterprises and their staff members shall strictly keep confidential the personal information of consumers collected, and shall not divulge, sell or illegally provide others with such personal information, enterprises shall not send commercial information to consumers without their consent or request or after the consumers have expressly refused to receive such information. Unless otherwise prescribed by law, enterprises that conduct fraudulent behavior in providing goods or services shall, on demand by consumers, compensate the losses suffered by the consumers by an amount that is three times to the purchase price paid by the consumers for the goods purchased or services received, or in a fixed

amount of RMB500 if the total compensation is less than RMB500.

On January 5, 2015, SAIC promulgated Measures for Punishments against Infringements on Consumer Rights and Interests, effective from March 15, 2015. Pursuant to these measures, a business operator that sells goods via the Internet, television or phone, by mail order or otherwise, bears the obligations to accept the return of goods by consumers without reason, and shall not deliberately delay performing, or unjustifiably refuse to perform, such obligations.

On March 24, 2016, the Ministry of Finance, the General Administration of Customs, GAC, and SAT jointly issued the Circular on Tax Policy for Cross-Border E-commerce Retail Imports, pursuant to which, among other things, (1) the imported commodities retailed through the cross-border E-commerce shall, according to types of the goods, be levied tariff, imports value-added tax, and consumption tax; individuals who purchase the imported retail goods through cross-border E-commerce shall be taxpayers and the actual transaction prices shall be dutiable price; (2) E-commerce corporations, corporation specialized in e-commercial transaction platform or logistic enterprises shall be the withholding obligors and be responsible for deducting taxes; and (3) the lists of Imported Retail Commodities through Cross-Border E-commerce will be promulgated separately by the competent department of the Ministry of Finance. The Ministry of Finance has issued two lists in connection to the Imported Retail Commodities on April 6, 2016 and April 15, 2016, respectively. In addition, On April 6, 2016, GAC issued the Announcement on Matters relating to the Regulation of Cross-border E-commerce Retail Imports and Exports and further specify the regulation concerning cross-border e-commerce retail imports and exports, effective from April 8, 2016.

On January 6, 2017, SAIC promulgated Interim Measures for Seven-day Unconditional Return of Products Purchased Online, effective from March 15, 2017, which further clarifies the standard of “good condition” of the products suitable for return, the calculation of seven-day return period, and the methods of payment refund for the returned products.

On 27 December 2016, the Standing Committee of National People's Congress released a draft E-commerce Law to solicit public comments. It will be China's first comprehensive law in the realm of e-commerce. It regulates electronic contracts, payments, package delivery, logistics services, and cross-border e-commerce. As this law is only in draft form, there are substantial uncertainties as to its enactment timetable, final content, likely interpretation and ultimate implementation of the E-commerce Law.

Regulations of Personal Information Protection

On December 28, 2012 the Standing Committee of the National People's Congress promulgated the Decision on Strengthening Internet Information Protection which provides that, among other things, internet service providers and other entities shall obtain consent from relevant persons before collecting and using personal electronic information during business activities and shall make public rules on collecting and using personal information; personal electronic information collected shall be strictly kept confidential and shall not be divulged, tampered with, damaged, sold or illegally provided to others; no person is allowed to send commercial electronic information to any recipient without the recipient's consent or request, or after the recipient gives an explicit refusal.

On July 16, 2013 the MIIT promulgated Provisions on Protecting Personal Information of Telecommunications and Internet Users which provides detailed rules for standards on collection and use of users' personal information by telecommunications business operators and internet information service providers and security measures on protecting users' personal information.

The Law on the Protection of Consumers' Rights and Interests amended on October 25, 2013 and effective from March 15, 2014 provides that business operators shall not send commercial information to consumers without their consent or request, or after the consumers have expressly refused to receive such information.

On January 5, 2015, SAIC promulgated Measures for Punishments against Infringements on Consumer Rights and Interests, effective from March 15, 2015. Pursuant to these measures, a business operator shall refrain from any of the following acts:

- (1) collecting or using the consumers' personal information without the consent of the consumers;
- (2) divulging, selling or illegally providing others with the consumers' personal information collected; and
- (3) sending commercial information to consumers without their consent or request, or after the consumers have expressly refused to receive such information.

On November 7, 2016, the Standing Committee of the National People's Congress promulgated the PRC Cyber Security Law which, to become effective from June 1, 2017, imposes the following new requirements for the internet operators:

- (1) notifying the relevant consumers and the applicable government authority of the occurrence or potential occurrence of any divulging, damaging or loss of the personal information collected; and
- (2) taking proper measures to delete or correct the personal information collected at the request of the consumers whose personal information is used inappropriately or contains erroneous information.

The PRC Cyber Security Law also increased the administrative punitive measures that the competent government authorities can take as well as the monetary penalty for any noncompliance.

Regulations of Concurrent-Business Insurance Agency

On August 4, 2000 the China Insurance Regulatory Commission, or the CIRC, promulgated the Interim Measures for the Administration of Concurrent-Business Insurance Agency, or the Interim Measures, effective as of the date of promulgation. A concurrent-business insurance agent shall obtain the License for Concurrent-Business Insurance Agency before its commencement of such business, and the scope of the agency business shall be subject to the types of insurance specified in the License for Concurrent- Business Insurance Agency.

On June 22, 2007 CIRC promulgated the Measures for the Administration of Insurance Licenses, effective on September 1, 2007. The insurance institutions within the territory of People's Republic of China shall obtain an insurance license, including Concurrent-Business Insurance Agencies.

The CIRC issued the License for Concurrent-Business Insurance Agency to Shanghai Network on October 11, 2014. The license is valid for a period of three years and we should handle the insurance agency business specified in our license.

Regulation of Advertising Activities

The principal regulations governing advertising businesses in China include the Advertising Law (2015 Revision) and the Advertising Administrative Regulations (1987). SAPPRT and SAIC are the main responsible regulatory authorities in China overseeing the entire advertising industry. SAIC has the authority to make administrative rules to regulate advertising activities, register or approve the establishment of advertising companies, and examine and oversee daily advertising activities to ensure relevant regulations are not violated. In addition to supervision by SAIC, SAPPRT sets technical standards for broadcasting, regulates signal landings among different broadcasting networks and monitors the operations of all TV and radio stations. Due to the politically sensitive nature of China's media industry, the contents of TV and radio programs must go through a lengthy approval process prior to broadcasting. Contents of advertisements, which are regulated to a lesser extent, must be approved by the TV or radio stations carrying the advertisements and proper advertising committee(s), effectively eliminating the possibility of broadcasting real-time, live advertising programs. The current regulations also prohibit private enterprises from owning or operating a TV or radio station.

Business License for Advertising Companies

Companies that engage in advertising activities must obtain from the SAIC or its local branches a business license with advertising business specifically included in the business scope. A company conducting advertising activities without such a license may be subject to penalties, including fines, confiscation of advertising income and an order to cease advertising operations. Our subsidiary Shanghai Advertising has obtained a business license with advertising specifically included in the business scope from the local branch of SAIC.

Advertising Airtime

Under PRC regulations, airtime used to broadcast TV direct sales programs and TV home shopping programs is typically considered to be advertising time. The Chinese government imposes strict regulations on TV station/channel ownership and operations, TV home shopping companies can only purchase blocks of airtime for product advertising as opposed to engaging in long-term channel leasing agreements as in some other countries. In addition to regulating TV station ownership, the SAPPFT also sets regulatory standards on the amount of advertising time allowed on TV broadcasting. Since 2009, the SAPPFT has issued a series of increasingly restrictive regulatory standards on the amount of advertising time allowed on TV broadcasting, including:

the Circular on Strengthening the Administration of TV Direct Sales Advertising and Home Shopping Programs issued by the SAPPFT on September 10, 2009 prohibiting the broadcast of TV direct sales advertising programs on some specialized TV channels, including news channels, international channels, and TV home shopping channels, and on satellite TV channels during the period from 6:00pm to 12:00am every day;

the Administrative Measures on Advertising on Television or Radio issued by the SAPPFT issued by the SAPPFT on September 8, 2009 and effective as of January 1, 2010 which was amended in November 2011 requiring that the total airtime allocated to commercial advertising on each TV channel not exceed 12 minutes per hour and not exceed 18 minutes in total during the period from 7:00pm to 9:00pm, and prohibiting commercial advertising in whatever form during broadcasting of an episode (calculated as 45 minutes) of a television drama; and

the Circular on Strengthening Administration of Infomercials Broadcast via Satellite TV Channels issued by the SAPPFT on October 29, 2013 and effective as of January 1, 2014, requiring satellite TV channels to follow a series of additional provisions, such as not broadcasting (i) infomercials more than once per hour, (ii) infomercials which exceed three minutes in length or (iii) infomercials with same content or selling the same product more than three times per day.

Under current PRC law, advertising operators can only sell advertising airtime to advertisers and are not allowed to sell to other advertising operators.

Advertising Content

PRC advertising laws and regulations set forth certain content requirements for advertisements in China, which include prohibition on, among other things, misleading content, superlative wording, socially destabilizing content, or content involving obscenities, superstition, violence, discrimination, or infringement of the public interest. Advertising for medical devices, fitness and other special products are subject to stricter regulation which prohibits any unscientific assertions or assurances in terms of effectiveness or usage, any statement on the recovery or response rate, comparison with other similar products in terms of effectiveness or safety, and any recommendation or certification by an endorser. Advertising relating to medical devices for personal use is subject to specific indications. In addition, all advertising relating to medical devices, fitness agrochemicals, as well as other advertisements that are subject to censorship by administrative authorities pursuant to relevant laws and regulations, must be submitted to the relevant administrative authorities for content review and approval prior to dissemination. Furthermore, SAPPFT and SAIC have issued a circular temporarily prohibiting, after August 1, 2006, the advertising of pharmaceutical products, diet and slimming products, medical devices, breast enhancement products and height increasing products in the form of TV- and radio-based direct sales programs pending adoption of new government rules. On September 10, 2009, the Circular on Strengthening the Administration of TV Direct Sales Advertising and Home Shopping Programs was issued by the SAPPFT, prohibiting the TV direct sales and home shopping programs to advertise pharmaceuticals, breast-enhancement products, diet and slimming products, and medical devices which are implantable or need instruction by experts. Meanwhile, the Administrative Measures on Advertising on Television or Radio, issued by the SAPPFT on September 8, 2009 and effective as of January 1, 2010 which was amended in November 2011, prohibited the pharmaceutical and medical device or health related advertising program to contain the recovery rate or efficiency rate or certification by the doctors, experts, patients or public figures. Furthermore, Criteria for the Examination and Publication of Medical Device Advertisements were issued by the Ministry of Health (currently merged into National Health and Family Planning Commission), the SAIC, the SAFD and became effective on May 20, 2009, which provided strict regulation on medical device advertisements publication. According to the Circular Concerning Further Severely Punishing Illegal Advertisements of Pharmaceuticals, Medical Devices and Health Food effective in February 2010, enterprises which published the illegal advertisements will be severely punished. On February 12, 2010 SAPPFT promulgated the Notice on Further Strengthening Examination and Supervision on Advertising on Television and Radio, which requires that, among other things, in TV shopping advertisement: (1) no host is allowed to participate in advertisement; (2) exaggerative voice, intonation and gestures are prohibited; and (3) no form such as news report, interview and news materials and information is allowed to be used. On July 31, 2015, the Notice on Further Strengthening the Examination and Supervision of Advertisement of Pharmaceuticals, Medical Devices and Health Food was issued by SAFD, which raises the standard of examining advertisements of pharmaceuticals, medical devices and health food in accordance with the new Advertising Law. See Item 3.D, “Key Information—Risk Factors— Risks Related to the Regulation of Our Business and Industry—Governmental actions to regulate TV- and radio-based direct sales programs of medical devices and diet and slimming products will adversely impact sales of our branded neck massager product line and some of our other products and may adversely impact our future overall operating results”.

Entities whose products are to be advertised, or advertisers, entities offering advertising services such as linking advertisers with TV stations or newspapers, or advertising operators, and disseminators are all required by PRC laws and regulations to ensure that the content of advertising they produce or disseminate is true and in full compliance with applicable laws and regulations. In providing advertising services, advertising operators and disseminators must

review the prescribed supporting documents provided by advertisers and verify that the content of advertising complies with applicable laws and regulations. In addition, prior to disseminating advertisements for certain commodities which are subject to government censorship and approval, advertising disseminators are obligated to check the relevant approval documents for those advertisements. Violation of these regulations may result in penalties, including fines, confiscation of advertising income, orders to cease dissemination of the advertising, orders to publish a correction of the misleading information and criminal punishment. In circumstances involving serious violations, SAIC or its local counterparts may revoke the violator's licenses or permits for advertising business operations. Furthermore, advertisers, advertising operators, and disseminators may be subject to civil liability if they infringe on the legal rights and interests of third parties in the course of their advertising business.

Beginning on January 1, 2008, advertisers dealing with advertisements that relate to pharmaceuticals, medical devices and health related foods are subject to a credit rating. SAFD and its local branches will annually collect information relating to the advertiser's record of compliance with the relevant advertising regulations in respect of the above products, and grade the credit of distributors based on the collected information. The credit rating of each advertiser will be either good credit, dishonor credit, or material dishonor credit. Any violations of related laws and regulations within one year by the advertising operator may result in a rating of dishonor credit or material dishonor credit for that year. Distributors with dishonor credit or material dishonor credit may be ordered to take corrective measures and may be subject to special supervision and/or public disclosure of their credit ratings.

In addition, PRC unfair competition law prohibits us and our distributors from conveying misleading, false or inaccurate information with respect to product quality, production, functionality, or other features, through advertising.

We have employed advertising industry professionals who will examine the content of our advertising and who will apply for the necessary approvals and permits for advertising certain special consumer products. In addition, our advertising channels, such as TV stations, newspapers, and radio stations, employ advertising inspectors who are trained to review advertising content for compliance with relevant laws and regulations. However, we cannot assure you that all of our advertising is in compliance with relevant PRC laws and regulations, nor can we assure you that the advertising our distributors place on local media networks complies with relevant PRC laws and regulations. In the past, we have been fined for certain advertising that is considered misleading or false by authorities. In some cases, we were required to accept product returns. From January 1, 2008, any violation of advertising regulations relating to our sleeping aid product and oxygen generating devices by us or our distributors may result in SAFD issuing a rating to us or our distributors of dishonor credit or material dishonor credit.

Regulation on Foreign Exchange Control and Administration

Foreign exchange in China is primarily regulated by:

• The Foreign Currency Administration Rules (1996), as amended; and

• The Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules.

Under the Foreign Currency Administration Rules, Renminbi is convertible for current account items, including the distribution of dividends, interest payments, and trade and service-related foreign exchange transactions. Conversion of Renminbi into foreign currency for capital account items, such as direct investment, loans, investment in securities, and repatriation of funds, however, is still subject to the approval of SAFE.

Under the Administration Rules, foreign-invested enterprises may only buy, sell, and remit foreign currencies at banks authorized to conduct foreign exchange transactions after providing valid commercial documents and, in the case of capital account item transactions, only after obtaining approval from SAFE. Capital investments directed outside of China by foreign-invested enterprises are also subject to restrictions, which include approvals by SAFE, MOFCOM, and the National Reform and Development Commission.

On November 19, 2012, the SAFE promulgated the Notice of the SAFE on Further Improving and Adjusting Foreign Exchange Administration Policies on Direct Investment, or the Notice, which came into force as of December 17, 2012. According to the Notice, (i) the opening of and payment into foreign exchange accounts under direct investment account are no longer subject to approval by the SAFE; (ii) reinvestment with legal income of foreign investors in China is no longer subject to approval by the SAFE; (iii) the procedures for capital verification and confirmation that foreign-funded enterprises need to go through are simplified.

On March 30, 2015 SAFE promulgated the Circular on Reforming the Administrative Approach Regarding the Foreign Exchange Capital Settlement of Foreign-invested Enterprises, or SAFE Circular 19, which became effective as of June 1, 2015. SAFE Circular 19 requires that, among other things, (i) capital and RMB fund converted from foreign currencies of a foreign invested enterprise shall not (a) directly or indirectly be used for expenditure beyond its business scope or prohibited by national laws and regulations; (b) directly or indirectly be used for investment into security unless otherwise provided by laws and regulations; (c) directly or indirectly be used for provision of entrusted RMB loans (unless it is within its business scope), repayment of inter-company borrowing (including third party advances) or repayment of bank RMB loans which have been sub-lent to third parties; (d) be used for payment of

relevant expenses related to purchase of real properties not for self-use unless it is a foreign invested real properties enterprise; (ii) in addition to the transfer of equity investment payments in original currencies, foreign-invested enterprises whose main business is investment (including foreign-invested investment companies, foreign-invested venture capital enterprises and foreign-invested equity investment enterprises) are allowed to directly settle their foreign exchange capitals and transfer the same to, or transfer RMB fund in their account pending for foreign exchange settlement payment to, the account of an invested enterprise according to the actual amount of investment, provided that the relevant domestic investment project is real and compliant; (iii) ordinary foreign-invested enterprises other than those of the aforesaid types shall (a) be governed by the prevailing provisions on domestic re-investment if they make domestic equity investments by capital transfer in original currencies; or (b) transfer RMB funds converted from foreign exchange settlement, according to the actual amount of investment, to an account pending for foreign exchange settlement payment which has been opened by the invested enterprise after completion of domestic re-investment registration required by local branches of SAFE if they makes domestic equity investment with fund converted from foreign exchange settlement.

On June 9, 2016, SAFE promulgated the Notice of the State Administration of Foreign Exchange on Reforming and Standardizing the Administrative Provisions on Capital Account Foreign Exchange Settlement, or Circular 16. Under Circular 16, onshore enterprises (including Chinese-funded enterprises and foreign-invested enterprises, excluding financial institutions) may settle their external debts in foreign currencies according to the method of voluntary foreign exchange settlement. The banks shall, in handling each transaction of foreign exchange settlement for an onshore enterprise according to the principle of payment-based foreign exchange settlement, review the authenticity of, and compliance with, the use by the domestic institution of the foreign exchange funds settled in the previous transaction (including voluntary settlement and payment-based settlement).

We receive substantially all of our revenue in Renminbi, which is currently not a freely convertible currency. Under our current structure, our income will be primarily derived from dividend payments from our subsidiaries in China.

The value of the Renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions. The conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China. On July 21, 2005, the PRC government changed its policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi will be permitted to fluctuate within a band against a basket of certain foreign currencies. This change in policy resulted initially in an approximately 2.0% appreciation in the value of the Renminbi against the U.S. dollar. There remains significant international pressure on the PRC government to adopt a substantial liberalization of its currency policy, which could result in a further and more significant appreciation in the value of the Renminbi against the U.S. dollar.

Regulation of Foreign Exchange in Certain Onshore and Offshore Transactions

In January and April 2005, the PRC State Administration of Foreign Exchange, or SAFE, issued two rules that require PRC residents to register with and receive approvals from SAFE in connection with their offshore investment activities. SAFE has announced that the purpose of these regulations is to achieve the proper balance of foreign

exchange and the standardization of the cross-border flow of funds.

On July 4, 2014, SAFE promulgated the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, which replaced the former circular commonly known as "Notice 75" promulgated by SAFE on October 21, 2005. SAFE Circular 37 requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle." SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiary of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls. Pursuant to the Circular on Further Simplifying and Improving the Direct Investment-related Foreign Exchange Administration Policies, or SAFE Circular 13, promulgated by SAFE, starting from June 1, 2015, the registration (including initial registration and amendment registration) under SAFE Circular 37 will be directly reviewed and handled by local banks.

As a Cayman Islands company, and therefore a foreign entity, if Acorn International purchases the assets or an equity interest of a PRC company owned by PRC residents in exchange for our equity interests, such PRC residents will be subject to the registration procedures described in SAFE Circular 37 and SAFE Circular 13. Moreover, PRC residents who are beneficial holders of our shares are required to register with SAFE in connection with their investment in us.

As a result of the uncertainties relating to the interpretation and implementation of SAFE Circular 37 and SAFE Circular 13, we cannot predict how these regulations will affect our business operations or strategies. For example, our present or future PRC subsidiaries' ability to conduct foreign exchange activities, such as remittance of dividends and foreign-currency-denominated borrowings, may be subject to compliance with such SAFE registration requirements by relevant PRC residents, over whom we have no control. In addition, we cannot assure you that any such PRC residents will be able to complete the necessary approval and registration procedures required by the SAFE regulations. We require all shareholders in Acorn International who are PRC residents known by us to comply with any SAFE registration requirements and we understand that the relevant shareholders have registered their offshore investment in us with Shanghai SAFE, but we have no control over either our shareholders or the outcome of such registration procedures. Such uncertainties may restrict our ability to implement our acquisition strategy and adversely affect our business and prospects. See Item 3.D, "Key Information—Risk Factors—Risks Relating to China—Regulations relating to offshore investment activities by PRC residents may increase the administrative burden we face and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by our shareholders who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose our PRC resident shareholders to liability under PRC law".

Regulation of Overseas Listings

On August 8, 2006, six PRC regulatory agencies, including MOFCOM, the State Assets Supervision and Administration Commission, or SASAC, the State Administration for Taxation, or SAT, SAIC, the China Securities Regulatory Commission, or CSRC, and SAFE, jointly adopted the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the New M&A Rule, which became effective on September 8, 2006 and was amended on June 22, 2009. This New M&A Rule, among other things, purports to require offshore SPVs formed for listing purposes and controlled directly or indirectly by PRC companies or individuals, such as our company, to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange.

Dividend Distributions

Pursuant to the Foreign Currency Administration Rules promulgated in 1996 and amended in 1997 and 2008, and various regulations issued by SAFE and other relevant PRC government authorities, the PRC government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of China.

The principal regulations governing the distribution of dividends paid by wholly foreign-owned enterprises and Sino-foreign joint equity enterprise enterprises include:

- The Wholly Foreign-Owned Enterprise Law (1986), as amended in 2000 and 2016;
- The Wholly Foreign-Owned Enterprise Law Implementing Rules (1990), as amended in 2001 and 2014;
- The Sino-foreign Joint Equity Enterprise Law (1979), as amended in 2001 and 2016;
- The Sino-foreign Joint Equity Enterprise Law Implementing Rules (1983), as amended in 2001 and 2014; and
- Company Law of the PRC (2014).

Under these regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, a foreign-invested enterprise in China is required to set aside at least a certain percentage of its after-tax profit based on PRC accounting standards each year to its general reserves. These reserves are not distributable as cash dividends. The board of directors of a foreign-invested enterprise has the discretion to allocate a portion of its after-tax profits to employee welfare and bonus funds. These funds, however, may not be distributed to equity owners except in the event

of liquidation. In 2015 and 2016, Acorn Information and Shanghai HJX Digital distributed cash dividends of RMB40 million and RMB20 million, respectively to China DRTV.

Regulations on Employee Share Options

In December 2006, the People's Bank of China promulgated the Administrative Measures for Individual Foreign Exchange, which set forth the requirements for foreign exchange transactions by PRC individuals relating to current account items and capital account items. The Implementation Rules of the Administrative Measures for Individual Foreign Exchange issued on January 5, 2007 by SAFE specify approval requirements for PRC citizens who are granted shares or share options by an overseas listed company according to its employee stock ownership plan or stock option plan.

On March 28, 2007, SAFE issued the Operating Rules for Administration of Foreign Exchange for Domestic Individual's Participation in Employee Stock Ownership Plans and Stock Option Plans of Overseas Listed Companies, or the Circular 78. On February 15, 2012, SAFE promulgated the Circular on Relevant Issues concerning Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas-Listed Companies, or Circular 7, in replacement of the Circular 78. According to Circular 7, individuals in PRC (including PRC citizens and foreign individuals who have lived in China over one year) who intend to participate in the stock incentive plan of the same overseas listed company shall collectively appoint a qualified PRC domestic agent or a PRC subsidiary of such overseas listed company ("a PRC agency") to conduct foreign exchange registration, open bank accounts and transfer and exchange funds and an overseas entity shall be appointed to conduct exercise of option, buying and selling of relevant stocks or equities and transfer of relevant funds. After such individuals' foreign exchange income received from participation in the stock incentive plan is remitted to PRC, relevant banks shall distribute the above funds from the account opened and managed by the PRC agency to such individuals' foreign exchange accounts. We and our employees within PRC who have been granted share options or stock appreciation rights, or PRC option/stock appreciation right holders, are subject to Circular 7 upon the listing of our ADSs on NYSE. If we or our PRC option/stock appreciation right holders fail to comply with these regulations, we or our PRC option/stock appreciation right holders may be subject to fines and other legal or administrative sanction.

Pursuant to the Notice on Relevant Issues Concerning Collection of Individual Income Tax Related to Income from Share Option issued by the Ministry of Finance and the SAT on March 28, 2005, Supplementary Notice on Payment of Individual Income Tax for Incomes Derived from Individual Stock Option issued by the SAT on September 30, 2006, the Notice on Relevant Issues Concerning Collection of Individual Income Tax for Income Derived from Share Appreciation Rights and Restricted Share Units issued by the SAT on January 7, 2009 and the Notice on Issues of Individual Income Tax Concerning Share Incentive Plan issued by the SAT on August 24, 2009, in connection with the share option plan of an overseas listed company, the difference received by a PRC individual who had been granted share options between the exercise price and the fair market price of such shares on the exercise date shall be imposed of individual income tax which shall be withheld by the PRC subsidiary of such overseas listed company.

Regulations on Labor Protection

The PRC Labor Contract Law and its Implementation Rules became effective on January 1, 2008 and September 18, 2008, respectively, which set out specific provisions related to fixed-term and unlimited-term employment contracts, part-time employment, labor dispatch, probation, consultation with labor union, employment without a written contract, dismissal of employees, severance and collective bargaining. According to the PRC Labor Contract Law and its implementing rules, an employer may terminate the labor agreement of an employee under certain specified circumstances and in some cases, such termination can only be done after fulfillment of certain procedural requirements, such as 30 days' prior notice or upon payment of one month's salary in lieu of such notice. In certain cases, the terminated employee is entitled to receive a severance payment equal to the average monthly salary during the 12-month period immediately preceding to the termination (inclusive of all monetary income such as base salary, bonus, allowances, etc.), for each year of service up to the date of termination. If an employer terminate an labor contract in any circumstance other than those specified under the PRC Labor Contract Law and its implementing rules, including termination without cause, the employer must either reinstate and continue to perform the employee's employment contract or pay the employee damages calculated at twice the rate for calculating the severance payment, subject to the employee's own request. In the case that the employee requests for damages, the employer is not required to pay other severance or the remainder of the amount owed under the employment contract unless the employment contract has otherwise provided for. On December 28, 2012 the Labor Contract Law was amended to impose more stringent requirements on labor dispatch which became effective on July 1, 2013. Pursuant to amended Labor Contract Law, (i) it is strongly emphasized that dispatched employees shall be entitled to equal pay for equal work as a fulltime employee of an employer; (ii) labor contracts between employers and employees shall be the basic form of employment adopted by Chinese enterprises and employment by labor dispatching is only a supplementary form and shall apply only to temporary, ancillary or substitute works; and (iii) an employer shall strictly control the number of dispatched employees so that they do not exceed certain percentage of total number of employees and the specific percentage shall be prescribed by the labor administrative department of the State Council.