Acorn International, Inc.
Form 20-F
April 18, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

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

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

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)

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

(Address of principal executive offices)

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 three 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

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

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: 82,439,960

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

US GAAP x	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 x No

Table of Contents

ACORN INTERNATIONAL, INC.

TABLE OF CONTENTS

Table of Contents

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 three ordinary shares;
- ADRs are to American depositary receipts, which, if issued, evidence our ADSs;
- $, US$ 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;
- RMB and Renminbi are to the legal currency of China; and
- we , us , our company and our refer to Acorn International, Inc., its predecessor entities, subsidiaries and affiliated entities.

This annual report on Form 20-F includes our audited consolidated statements of operation data for the years ended December 31, 2010, 2011 and 2012, and audited consolidated balance sheet data as of December 31, 2011 and 2012.

We and certain of our shareholders completed the initial public offering of 8,855,000 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 that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. In some cases, these forward-looking statements can be identified by words or phrases such as aim , anticipate , believe , continue , estimate , expect , intend , to , may , plan , potential , will or other similar expressions. The forward-looking statements included in this annual report relate to, among other

- our goals and strategies;
- expected trends in 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 manage our featured product lines;
- competition in the TV direct sales market and retail market in China for our consumer products;
- our ability to effectively control our cost of sales and efficiently access media channels and manage our media time; and
- PRC governmental policies and regulations relating to our businesses.

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. 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.

Table of Contents

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, 2010, 2011 and 2012, and the selected consolidated balance sheet data as of December 31, 2011 and 2012, have been derived from our audited consolidated financial statements for the years ended December 31, 2010, 2011 and 2012, and are included elsewhere in this annual report. Our selected consolidated statements of operations data for the years ended December 31, 2008 and 2009, and our consolidated balance sheet data as of December 31, 2008, 2009 and 2010, have been derived from our audited consolidated financial statements that are not included in this annual report. 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. Our consolidated financial statements are prepared and presented in accordance with U.S. GAAP.

Table of Contents

	For the years ended December 31,				
	2008	2009	2010	2011	2012
	(in thousands, except share and per share data)				
Condensed Consolidated Statements of Operations Data					
Revenues:					
Direct sales, net	$ 166,947	$ 160,358	$ 195,821	$ 291,525	$ 193,615
Distribution sales, net	67,190	127,228	97,420	70,533	48,959
Total revenues, net	234,137	287,586	293,241	362,058	242,574
Cost of revenues:					
Direct sales	83,301	67,531	106,990	160,360	96,472
Distribution sales	37,326	83,097	74,732	45,584	35,475
Total cost of revenues	120,627	150,628	181,722	205,944	131,947
Gross profit	113,510	136,958	111,519	156,114	110,627
Operating (expenses) income:					
Advertising expenses	(73,381)	(61,048)	(58,470)	(68,563)	(58,338)
Other selling and marketing expenses[1]	(38,317)	(42,956)	(43,377)	(59,854)	(50,346)
General and administrative expenses[1]	(28,926)	(31,196)	(25,434)	(31,681)	(27,071)
Impairment of goodwill and intangible assets	(8,668)	(15,248)			
Other operating income, net	5,039	6,004	2,977	5,084	3,277
Total operating (expenses) income	(144,253)	(144,444)	(124,304)	(155,014)	(132,478)
Income (loss) from operations	(30,743)	(7,486)	(12,785)	1,100	(21,851)
Other (expenses) income	(626)	2,068	4,826	7,822	5,755
Income tax (expense) benefit	(5)	2,539	1,539	(3,111)	(1,822)
Equity in losses of affiliates	(41)	(417)	(797)	(772)	
Income (loss) from continuing operations	(31,415)	(3,296)	(7,217)	5,039	(17,918)
Income from discontinued operations, net of taxes	8,274	15,363			
Income from extraordinary items, net of tax			827		
Net income (loss)[2][3]	(23,141)	12,067	(6,390)	5,039	(17,918)
Net income (loss) attributable to non-controlling interests	(3,629)	(184)	(19)	84	(8)
Net income (loss) attributable to Acorn International, Inc	(26,770)	11,883	(6,409)	5,123	(17,926)
Net income (loss) attributable to holders of ordinary shares	$ (26,770)	$ 11,883	$ (6,409)	$ 5,123	$ (17,926)
Income (loss) per ordinary share:					
Basic	$ (0.31)	$ 0.13	$ (0.07)	$ 0.06	$ (0.20)
Diluted	$ (0.31)	$ 0.13	$ (0.07)	$ 0.06	$ (0.20)
Weighted average number of shares used in calculating income (loss) per ordinary share					

Basic	86,856,467	88,174,675	88,923,162	89,629,395	89,965,979
Diluted	86,856,467	88,174,675	88,923,162	89,796,835	89,965,979

Table of Contents

	2008	2009	As of December 31, 2010 (in thousands)	2011	2012
Condensed Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 147,649	$ 142,953	$ 91,667	$ 111,180	$ 90,975
Prepaid advertising expenses	16,757	9,968	8,433	11,655	8,563
Total assets	304,185	273,383	214,632	245,676	207,397
Deferred revenue	12,798				904
Total liabilities	74,860	68,357	30,812	48,781	27,595
Total liabilities and equity	$ 304,185	$ 273,383	$ 214,632	$ 245,676	$ 207,397

	2010	For the years ended December 31, 2011 (in thousands, except percentages)	2012
Selected Operating Data			
Number of inbound calls generated through direct sales platforms	6,487	6,107	4,377
Conversion rate for inbound calls to product purchase orders	25.4%	31.4%	36.2%
Total TV direct sales program minutes	290	186	188

(1) Includes share-based compensation of:

	2008	2009	For the years ended December 31, 2010 (in thousands)	2011	2012
Other selling and marketing expenses	$ (292)	$ (94)	$	$	$
General and administrative expenses	$ (4,176)	$ (1,751)	$ (215)	$ (130)	$ (424)

(2) Includes:

	2008	2009	For the years ended December 31, 2010 (in thousands)	2011	2012
Share-based compensation	$ (4,468)	$ (1,846)	$ (215)	$ (130)	$(424)
Goodwill and intangible assets impairment losses	(8,668)	(15,248)			
(Loss) Gain on change in fair value of derivative assets	(3,275)	(1,306)	199	306	

(3) Net income 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 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 RMB6.2855, which was the prevailing rate on December 31, 2012. The prevailing rate on April 15, 2013 was $1.00 to RMB6.2454. We make no representation that any Renminbi or U.S. dollar amounts could have been, or could

4

Table of Contents

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 People s Bank of China sets and publishes daily a base exchange rate. Until July 21, 2005, the People s Bank of China set this rate with reference primarily to the supply and demand of Renminbi against the U.S. dollar in the market during the prior day. Beginning on July 21, 2005, the People s Bank of China has set this rate with reference primarily to the supply and demand of Renminbi against a basket of currencies in the market during the prior day. The People s Bank of China also takes into account other factors such as the general conditions existing in the international foreign exchange markets. Although governmental policies were introduced in the PRC in 1996 to reduce restrictions on the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or security, requires the approval of the State Administration for Foreign Exchange and other relevant authorities.

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**
2008	6.8225	6.9193	6.7800	7.2946
2009	6.8282	6.8314	6.8201	6.8399
2010	6.6227	6.7668	6.6227	6.8284
2011	6.3009	6.4445	6.3009	6.6349
2012	6.2855	6.3124	6.2670	6.3495
October	6.3002	6.3144	6.2992	6.3449
November	6.2892	6.2953	6.2852	6.3082
December	6.2855	6.2900	6.2855	6.2949
2013				
January	6.2795	6.2787	6.2691	6.2897
February	6.2779	6.2842	6.2779	6.2898
March	6.2689	6.2743	6.2689	6.2822
April (through April 15, 2013)	6.2454	6.2583	6.2674	6.2454

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

Table of Contents

D. Risk Factors

Risks Relating to Our Business

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 continues to evolve in conjunction with the evolution of China s direct sales industry (including the TV home shopping industry) and market conditions. The direct sales industry in China is still in the early stage of development and the competitive landscape and range of products being offered continue to evolve rapidly. Our business model has varied throughout our operating history in response to changes in the direct sales industry. In addition to our core TV direct sales platform, we currently focus on Internet and outbound calls, which we expect to be of higher growth potential and growing importance to our business in the future. 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 the leading media and branding company in China and to capitalize on our integrated multi-media platform with an aim to become partners of choice for both well-established and promising new businesses to market and distribute their products in China. To achieve this goal, our management has adopted a new performance review system since 2010 which focuses on the optimization of our media return. In addition, while maintaining our distribution network, we expect to focus more on our TV and other direct sales platform starting from 2011. However, there can be no assurance that we will be able to effectively implement our business strategies and the new performance review system, which could materially adversely affect our result of operations and prospects.

Our operating results fluctuate from period to period, making them difficult to predict. Our operating results for a particular period could fall below our expectations or the expectations of investors or any market analyst that may issue reports or analyses regarding our ADSs, resulting in a decrease in the price of our ADSs.

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

- the mix of TV direct sales programs dedicated to our proprietary and third party products;
- the mix of products selected by us for marketing through our TV direct sales programs, our other direct sales channels and our nationwide distribution network and their average selling prices;
- negative publicity about our products;
- 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 cycles of our products featured in our TV direct sales programs, with such sales typically growing rapidly over the initial promotional period and then declining over time, sometimes precipitously in a short period of time;

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

Table of Contents

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:

- any requirement to suspend or terminate a particular TV direct sales program, including in response to regulatory actions;
- new laws, regulations or rules promulgated by the PRC government governing the TV direct sales industry;
- 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 investments in marketable 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.

Our best-selling featured product lines account for, and are expected to continue to account for, the substantial majority of our sales. 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.

Our five best-selling featured product lines accounted for 86.1%, 85.5% and 82.1% of our gross revenues in 2010, 2011 and 2012, respectively. In 2012, sales of our mobile phone product line, which was our best-selling product in 2012, accounted for 26.6% of our gross revenues in 2012 as compared to 45.7% in 2011. In addition, our cosmetic product line, which has consistently been one of our five best-selling products since 2008, has experienced a large decline due to the slower-than-expected sales of Aoya products and accounted for 2.9% of our gross revenues in 2012 as compared to 6.8% in 2011. 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 TV direct sales programs, our effective management of product inventory and the stage of our products   lifecycles during the period. Customer response to our TV direct sales programs depends on many factors, including the appeal of the products being marketed, the effectiveness of the TV direct sales programs, the viability of competing products and the timing and frequency of airtime. 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.

Table of Contents

Although we have previously offset declining sales of a featured product line through increased sales of a new or expanded featured product line, we may be unable to do so in the future. 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.

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 ability to develop, maintain and enhance a given products brand image and recognition depends largely on our ability to remain a leader in the TV direct sales market industry in China. Our brand promotion efforts, particularly our brand promotion activities, may be expensive and may fail to either effectively promote our product brands or generate additional sales.

Our product brands, corporate reputation and product sales could be harmed if, for example:

- our advertisements, including our TV direct sales programs, 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;
- consumers confuse our TV direct sales programs with those of our competitors, some of which may promote inferior products, be misleading or inaccurate, or be of poor production quality; or
- consumers find our outbound calls 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. We believe that this case will play a great role to prevent similar events in the future, however, we can not assure you that similar events won t happen in the future. We believe that we have taken the necessary steps to prevent similar events from recurring. However, 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.

Our business depends on our access to TV media time to market our products in China, which is limited by PRC regulations. We do not generally have long-term contracts to purchase TV media time, and any regulatory or other disruption of our access to desired TV time slots could negatively impact the effectiveness of our TV direct sales platform.

Our business is dependent on having access to media time to televise our TV direct sales programs. A significant portion of our direct sales, which accounted for 66.8%, 80.5% and 79.8% of our total net revenues

Table of Contents

in 2010, 2011 and 2012, respectively, are generated through our TV direct sales platform. Under PRC regulations, airtime used to broadcast retail sales programs is generally considered advertising time. PRC regulations restrict the overall daily TV advertising time and the amount of TV advertising time during certain time periods. New regulations and rules that imposed tighter restrictions on TV advertising were issued in 2009. The Circular on Strengthening the Administration of TV Direct Sales Advertising and Home Shopping Programs issued by the State Administration of Radio, Film and Television, or SARFT, on September 10, 2009 requires that TV direct sales advertising programs not be broadcast on some specialized TV channels, including news channels, international channels, and TV home shopping channels and not be broadcast 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 SARFT on September 8, 2009 and effective as of January 1, 2010 which was amended on November 15, 2011 further requires 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; no commercial advertising shall be inserted in whatever form during broadcasting of an episode (calculated as 45 minutes) of a television drama. Violation of these time restrictions may result in a warning, an order to correct the violation, a fine of up to RMB20,000, the suspension of broadcasting relevant to advertising, the suspension of the operation of the TV channel where the relevant advertising is broadcast, or even the withdrawal of the TV station s operating license.

Our TV direct sales programs, which are typically five to ten minutes in length, are in most cases treated by TV stations as advertising for purposes of complying with these PRC regulations. Accordingly, adverse or unanticipated regulatory changes, including any change that limits the amount of time available for TV advertising generally or its availability to us, could significantly harm our business or limit our ability to operate. For example, the 2009 new regulations and rules described above have caused a strong increase in media price and as a result, we have to further lower our purchase of TV advertising time to focus on more cost effective channels and time slots and to better control our cost. We purchase TV advertising time mainly from TV advertising agencies that have exclusive rights to sell certain TV advertising time slots for certain TV channels, while we also purchase TV advertising time from TV stations directly. Competition for attractive TV advertising time and for channels in China is intense, in part, due to the daily restrictions discussed above. Competitors for advertising time include other TV-based retail companies and companies seeking to advertise their own products. In addition, certain TV channels have in the past allocated, and might choose in the future to allocate, fewer time slots for TV direct sales programs. As our existing contracts expire, we may be unable to purchase or renew desired advertising time slots on desirable TV channels or at favorable price levels, if at all. Any significant increase in media price or decreases in our access to media time, including as result of any failure to renew or extend our existing contracts with TV stations or their advertising agencies, could negatively impact the effectiveness of our TV direct sales platform and our TV direct sales net revenues and total net revenues.

Our advertising commitments represent our largest operating expenditure. However, our advertising commitments may not generate higher net revenues, thereby negatively impacting our overall profitability.

The purchase of TV advertising time is our largest operating expenditure. Any significant increase in the cost of media time, in particular in the event that the increase in media cost outpaces our revenue growth, could negatively impact our overall profitability. Our TV advertising time purchase contracts typically require us to make advance payment before broadcasting our TV direct sales programs. As of December 31, 2012, we had signed contracts to purchase $43.3 million of TV advertising time for direct sales programs for 2013. Accordingly, if we fail to manage our media time efficiently or effectively, and our TV advertising efforts fail to generate sufficient return or profit potential, our results of operations and business performance may be materially and adversely affected. In addition, we may be unable to use all of our purchased time due to factors out of our control, such as preemption of our time by special programming events and programming overruns by relevant TV stations. For example, in 2008, approximately 10.1% of our purchased TV advertising time was preempted by these TV stations due to special events such as the Beijing Olympic Games in August 2008, which significantly affected our sales performance in the third quarter.

Table of Contents

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 2010, 2011 and 2012, 33.2%, 19.5% and 20.2%, respectively, of our net revenues were generated through our distributors across China. Our largest distributor accounted for approximately 1.4%, 1.2% and 1.1% of our gross revenues in 2010, 2011 and 2012, 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. 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 may result in decreased sales.

We have limited ability to manage the activities of our distributors, who are independent 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 local TV and 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; 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 Babaka branded posture correction 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.

Some of our distributors may compete with us in certain TV direct sales markets, possibly negatively affecting our direct sales in those markets.

Several of our distributors marketed and sold some of our and our competitors products through their own TV direct sales platforms and call centers. Of those distributors, one was among our five best-performing

Table of Contents

distributors in 2009, 2010 and 2011, with aggregate revenue contribution of approximately 2.0%, 2.3% and 0.8% of our gross revenues in 2009, 2010 and 2011, respectively. Each of these distributors was a party to our standard distribution arrangement and each operated its own TV direct sales platform prior to becoming our distributor. These distributors continue to operate their own TV direct sales platforms. These distributors TV direct sales efforts may compete with and negatively affect our own TV direct sales in their respective territories. We ceased our cooperation with these distributors in April 2012. However, there can be no assurance that none of our distributors will compete with us in their respective territories in the future. In the event that any of our distributors competes with us, our sales and financial results may be adversely affected.

We may not be able to achieve revenue growth or return to profitability.

Historically we recorded rapid revenue growth and were generally profitable. However, in 2012 our revenues declined by $119.5 million, or approximately 33%, primarily due to rapidly declining mobile phone revenues, and we experienced a $17.9 million net loss compared to $5.0 million in net income in 2011. We may not be able to grow our revenues or return to profitability in future periods. Various factors, such as economic conditions, regulatory considerations and competition, and our ability to successfully introduce new products with acceptable sales levels and margins may impede future revenue growth and profitability. If our revenues decline, we may be unable to timely reduce our expense levels, in turn, harming our profitability or resulting in increased losses. To the extent we incur losses, we will be required to fund those losses from our cash balances.

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 with other entities as a means of developing new products, acquiring managerial expertise or further expand 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.

Table of Contents

We depend on our senior management team, key personnel and skilled and experienced employees in all aspects of our business, and our business and operations may be severely disrupted and our performance negatively affected if we lose their services.

Our future success significantly depends upon the continuing service of our senior management team, including Robert W. Roche, our co-founder and chairman of the board of directors, Don Dongjie Yang, our co-founder, chief executive officer and director, and Peng Lu, our president. If one or more members of our senior management team or other key employees are unable or unwilling to continue in their present position, we may not be able to replace them 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 for any of our senior management.

To maintain our competitive position and expand our operations, we must attract, train and retain skilled and experienced employees in numerous areas, including product development, media procurement and call center operations. The turnover rate for our call center employees located in our three call centers was approximately 49% in 2010 and 46% in 2011 and 110% in 2012, reflecting both voluntary terminations and termination of employees failing to meet our performance standards. Any inability to attract and retain a significant number of skilled and experienced employees in our call centers or other critical areas could seriously disrupt our business and operations and negatively affect our financial performance.

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 local delivery companies to deliver products sold through our direct sales platforms. EMS and local delivery companies made deliveries of products representing 32.5% and 49.5% of our sales in 2010, respectively, 37.3% and 45.2% of our sales in 2011, respectively, and 26.7% and 53.3% of our sales in 2012, respectively. Although we have started offering credit card payment options for selected card holders, 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%, 70% and 72% were successful in 2010, 2011 and 2012, 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 an average of 24 days to remit to us the COD payments received from our customers. Of our total accounts receivable balance as of December 31, 2010, 2011 and 2012, $0.2 million or 1.6%, $1.8 million or 10.7% and $3.6 million or 25.3%, respectively, were due from EMS. 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 2010, 2011 and 2012 was approximately $0.3 million, $0.1 million, and $0.9 million respectively. We may be required to write off similar or higher amounts 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.

In addition, one local delivery company that we used for delivery of our products became insolvent in 2011. Although we are trying to recover the outstanding account receivables due from such local delivery company, our management considered that the possibility to fully collect such account receivables is remote and made a $2.5 million bad debt provision in connection with the receivables from such local delivery company. We also

Table of Contents

recorded similar bad debt provision of $0.5 million in 2012. If any similar event occurs in the future, our business and results of operations could be materially and adversely affected.

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

- other TV direct sales companies operating in China with generally similar business models to ours, including Moneng TV, and Jiayuan Shopping;

- TV home shopping companies that operate across China or in large parts of China, such as CCTV Home Shopping and Hunan TV Happigo, and companies that operate on multiple channels in multiple provinces, such as Oriental CJ Home Shopping and U-you Home Shopping;

- 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 BBK, Noah, Readboy, and other brands, and our mobile phone products which compete with similar products sold by local and international mobile phone manufacturers; and

- traditional retailers and distributors, as well as direct marketers such as Avon and Amway, operating in China which currently or in the future may offer competing products, including products under their own brand, or may otherwise offer or seek to offer small and medium manufacturers and suppliers distribution capabilities throughout China.

Particularly, we are facing more intense competition from TV home shopping companies, whose number has increased significantly during the past years in China. Many of these companies are supported by, or affiliated with, TV or radio stations and therefore may have access to cheaper TV airtime than us.

In addition, large multi-national infomercial TV shopping companies may enter the China market directly or indirectly. Entry by these players becomes more likely if existing PRC restrictions on content, number of advertising hours per day and foreign ownership of TV stations are relaxed.

We also compete with companies that make imitations of our products at substantially lower prices, such as our Babaka branded posture correction products, which may be sold in department stores, pharmacies and general merchandise stores.

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 2010, 2011 and 2012, approximately 66.8%, 80.5% and 79.8% of our total net revenues, respectively, were generated through our direct sales platforms with orders processed by our call centers. Our call centers rely heavily on our telephone and management information systems, or MIS, to receive customer calls at our call centers, process customer purchases, arrange product delivery and assess the effectiveness of advertising placements and consumer acceptance of our products, among other things. As our business evolves and our MIS

Table of Contents

requirements change, we may need to modify, upgrade and replace our systems. We work closely with third-party vendors to provide telephone 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 experience short periods of power outage. 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.

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.

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 third parties, such as hackers or criminal organizations, from stealing 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. 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 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 crime will likely increase accordingly. We must therefore be prepared to increase our security measures and efforts so that our customers have confidence in the reliability of the online payment systems that we use.

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 approximately 300 trademark registrations 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, the steps we have taken may still be inadequate to prevent the misappropriation of our intellectual property. Separately, we are in the process of applying for registration or transfer of approximately 110 trademarks in China.

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 recently discovered unauthorized products 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, and our cosmetic 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, currently are, 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, currently are, 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 patent 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 proceedings 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 business 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 become a party to legal proceedings which, if adversely decided, could materially adversely affect us.

We may from time to time become a party to legal proceedings, defense of which may increase our expenses and divert management attention and resources. For example, in July 2011, Shanghai HJX Digital

Table of Contents

Technology Co., Ltd., or Shanghai HJX, filed a suit in the People s Court of Guangzhou Baiyun District against Guangzhou Yangyikang Electric Device Co., Ltd., or Yangyikang, claiming that Yangyikang breached the research and development contract between Yangyikang and Shanghai HJX by not performing its research and development obligations under the contract and asserted that Yangyikang should return the RMB2.0 million (approximately $317,415) R&D fees. On September 30, 2011, Shanghai HJX received the verdict from the People s Court of Guangzhou Baiyun District on the jurisdiction of the suit. Shanghai HJX was ordered to file the suit in the Guangzhou Intermediate People s Court. On January 29, 2012, Shanghai HJX filed a suit to the Guangzhou Intermediate People s Court in accordance with the verdict. A court decision was delivered on March 19, 2013, supporting most of the claims brought up by Shanghai HJX. The court ruled that Yangyikang should return the RMB2.0 million (approximately $317,415) R&D fees and make payment of interest to Shanghai HJX. Any adverse outcome in any similar proceedings that we are a party could have a material adverse effect on our business, results of operations and financial condition.

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.

Insurance companies in China offer limited business insurance products and do not, to our knowledge, offer business liability insurance. While business interruption insurance is available to a limited extent in China, we have determined that the risks of disruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to subscribe for such insurance. As a result, except for all-risks insurance on finished goods inventory stored in our central warehouses, we 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.

We do not carry product liability insurance coverage, and our sale of our and other parties products could subject us to product liability claims and potential safety-related regulatory actions. 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 and neck massager product lines in our health product category, and our sale of other parties products could each expose us to product liability claims for personal injuries. Also, if these 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, the 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 criminal liabilities could be imposed. We currently do not carry any product liability insurance coverage. 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 almost 21.4% of the products we sell in terms of revenues in 2012, with the balance provided by third-party suppliers and manufacturers in China. We purchase the materials we need to manufacture

Table of Contents

our products, including our electronic learning product line, from outside suppliers in China. We typically purchase all production materials, including critical components such as flash memory, chipsets and LCD display screens for our electronic learning products, on a purchase order basis and do not have long-term contracts with our suppliers.

If we fail to develop or maintain our relationships with our suppliers, we may be unable to manufacture 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.

Our leases of land and manufacturing and warehouse facilities in Beijing may not be in full compliance with PRC laws and regulations and we may be required to relocate our facilities, which may disrupt our manufacturing operations and result in decreased net revenues.

Our Beijing manufacturing facility and a warehouse are built on a plot of land we leased from Beijing Tongzhou District Lucheng Town Chadao Village for a term of 30 years. The Beijing land is collectively owned land and is not technically permitted to be leased to others for non-agricultural purposes such as commercial enterprises like ours under relevant PRC laws. The PRC land authority also has the power to order the lessor to terminate the lease with us, to confiscate any illegal gains or order the payment of fines. If our lease is terminated, we would be required to relocate our facilities. Although we believe that the relocation cost, if any, would not be significant, such relocation could disrupt our manufacturing operations and result in lower net revenues.

We may require additional capital, which may not be available on commercially reasonable terms, or at all. Capital raised through the sale or issuance of equity securities may result in dilution to our shareholders. Failure to obtain such additional capital could have an adverse impact on our business strategies and growth prospects.

We believe that our current cash and cash equivalents and cash flow from operations will be sufficient to meet our anticipated cash needs for the next 12 months. We may, however, require additional cash resources due

17

to changed business conditions or other future developments, including any investments, joint ventures or acquisitions we may decide to pursue. If these resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. Financing may be unavailable in amounts or on terms acceptable to us, or at all, which could have an adverse impact on our business strategies and growth prospects.

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.

If we are unable to maintain an effective system of internal control over financial reporting, we may be unable to accurately report our financial results or prevent fraud.

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 2011, our management identified several material weaknesses in our internal controls over financial reporting. While our management concluded that these material weaknesses were remediated in 2012, and that our internal control over financial reporting was effective as of December 31, 2012, 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.

Risks Related to Our Industry

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.

All of our net revenues are generated by sales of consumer products in China. 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

Table of Contents

and power. China s TV direct sales 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, particularly in light of the current European economic and sovereign debt crisis. Any slowdown or decline in China s consumer retail markets would have a direct adverse impact on us and could adversely affect our business, financial condition and results of operations.

If infomercials and the products promoted on infomercials are not accepted by TV viewers in China, our ability to generate revenues and sustain profitability could be materially and adversely affected.

In 2010, 2011 and 2012, we derived 34.8%, 36.2% and 41.9%, respectively, of our total net revenues from our TV direct sales platforms. We expect that in the future a substantial portion of our future revenues and profits will continue to be dependent upon the receptivity of Chinese TV viewers to infomercials such as our TV direct sales programs and the products showcased therein. Many Chinese TV viewers are not accustomed to purchasing products directly from TV. As a result, TV viewers in China may be both more likely to mistrust infomercials as a commercial medium and less likely to purchase products from TV direct marketers such as us. If we are unable in the future to increase receptivity for our TV direct sales programs and the products showcased therein, our ability to generate revenue and sustain profitability could be materially and adversely affected.

Risks Related to the Regulation of Our Business

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, including the content of our TV direct sales programs, 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 TV sales programs, 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 new Food Safety Law of the PRC effective from June 1, 2009, 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, advertisings 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 fall into 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 and neck massaging products may result in SAFD imposing on us or our distributors a dishonor credit or material dishonor credit rating. Our and our distributors past and 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.

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 TV direct sales programs or other 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, including our advertising for our electronic learning products. For example, on April 12, 2010 Shanghai Acorn Network Technology Development Co., Ltd was imposed a fine of RMB 215,700 by Shanghai Administration of Industry and Commerce Qingpu Branch for its misleading advertising in its printed advertisement. 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. 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.

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.

In July 2006, the State Administration of Radio, Film and Television, or SARFT, and the State Administration for Industry and Commerce, or SAIC, issued a circular temporarily prohibiting the broadcast of TV-and radio-based direct sales programs regarding pharmaceutical products, diet and slimming products, medical devices, breast enhancement products and height increasing products on and after August 1, 2006, pending adoption of new rules governing those direct sales activities. The Circular on Strengthening the Administration of TV Direct Sales Advertising and Home Shopping Programs, issued by the SARFT on September 10, 2009, prohibited the TV direct sales and home shopping programs advertising the pharmaceuticals, breast-enhancement products, diet and slimming products, and the medical devices which are implantable or need instruction by experts. Meanwhile, the Administrative Measures on Advertising on Television or Radio, issued by the SARFT on September 8, 2009 and effective as of January 1, 2010 which was amended on November 15, 2011, prohibited the pharmaceutical and medical device or health related advertising programs 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, the State Administration for Industry and Commerce, and the SFDA 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 publish the illegal advertisements will be severely punished. Consequently, we will not be able to broadcast TV-and radio-based direct sales programs for some of our products, including our oxygen generating product and neck massager product. For the near-term, our direct and distribution sales of these restricted products will be adversely impacted. The overall impact on our future operating results depends on, among other things, our success in promoting the products covered by the circular through other media channels; the degree to which distribution sales of our restricted products are impacted by the ban on TV direct sales programs; our ability to offset these decreased sales with sales of non-restricted products using our committed TV advertising time and the related sales price and margins of those non-restricted products; and the nature of, and restrictions imposed by, the future rules when adopted.

Table of Contents

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 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 National Development and Reform Commission and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2011 Revision), 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. In addition, our PRC legal counsel, Commerce & Finance, has advised us 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 is 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 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

Table of Contents

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, we have been advised by our PRC legal counsel, Commerce & Finance, that, 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.

However, we cannot assure you that the PRC government will not take a different view from ours. If the PRC government determines that our acquisition of Shanghai Advertising violated the requirements on foreign investment or re-investment in advertising businesses in China, as neither Acorn Consulting nor its shareholders have 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.

If the PRC government takes the view that the agreements that establish the structure for operating our TV and other direct sales business in China does 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 direct sales business is highly restricted and must be approved by MOFCOM. To address these restrictions, two affiliated Chinese entities, Shanghai Acorn Network Technology Development Co., Ltd., or Shanghai Network, and Beijing Acorn Trade Co., Ltd., or Beijing Acorn, hold the licenses required 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. Our two affiliated Chinese entities are currently owned by two PRC citizens, Don Dongjie Yang, our co-founder, chief executive officer and director, and Weiguo Ge, one of the assistant general managers of our finance department. Mr. Yang and Mr. Ge collectively hold 12.93% of the outstanding shares of our Company as of the date of this Form 20-F. We have entered into contractual arrangements with these affiliated entities pursuant to which our wholly owned subsidiary, Acorn Information Technology (Shanghai) Co., Ltd., or Acorn Information, provides technical support and operation and management services to these affiliated entities. In addition, we have entered into agreements with these affiliated entities and Don Yang and Weiguo Ge 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 .

As advised by our PRC legal counsel, Commerce & Finance, the ownership structures of Acorn Information, Shanghai Network and Beijing Acorn are in compliance with existing PRC laws and regulations and our contractual arrangements among Acorn Information, Shanghai Network and Beijing Acorn 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, 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 and our affiliated entities;
- discontinuing or restricting the operations of Acorn Information 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 or our affiliated entities may be unable to comply;

Table of Contents

requiring us or Acorn Information or our affiliated entities to restructure the relevant ownership structure or operations; or

restricting or prohibiting our use of the proceeds of the additional public offering 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 two affiliated Chinese entities and their shareholders, Don Dongjie Yang and Weiguo Ge, 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 two affiliated entities in China, collectively owned 100% by Don Dongjie Yang, our co-founder, chief executive officer and director, and Mr. Weiguo Ge, one of the assistant general managers of our finance department, to operate our business. 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 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. Furthermore, the interests of Don Dongjie Yang or Weiguo Ge as the shareholders of two affiliated entities may sometimes differ from our interests as a whole. We cannot assure you that when conflicts of interest arise, Don Dongjie Yang and Weiguo Ge will act in the best interests of ours or that conflicts of interests will be resolved in our favor. We currently do not have existing arrangements to address potential conflicts of interest Don Dongjie Yang or Weiguo Ge may encounter in their capacity as beneficial owners, director and officer of the two affiliated entities, on the one hand, and as our beneficial owners, director and officer, on the other hand. We believe Don Dongjie Yang or Weiguo Ge will not act contrary to any of the contractual arrangements and the Exclusive Purchase Agreement provides us with a mechanism to remove them as shareholders of the two affiliated entities should any of them act against us. However, under the current contractual arrangements, as a legal matter, if any affiliated entity or Don Dongjie Yang or Weiguo Ge fails to perform its or his 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 Don Dongjie Yang or Weiguo Ge refuses to transfer his 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 Don Dongjie Yang or Weiguo Ge otherwise acts in bad faith toward us, we may have to take legal action to compel him to fulfill his contractual obligations. In addition, as each of our two affiliated entities is jointly owned and effectively managed by Don Dongjie Yang and Weiguo Ge, it may be difficult for us to change our corporate structure or to bring claims against any affiliated entity or Don Dongjie Yang or Weiguo Ge if any of them fails to perform its or his obligations under the related contracts or does not cooperate with any such actions by us.

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. In the event we are unable to enforce these contractual arrangements, which relate to critical aspects of our operations, we may be unable to exert effective control over our operating entities, and our ability to conduct our business may be negatively affected.

Table of Contents

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 13 PRC subsidiaries and two Chinese affiliated 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 13 PRC operating subsidiaries incur 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. In addition, it is not permitted under Chinese law for our PRC subsidiaries to directly loan funds to each other. 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.

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

Recently China has been imposing more stringent requirements on electronic 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 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; 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.

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 mails in connection with our products through the contact information we have collected. After effectiveness of Internet Information Protection Rules, we are taking certain actions to comply with the requirements. However, given the limited interpretation on the newly promulgated 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 that all of our clients personal information are legally collected and used and fully

Table of Contents

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 competent government authorities take a view that we fail to comply with relevant laws and regulations in connection with electronic bulletin board service, we may be required to shut down our electronic bulletin board service, which may adversely affect the sales of our electronic learning products.

Under the Administrative Measures on Internet Information Services promulgated by the State Council on September 25, 2000 and the Provisions on the Administration of Electronic Bulletin Board Services on the Internet promulgated by the Ministry of Information Industry (currently as the Ministry of Industry and Information Technology) on October 8, 2000, where an Internet information service provider intends to provide electronic bulletin board services (including electronic bulletin board, electronic plain board, electronic forum, network chatting room, message board and other interactive means), it shall submit a specific application for approval or specific filing when applying for an operation permit or filing for its non-operational Internet information services with the Ministry of Information Industry or its local counterparts. On July 4, 2010 the State Council promulgated the Decision on the Fifth Batch of Administrative Examination and Approval Items to be Canceled and Delegated to Lower Administrative Levels which canceled the approval and filing requirement in connection with the Internet electronic bulletin board services. However, based on our consultation with relevant government authority in Shanghai, it is soliciting public opinions to come up with a proposed rule, pursuant to which approval or filing may be required for provision of electronic bulletin board services. Therefore, it is not clear at this stage whether the approval or filing requirement in connection with the provision of electronic bulletin board service has been canceled or is only temporarily suspended in Shanghai.

Currently we provide electronic bulletin board service on our websites *www.ozing.com.cn* and *www.ozing.cn*, through which users of our electronic learning products can communicate with each other. We believe that such electronic bulletin board service is a good way to promote and attract more potential users to buy our electronic learning products. However, due to the lack of clear rules or approval procedures at present, we cannot obtain approval or submit filing application for our electronic bulletin board service. We will submit application for approval or filing of electronic bulletin board service if the aforesaid new rule is promulgated or as Shanghai government authority requires. However, we cannot assure you that relevant competent government authority will not, currently or in the future, take a view that we failed to comply with laws and regulations with respect to our provision of electronic bulletin board service. In such case, relevant competent government authority may require us to shut down our electronic bulletin board service, which may adversely affect the sales of our electronic learning products.

Risks Relating to 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

Table of Contents

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, given the current European economic and sovereign debt crisis, we cannot assure you that the Chinese economy will continue to grow, that if there is growth, such growth will be steady and uniform, or that if there is a slowdown, such slowdown will not have a negative effect on our business. Any significant change in China s political or social conditions may also adversely affect our operations and financial results.

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, Zhuhai Acorn Electronic Technology Co., Ltd., Beijing Acorn Youngleda Oxygen Generating Co., Ltd. and 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 was 33% for calendar years ended on or before December 31, 2007 and 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. 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. In addition, China passed a new Enterprise Income Tax Law, or the New EIT Law, and its implementing rules, both of which became effective on January 1, 2008. Some of our preferential tax treatments could be discontinued or phased out under the New EIT Law. Loss of any preferential tax treatments and subsidies could have material and adverse effects on our results of operations and financial condition. 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 will generally be subject to the uniform 25% enterprise income tax rate as to their global income. Under the implementation rules, de facto management is defined substantial and overall management and control over such aspects as the production and business,

Table of Contents

personnel, accounts and properties of an enterprise. In addition, two tax circulars issued by the State Administration of Taxation 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. 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 contractual arrangements entered into among Acorn Information, each of our consolidated affiliated entities and their shareholders and those arrangements entered into between us or one of our Chinese subsidiaries and an entity affiliated with us may be subject to audit or challenge by the Chinese tax authorities. A finding that we, Acorn Information, 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. The new 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 new 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

Table of Contents

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. We could face material and adverse tax consequences if the PRC tax authorities determine that the contractual arrangements entered into among Acorn Information, each of our consolidated affiliated entities and their shareholders or those arrangements entered into between us or one of our PRC subsidiaries and an entity affiliated with us do not represent arm s-length prices and as a result, adjust any of the income in the form of a transfer pricing adjustment. 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 PRC legal system embodies uncertainties which could limit the available legal protections.

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. 12 of our 13 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 some time 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, 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.

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

Table of Contents

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, devaluation of the Renminbi could negatively impact our results of operations.

Because all of our net revenues are generated in Renminbi, appreciation or depreciation in the value of the Renminbi relative to the U.S. dollar will affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars and earnings from and the value of any U.S. dollar-denominated investments we make in the future. Since we rely entirely on dividends paid to us by our PRC operating subsidiaries, and since our net revenues are generated in Renminbi while our results are reported in U.S. dollars, any significant devaluation of Renminbi would have a material adverse effect on our net revenues and financial condition, and the value of, and any dividends payable on, our ADSs in foreign currency terms.

Since July 2005, the Renminbi has no longer been pegged to the U.S. dollar. Although currently the Renminbi exchange rate versus the U.S. dollar is restricted to a rise or fall of no more than 0.5% per day and the People s Bank of China, or PBOC, regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future Chinese authorities may lift restrictions on fluctuations in the Renminbi exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions 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 successfully hedge our exposure 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.

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, our PRC legal counsel, Commerce & Finance, has advised us 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.

Notice on Issues Relating to the Administration of Foreign Exchange in Fund-raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75, was promulgated by the SAFE in October 2005 and requires registration by PRC residents with the local SAFE if

Table of Contents

they use assets or equity interests in PRC entities as capital contributions to establish offshore companies, referred to as special purpose company , or if they inject assets or equity interests of their PRC entities into special purpose company to raise capital overseas (defined under Notice 75 as Round-trip Investment). Notice 75 applies not only to our shareholders who are PRC residents but also to our prior and future offshore acquisitions.

Notice 75 retroactively requires registration by March 31, 2006 of direct or indirect round-trip investments previously made by PRC residents in offshore special purpose companies. In addition, any PRC resident who makes, or has previously made, direct or indirect investments in such an special purpose company is required to further update that registration for such matters as increasing or decreasing in the special purpose company s share capital, transfers or swaps of its shares, mergers, long-term equity or debt investments, and the creation of any security interest. If a PRC shareholder with a direct or indirect stake in an offshore special purpose company fails to make or update the required SAFE registration, the PRC subsidiaries of such offshore special purpose company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Further, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for violation of the relevant rules relating to transfers of foreign exchange. On May 20, 2011 SAFE promulgated the Implementing Rules for Foreign Exchange Administration Concerning Financing and Round-Trip Investment by Domestic Residents through Offshore Special-Purpose Companies which became effective on July 1, 2011 (the Implementing Rules). The Implementing Rules provide in detail the procedures, required documents and review standard of foreign exchange registration regarding financing and round-trip investment by domestic residents through offshore special-purpose companies.

We have already notified our shareholders, and the shareholders of the offshore entities in our corporate group, who are PRC residents to urge them to make the necessary applications and filings, as required under Notice 75 and its implementing rules. 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 the regulation or other related legislation. 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. As advised by our PRC legal counsel, Commerce & Finance, a separate registration in respect of Notice 75 is not applicable to our acquisition of Yiyang Yukang, and our obligation under Notice 75 after the acquisition would be to update our original registration to include Yiyang Yukang as one of our PRC subsidiaries. In addition, in 2012 we acquired 9.3% of total shares of China Branding Group Limited, a company incorporated under the law of Cayman Islands, through our Hong Kong subsidiary, Bright Rainbow Investment Limited. As such, our shareholders as PRC individual residents shall update such shareholding into their respective foreign exchange registration.

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

Table of Contents

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 same 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 State Administration of Taxation on March 28, 2005 and the Notice on Issues of Individual Income Tax Concerning Share Incentive Plan issued by the State Administration of Taxation 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 excises 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 establishes time limits for probationary periods. Because the Labor Contract Law and its implementing rules lack of 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. 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 will become 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. Currently, a majority of our call center employees are recruited as dispatched employees. Pursuant to the current Labor Contract Law, where a labor-dispatching enterprise violates the Labor Contract Law and causes losses to a dispatched employee, such labor-dispatching agency and the relevant enterprise that engages such dispatched employee shall assume joint and several liabilities. 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. In addition, after the amended Labor Contract Law becomes effective, we may need to reduce the number of dispatched workers to comply with the percentage limitation of dispatched employees in an enterprise, which may result in an increase in our labor costs.

Table of Contents

The audit report included in this annual report are prepared by auditors who are not inspected by the Public Company Accounting Oversight Board and, as such, you are 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 US Securities and Exchange Commission, as auditors of companies that are traded publicly in the United States and a firm registered with the US Public Company Accounting Oversight Board (United States) (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.

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. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor s audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

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. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

Recently, the SEC commenced administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the Chinese affiliates of the big four accounting firms, including our auditors, and also against BDO China Dahua. The Rule 102(e) proceedings initiated by the SEC relate to these firms failure to produce documents, including audit workpapers, to the request of the SEC pursuant to Section 106 of the Sarbanes-Oxley Act of 2002, as the auditors located in the PRC are not in a position lawfully to produce documents directly to the SEC because of restrictions under PRC law and specific directives issued by the China Securities Regulatory Commission. As the administrative proceedings are ongoing, it is impossible to determine their outcome or the consequences thereof to us. The issues raised by the proceedings are not specific to our auditors. or to us, but affect equally all audit firms based in China and all China-based businesses with securities listed in the United States. However, if the administrative judge were to find in favor of the SEC under the proceeding and depending upon the remedies sought by the SEC, these audit firms could be barred from practicing before the SEC. As a result, 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 may result in their delisting. Moreover, any negative news about the proceedings against these audit firms may erode investor confidence in China-based, United States listed companies and the market price of our ADSs may be adversely affected.

Natural disasters could disrupt the Chinese economy and our business.

In early 2008, a series of severe snow storms swept through most provinces in China, among which Hunan, Hubei, Henan, Shandong, Jiangsu, Anhui and Shanghai were hardest hit. Disruption of transportation as a result of the snow storm adversely affected our ability to successfully deliver our products to our customers and the customers willingness to accept our products.

In addition, in May 2008, a major earthquake struck Wenchuan in the Sichuan province in southwestern China, causing significant damage to the area, including Chengdu. The earthquake and its aftershocks caused great loss of life, injuries, property loss and disruption to the local economy. As a result of the earthquake, we experienced disruptions in our order fulfillment and deliveries to Sichuan and the western China region. In addition, our advertising time was suspended for three days during the memorial period following the

Table of Contents

earthquake. Since the date of the earthquake, our advertising time has been further disrupted and we have experienced a decline in the viewership and response rate of our infomercials. This earthquake or future geological occurrences could impact our business and the Chinese economy. A significant earthquake or other geological disturbance in any of China s other more populated cities and financial centers could severely disrupt the Chinese economy, undermine investor confidence and have a material adverse effect on our business, financial condition, results of operations and prospects.

Furthermore, any outbreak of avian flu, or severe acute respiratory syndrome in China, or similar adverse public health developments, may, among other things, significantly disrupt our ability to adequately staff our business, restrict the level of economic activity in affected areas and have a material adverse effect on our business, financial condition, results of operations and prospects.

Risks Relating to Our ADSs

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 2013 we believe we were classified as a PFIC for the 2012 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 2013 will not be determinable until after the close of the taxable year ending December 31, 2013. 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 2013 and any future taxable year. Based on a determination made in 2013 with respect to the 2012 taxable year, we believe we were classified as a PFIC for the 2012 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 2012 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

Table of Contents

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 trading prices of our ADSs may be volatile and could fluctuate widely in response to factors such as variations in our financial results, announcements of new business initiatives by us or by our competitors, recruitment or departure of key personnel, distributors and suppliers, changes in the estimates of our financial results or changes in the recommendations of any securities analysts electing to follow our securities or the securities of our competitors. In addition to market and industry factors, the price and trading volume of our ADSs may be highly volatile for specific business reasons. Any of these factors may result in large and sudden changes in the trading volume and price for our ADSs.

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.

Our amended and restated memorandum and articles of association provide for a staggered board, which means that our directors, excluding our chief executive officer, are divided into three classes, with nearest to but no greater than one-third of our board, excluding our chief executive officer, standing for election every year. Our chief executive officer at all times serves as a director, and has the right to remain a director, so long as he remains our chief executive officer. This means that, with our staggered board, at least two annual shareholders meetings, instead of one, are generally required in order to effect a change in a majority of our directors. Our staggered board can discourage proxy contests for the election of our directors and purchases of substantial blocks of our shares by making it more difficult for a potential acquirer to take control of our board in a relatively short period of time.

Table of Contents

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 U.S. states, such as Delaware, have more fully developed and judicially interpreted bodies of corporate law than the Cayman Islands.

The Cayman Islands courts are unlikely:

- to 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

- to 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.

Our shareholders have limited ability to bring an action against us or against our directors and officers, or to enforce a judgment against us or them, because we are incorporated in the Cayman Islands, because we conduct a majority of our operations in China and because the majority of our directors and officers reside outside the U.S.

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.

Unlike many jurisdictions in the United States, Cayman Islands law does not specifically provide for shareholder appraisal rights on a merger or consolidation of a company. This may make it more difficult to assess

Table of Contents

the value of any consideration shareholders may receive in a merger or consolidation or to require that the offer or give additional consideration if the shareholders believe the consideration offered is insufficient.

Shareholders of Cayman Islands exempted companies like ours have no general rights under Cayman Islands law to inspect corporate records and accounts or to obtain copies of lists of shareholders of these companies. Our directors have discretion under our 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 our shareholders 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 U.S. company.

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. Upon receipt of voting instructions from a holder of ADSs in the manner set forth in the deposit agreement, the depositary will endeavor to vote the underlying ordinary shares in accordance with these instructions. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting is ten days. When a general meeting is convened, holders of our ADSs may not receive sufficient notice of a shareholders 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 depositary 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 depositary 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 depositary to vote their shares. Furthermore, the depositary 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 depositary 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.

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 Acorn Network Co., Ltd., or Shanghai Acorn, 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 Acorn 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

Table of Contents

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 .

Our principal executive offices are located at 18/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 *http://ir.chinadrtv.com*. The information on our website does not form a part of this annual report. 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. 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 media and branding company in China, operating one of China s largest TV direct sales businesses in terms of revenues and TV airtime. We have strong media resources, and have built a proven track record of developing, promoting and selling a diverse portfolio of proprietary-branded products, as well as products from established third parties. Our longer term goal is to become the leading media and branding company in China and to capitalize on our integrated multi-media platform with an aim to become partners of choice for both well-established and promising new businesses to market and distribute their products in China. To achieve this goal, our management adopted a new performance review system since 2010 which focuses on the optimization of our media return, shifted our core strategy to generate sales by building proprietary brands via buying and utilizing all forms of media, and expected to further increase our media purchases.

Our media resources consist primarily of airtime purchased from both national and local TV channels in China. In 2012, our TV direct sales programs, which are typically five to ten minutes in length, were broadcast on 25 CCTV and national satellite TV channels, and ten local TV channels in China. With media cost continues to increase, we seek to increase the effectiveness of our advertising expenses by focusing on our best-selling products while gradually eliminating products that are not conforming to our overall strategies. TV direct sales, being our primary sales channel, accounted for approximately 34.8%, 36.2% and 41.9% of our net revenues in 2010, 2011 and 2012, respectively.

Taking advantage of the exposure of our TV advertising programs, we have established our other direct sales platform consisting of outbound calls, Internet sales, catalog sales and third-party bank channel sales, with an aim to further strengthen our brand promotion efforts and to generate additional revenue opportunities from our growing customer base. We also maintain a nationwide distribution network across all provinces in China, which allows us to reach over 7,900 retail outlets across China. We typically grant our distributors the exclusive right to distribute selected products in their respective territories. We work closely with our distributors to expand their retail outlet reach, extend our product lifecycles and maximize our sales by promoting our brands through our TV direct sales platform, advertising in local print media and other joint promotional efforts. In 2010, 2011 and 2012, sales generated through our nationwide distribution network accounted for 33.2%, 19.5% and 20.2% of our total net revenues, respectively.

With our strong media resources, we have developed several leading proprietary-branded product lines, including Aoya cosmetic products, Yierjian fitness products, Ozing electronic learning products and Babaka posture-correction products. Our significant TV airtime presence allows us to test-market, promote and sell products in China s geographically dispersed and fragmented consumer market. We seek to maximize sales penetration of our products that have strong sales and brand development potential by selling them through our comprehensive media formats. In 2012, we primarily focused on growing sales of our proprietary branded products, mainly our Yierjian fitness products as well as our Ozing electronic learning products.

We currently operate call centers in Shanghai, Beijing and Wuxi which process telephone orders generated by our TV and other direct sales platforms and gather real-time data to help analyze the effectiveness of our advertising spending and to adjust our product offerings. Our call centers operate 24 hours per day. Each of our call centers also places outbound calls to selected customers to market our products. In addition, our call center sales representatives are trained to identify and act upon cross-selling and up-selling opportunities while processing customer orders. As of December 31, 2012, we had an aggregate of 940 sales representatives and 19 customer service representatives.

In selecting new products to be offered via our diversified sales channels, we seek to identify offerings in underserved market segments with potential national appeal for which we believe our sales channels and marketing and branding expertise can create value. We identify new products that we believe we can successfully market through our TV direct sales platform through a standardized selection process. We typically focus on the marketing and sales of a limited number of featured product lines at any given time, and our TV direct sales programs allow us to promote our specific products by highlighting their unique value to consumers as well as creating brand awareness. Featured products offered in 2012 included mobile phones, fitness products, electronic learning products, collectible products and health products. To better help us identify potential new products, we entered into an exclusive partnership agreement on July 21, 2011 with Global Infomercial Services, Inc., or GIS, a related party of Mr. Robert Roche, our co-founder and chairman of the board of directors. For details of our cooperation with GIS, see Item 7.B, Related Party Transactions . Pursuant to the exclusive partnership agreement, GIS will search for and identify products of interest that have been or are being sold in North America, South America, or Europe and help us obtain the rights to such products. As of the date of this Form 20-F, we identified three new products through GIS, including Legmagic, True Sleeper and DiDi7, among which Legmagic had been marketed in 2012.

Our Media Resources and Sales Platforms

We have strong media resources through which we sell and market our proprietary products as well as certain third-party products, primarily across our direct sales platforms. Our media resources include our TV airtime purchased from TV stations and our Internet website, supplemented by other print media and radio. We believe our nationally televised TV direct sales programs help build strong brand awareness among China s consumers and generate significant demand for the products featured in those programs, which stimulates our sales generated from other media simultaneously. Taking advantage of the exposure of our TV advertising programs, we have established our other direct sales platform consisting of outbound calls, Internet sales, catalog sales and third-party bank channel sales, with an aim to further strengthen our brand promotion efforts and to generate additional revenue opportunities from our growing customer base. In addition, our nationwide distribution network, coupled with local marketing and promotional efforts, helps us to further enhance the awareness of and demand for our products, thereby broadening our customer reach and enhancing the penetration of those products on a nationwide basis within a short period of time.

TV Direct Sales Platform

Our TV direct sales platform is one of our primary sales platforms and accounted for a significant portion of our net revenues, approximately 34.8%, 36.2% and 41.9% of net revenues in 2010, 2011 and 2012, respectively. We generally focus our TV direct sales marketing efforts on approximately four to six featured product lines to maximize awareness of these featured offerings and to generate strong consumer demand. Our TV direct sales programs, which are generally five to ten minutes in length, consist of in-depth demonstrations and explanations of the product in an entertaining and informative manner, and provide phone numbers for customers to call to make further inquiries or to purchase the product. In addition to explaining the functionality of a product in the programs, we also highlight the value proposition of that product. Our TV direct sales programs typically feature one or more spokespersons or celebrity personalities and employ a variety of formats, including studio programs and reality shows , which we believe help to demonstrate the features and functions of the products that we are marketing. Our TV direct sales programs for new products are broadcast on national and/or local TV channels in China depending on the features of the products during selected time slots to ensure sufficiently broad and targeted viewer coverage.

A critical component to the success of our TV direct sales platform is our ability to efficiently access media channels and manage our media airtime. In 2012, our TV direct sales programs were broadcast on 25 CCTV and

Table of Contents

national satellite TV channels and ten local TV channels in China. Since commencing our operations in 1998, we have formed close and strong relationships with various CCTV and national satellite channels, as well as several TV advertising agencies that have exclusive rights to sell certain advertising time slots for certain CCTV and national satellite channels, and we have been purchasing advertising time on several CCTV channels and national satellite channels for over ten years. We purchase advertising time mainly through their advertising agencies. As required under current PRC law, we primarily purchase non-primetime broadcast time slots for our TV direct sales programs. We believe our relationships with various CCTV and satellite channels, coupled with the scale of our operations and sales track record, help us to secure desired broadcast airtime slots on the channels we target. In 2010, 2011 and 2012, we produced and broadcasted over 290,000, 186,000 and 187,000 minutes of TV programs, respectively, corresponding to over 99, 60 and 60 hours per week, respectively. With the continued increase in media costs, we have been adjusting our media purchase strategies with an aim to optimize our media returns. The fluctuation in the TV airtime purchased primarily reflects our more focused media purchases designated to enhance our media efficiency. In 2013, we expect our media purchase to focus on CCTV and satellite channels as these channels generally provide higher media efficiency than local channels.

If a TV direct sales program for a specific product achieves satisfactory results during the initial test-marketing phase, we may elect to include that product in our TV direct sales platform for full-scale marketing and selling. If selected for full-scale marketing, a TV direct sales program for a product will then be frequently broadcast on several TV channels in various time slots. We then track the success of a TV direct sales program in various time slots on various TV channels with data on our profitability relative to our marketing expenses, on a weekly basis, and we adjust the frequency of the broadcast of the TV direct sales program and the content of the program, its broadcast time slots and the TV channels on which the program airs to create a broadcasting schedule that maximizes the overall profitability of the TV direct sales program.

Other Direct Sales Platform

Our other direct sales platform, which consists of outbound calls, Internet sales, catalog sales and third-party bank channel sales, accounted for a significant portion of our net revenues. Approximately 32.0%, 44.3% and 37.9% of our net revenues in 2010, 2011 and 2012 were generated from our other direct sales platform, respectively.

Outbound Calls. As of December 31, 2012, our database contained approximately 16 million names of individual customers, the majority of whom have placed orders to us or made calls to our call centers in the past 15 years. As of December 31, 2012, our 458 specialized outbound call center sales representatives utilize our customer database to target calls at customer subgroups identified as likely purchasers of particular products. Our outbound telemarketing sales accounted for approximately 26.6% of our net revenues in 2012. We expect that the number of customers in our database will continue to grow and sales from outbound telemarketing will be of higher growth potential and growing importance to our business in the future.

Internet Website. We sold over 2,000 kinds of products via our website in 2012, both through our official website and on the platforms of China s leading e-commerce companies, of which 208 were our proprietary-branded products while the remainder were third-party products.

Catalogs. We sold over 2,100 kinds of products via our catalogs in 2012, of which 164 were our proprietary-branded products and the remainder were third-party products. Our catalogs are currently distributed together with the products purchased and shipped to our customers. In addition, we also track customers who have previously purchased products from us and distribute our catalog to them after their initial purchase. We issued 19 catalogs in 2012. Our catalog sales in 2012 accounted for approximately 2.63% of our net revenues.

Third-Party Bank Channels. In 2007, we began relationships with four established domestic banks in the PRC through which we directly market products through specialized catalogs to credit card holders of these banks. As of December 31, 2012, we maintained relationships with eight domestic banks. As part of these arrangements, customers can use their credit cards from these banks to purchase our products and to make

Table of Contents

payments on a zero-interest and zero-fee installment basis. Revenue generated by our third-party bank channel sales in 2012 accounted for approximately 2.2% of our net revenues. Starting from 2012, we focused on other more profitable sales channels rather than third-party bank channels.

Nationwide Distribution Network

We use our nationwide distribution network to distribute a selected number of our products promoted through our TV direct sales programs which we believe offer sufficient profit potential and may be developed as a national product brand. Our distribution network broadens our customer reach and enhances the penetration of those products on a nationwide basis within a short period of time. Our network covers all provinces in China through over 100 distributors, which allows us to reach over 7,900 retail outlets across China. These retail outlets include bookstores, supermarkets, pharmacies, specialty retail chains and department stores. In addition to our ground distribution network, starting from 2012, we also engaged distributors on China s leading e-commerce platforms to promote and market our products. In 2010, 2011 and 2012, sales generated through our nationwide distribution network accounted for 33.2%, 19.5% and 20.2% of our net revenues, respectively. We typically provide our distributors with the exclusive right to distribute selected products in their respective territories. In 2010, 2011 and 2012, sales generated by our top five distributors accounted for 6.1%, 4.8% and 4.3% 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 and electronic dictionary 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 TV direct sales platform, or the minimum retail prices set by us. In addition, we typically require our distributors of electronic learning products and electronic dictionary products to fully settle their payment obligations before we deliver new products to them. Our distributors may not sell competing products in their respective territories. Furthermore, distributors of our electronic learning products and electronic dictionary 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 3,800 products which are sold primarily through our TV direct sales platform, other direct sales platform comprising of outbound calls, Internet sales, and catalogs sales as well as our nationwide distribution network. Our recently featured product categories include mobile phones, fitness products, electronic learning products, collectibles products and health products, all of which are primarily sold through our TV 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 the five product lines we presently feature, we also sell other products including consumer electronics products primarily through our other direct sales platforms.

Recent Featured Product Categories

We generally focus on marketing and selling four to six featured product lines at any one time through our TV and other direct sales platforms and a limited number of products through our nationwide distribution network. In 2012, we featured products in the following categories and under the following proprietary and third-party brands:

Mobile phone Products featuring Gionee and Konka branded mobile phones. Mobile phone products accounted for 42.6%, 45.7% and 26.6% of our total gross revenues in 2010, 2011 and 2012, respectively. The retail prices for the mobile phone products that we market ranged from RMB412 to RMB6,090 per unit in 2010, RMB299 to RMB6,799 per unit in 2011 and RMB199 to RMB6,399 (or approximately $32 to $1,014) per unit in 2012.

Fitness Products featuring Yierjian branded abdominal trainer. Fitness products accounted for 0.1%, 3.3% and 25.7% of our total gross revenues in 2010, 2011 and 2012, respectively. Our fitness products was the main driver for our revenue and gross margin growth in 2012. We plan to launch upgraded versions of our Yierjian products in 2013 and expect the product line to remain one of our major revenue drivers in 2013. The retail prices for our fitness products ranged from RMB32 to RMB3,984 per unit in 2010, RMB15 to RMB3,984 per unit in 2011 and RMB15 to RMB2,999 (or approximately $2 to $475) per unit in 2012.

Electronic Learning Products featuring the Ozing branded electronic learning device. Electronic learning products accounted for 23.7%, 17.2% and 17.0% of our total gross revenues in 2010, 2011 and 2012, respectively. Our primary Ozing branded product is a multi-functional handheld electronic device with a screen display that provides lessons for independent English learning. In the third quarter of 2012, we launched new models of our Ozing products incorporating mobile internet interactive features, which we expect to become one of our major revenue drivers in 2013. The retail prices for our electronic learning products ranged from RMB498 to RMB1,998 per unit in 2010, RMB258 to RMB1,998 per unit in 2011, and RMB348 to RMB2,999 (or approximately $55 to $475) per unit in 2012.

Collectibles Products. Collectibles products accounted for 6.1%, 9.1% and 8.4% of our total gross revenues in 2010, 2011 and 2012, respectively. The retail prices for our collectibles products ranged from RMB35 to RMB984,600 per unit in 2010, RMB32 to RMB16,800 per unit in 2011 and RMB32 to RMB99,000 (or approximately $5 to $15,683) per unit in 2012.

Health Products featuring Babaka posture correction products. Health products accounted for 4.4%, 3.7% and 4.4% of our total gross revenues in 2010, 2011 and 2012, respectively. The retail prices for our health products ranged from RMB10 to RMB19,800 per unit in 2010, RMB9.9 to RMB19,800 per unit in 2011, and RMB9.7 to RMB11,880 (or approximately $2 to $1,882) per unit in 2012.

Our five best-selling products and product lines in 2010, 2011 and 2012 are set forth below:

		2010			2011			2012		
Product	**Brand**	**Revenues**	**% of gross revenues**	**Rank**	**Revenues**	**% of gross revenues**	**Rank**	**Revenues**	**% of gross revenues**	**Rank**
		(in thousands, except percentages and ranks)								
Mobile phone products	Gionee, K-touch, U-king, Lenovo, Nokia and Konka	$ 125,074	42.6%	1	$ 165,958	45.7%	1	$ 64,713	26.6%	1
Fitness products	Yierjian							$ 62,630	25.7%	2
Electronic learning and dictionary products	Ozing, Meijin	$ 69,535	23.7%	2	$ 62,539	17.2%	2	$ 41,345	17.0%	3
Collectibles products		$ 18,040	6.1%	4	$ 33,194	9.1%	3	$ 20,427	8.4%	4
Health products	Babaka, Zehom							$ 10,692	4.4%	5
Cosmetic products	Aoya, Cobor, Dr Cell, Softto and CMM	$ 26,233	8.9%	3	$ 24,857	6.8%	4			
Consumer electronic products	Eroda	$ 14,035	4.8%	5	$ 24,249	6.7%	5			
Total top five		**$ 252,917**	**86.1%**		**$ 310,797**	**85.5%**		**$ 199,807**	**82.1%**	
Other products revenues		$ 40,609	13.9%		$ 52,202	14.5%		$ 43,473	17.9%	
Total gross revenues		$ 293,526	100.0%		$ 362,999	100.0%		$ 243,280	100.0%	
Total sales tax		$ (285)			$ (941)			$ (706)		
Total revenues, net		$ 293,241			$ 362,058			$ 242,574		

Table of Contents

New Products

We seek to identify new products that offer sufficient profit opportunities and address consumers changing needs. In 2012, we introduced five new products for full-scale sales and marketing. In the future, we will continue to seek to diversify our product offerings and our customer base, encourage repeat purchases by our existing customers, and create recurring revenue opportunities. Examples of our successful product launches include A320 mobile phones under the Gionee brand launched in 2010, which turned out to be very successful products. In 2012, we launched the Yierjian upgraded products and Konka K58 mobile phones successfully. We also plan to introduce new products that we believe will offer longer product lifecycles and enjoy broad consumer appeal.

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 agreement in effect as of 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 $0.07 million from Metlife in 2012 and expect to further expand our insurance product operations in 2013.

Product Development

We employ a rigorous and systematic approach to identifying and developing products. Our product development process comprises product identification, pre-testing preparation and test-marketing for marketing through our TV direct sales channels. We generally test 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. During the test marketing period, we closely evaluate customer feedback and sales of the relevant product through our call centers. Products that meet certain pre-defined standards are launched on a national scale. Products that do not meet our pre-defined standards may undergo a change in marketing strategy and be retested, or may be removed from our product portfolio. In 2012, we test-marketed 11 new or upgraded products over our TV direct sales platform, of which five progressed from the test marketing stage to full-scale sales and marketing.

Product Identification

We typically seek to identify consumer products that we believe offer good value and quality, are not widely available and can generate sufficient profit potential. Our success in developing leading product brands has provided us with access to a large pool of potential products from various suppliers and manufacturers in China. In addition to identifying new products through external sources, we also focus on our internal product development efforts relating to our existing product portfolio. These products, with their existing brand awareness and consumer acceptance, provide significant opportunities to introduce upgraded products and related new products under the same brand.

Pre-testing Preparation

During our pre-testing preparation phase, our product development team analyzes and identifies a product s unique features and value proposition to formulate a marketing and distribution strategy, including setting a selling price for the test-marketing phase, a sales target and a weekly marketing plan. Our in-house product development team works with independent production companies to produce TV direct sales programs tailored for each product. To ensure service quality and assist in gathering consumer feedback, our product development team concurrently provides our call center employees with training and sales scripts to assist them in receiving purchase order calls in response to our TV test-marketing activities.

Test Marketing

The test-marketing phase usually lasts from one week to three weeks, during which time our test TV direct sales programs are aired during targeted broadcast airtime slots on selected TV channels. During the test-marketing phase, we gather and analyze real-time data and consumer feedback collected by our call centers through designated test numbers. Using this data and feedback, we attempt to predict the demand, growth potential and anticipated selling prices of the products. In analyzing the data to determine whether we should move a product into full-scale marketing on our TV direct sales platform, we focus on key benchmarks, including, most importantly, estimated profitability relative to our media expenses. We then determine whether the product has the potential to be developed into a proprietary branded product line so that its lifecycle can be prolonged by introducing it into our nationwide distribution network.

Call Center Operations

Our sales operations and media purchase activities are supported by our call centers located in Beijing, Shanghai and Wuxi. Our call center in Wuxi began operation in 2009 and we shifted more outbound calls and after-sales services to our Wuxi call center to capitalize on its lower labor costs than in Beijing and Shanghai. Our call centers process telephone orders generated by our TV and other direct sales platforms and gather real-time data to help us analyze the effectiveness of our advertising spending and adjust our offerings. Sales representatives in each of our call centers also place outbound calls to selected customers to market our products. As of December 31, 2012, we had 940 dedicated sales representatives. In 2010, 2011 and 2012, our call centers processed an average of approximately 17,800, 16,700 and 11,990 incoming calls per day, respectively, for products marketed through TV direct sales platform. The decrease in the numbers of incoming calls primarily reflected an overall decrease in our media efficiency. To effectively convert inbound calls to customer orders, our sales representatives follow a prepared script that covers frequently asked questions to guide the sales call. Our call center supervisors closely monitor calls received and revise and update the scripts based on their assessment of the scripts effectiveness during the customer calls and in response to customer feedback. Our sales representatives are also trained to promote, cross-sell or upsell complementary and/or additional products.

We constantly and systematically seek to evaluate and improve the cost-effectiveness of our inbound and outbound call operations. The primary performance metric we track and analyze on a daily basis is the conversion rate of our inbound calls. We seek to increase the rate of successfully completed orders per call connected by directing customer calls to our call center sales representatives with specialized product training and knowledge about the specific product.

Our call centers also collect real-time data to help us to continually analyze the effectiveness of our advertising spending and product offerings. 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 TV sales program product mix, broadcast time slots and channels to maximize the profitability of our TV direct sales operations.

Customer Loyalty Initiatives

We also market the products through our customer loyalty program. Our current customer loyalty program includes coupon discounts and membership points. Coupon discounts are given to customers who purchase specified products. These coupons, which can be applied to future purchases of products marketed in our catalogs, range from approximately RMB20 to RMB600 (or approximately \$3.2 to \$95). Membership points are awarded to customers when they make purchases from us (other than purchasing through our distribution network). Customers are awarded membership points based on the type of product purchased with point values around 10% of retail price, with every ten points equaling RMB1 (approximately \$0.16). Customers can use these membership points to partially or fully offset the cost of future product purchases.

Table of Contents

Order Fulfillment

The majority of 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 seven to ten days of the date of receiving the order. In 2010, 2011 and 2012, of the total attempted product deliveries by EMS and local delivery companies on a cash-on-delivery, or COD, basis, approximately 68%, 70% and 72% 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 four weeks, and local delivery companies seven to ten days, to return undelivered products to us.

In 2010, 2011 and 2012, approximately 83.7%, 77.3% and 93.1% 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). Our non-COD customers typically pay by credit cards. 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. 18 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 an average of 24 days for us to receive payments from EMS compared to an average of seven to ten days from local delivery companies. Of our total accounts receivable balance as of December 31, 2010, 2011 and 2012, $0.2 million or 1.6%, $1.8 million or 10.7% and $3.6 million or 25.3%, respectively, was due from EMS.

In 2010, 2011 and 2012, approximately 32.5%, 37.3% and 26.7% of our net revenues resulted from products delivered by EMS, respectively, and approximately 49.5%, 45.2% and 53.3% 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 centers within our Beijing, Shanghai and Wuxi call centers are currently staffed with approximately 19 customer service representatives working ten hours a day to provide quality customer service. 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. For our TV direct sales products, our customers enjoy an unconditional product return within 30 days of their respective purchases. 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 2010, 2011 and 2012. 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 2010, 2011 and 2012.

Supply and Inventory

Supply

We manufacture a substantial portion of the proprietary products we currently offer in terms of net revenues. Our manufacturing operations involve mainly assembly processes and generally only require us to deploy a limited amount of capital. Most of the components we use in our products are readily available in the market.

We began our manufacturing operations in 2000 with the production of our oxygen generating devices. Beginning in 2005, we expanded our manufacturing operations to include all of our electronic learning products and posture-correction product lines. For some of our products, we provide designs or technical requirements to our third-party suppliers.

We believe that if we decide to discontinue our manufacturing operations for any of our products for any reason, we would be able to subcontract the manufacturing of these products on commercially reasonable terms within a reasonable period of time.

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. When a product is no longer sold through our TV direct sales programs and/or our nationwide distribution network, our inventory of that product is generally limited.

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, one of which is primarily engaged in developing electronic dictionaries. 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:

- other TV direct sales companies operating in China with generally similar business models to ours, including Moneng TV, and Jiayuan Shopping;

- TV home shopping companies that operate across China or in large parts of China, such as CCTV Home Shopping and Hunan TV Happigo, and companies that operate on multiple channels in multiple provinces, such as Oriental CJ Home Shopping and U-you Home Shopping;

- 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 BBK, Noah, Readboy, and other brands, and our

Table of Contents

mobile phone products which compete with similar products sold by local and international mobile phone manufacturers; and

traditional retailers and distributors, as well as direct marketers such as Avon and Amway, operating in China which currently or in the future may offer competing products, including products under their own brand, or may otherwise offer or seek to offer small and medium manufacturers and suppliers distribution capabilities throughout China.

Particularly, we are facing more intense competition from TV home shopping companies in China, the number of which has increased significantly since 2009. Many of them are supported by, or affiliated with, TV or radio stations and therefore, may have access to cheaper TV airtime than we do.

In addition, large multi-national infomercial TV shopping companies may enter the China market directly or indirectly. Entry by these players becomes more likely if existing PRC restrictions on content, number of advertising hours per day and foreign ownership of TV stations are relaxed.

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 that we compete primarily on the basis of the ability to secure significant TV and other media access on a nationwide basis and to effectively manage the TV advertising time and other media resources, such as newspaper and radio advertising that we secure. In particular, we believe our TV media access and management experience helps us to be one of the largest TV direct sales operators in China in terms of revenues, and to maximize the effectiveness of our TV direct sales programs, reduce our risk of product failure and minimize associated costs. 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. We believe we compete favorably on the basis of each of these factors. However, 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, our posture-correction product lines. 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 approximately 300 trademark registrations and are in the process of applying for registrations or transfer for approximately 110 trademarks in China. We own 11 invention, utilities and packaging design patents in China pertaining to our sleeping aid products, neck protected pillow, body relaxing chairs, posture-correction products and engine lubricant products.

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, currently are, and in the future may again be, the subject of claims for infringement, invalidity, or indemnification relating to other parties proprietary rights. For example, in June 2012, Yangya Zidian Co., Ltd., or Yangya Zidian, filed a suit in the Beijing First Intermediate People s Court against Shanghai HJX, alleging that Shanghai HJX has infringed upon its copyright. Yangya Zidian brought 18 law suits separately against our 18 Ozing electronic learning products, for each product Yangya Zidian claimed that Shanghai HJX should delete the video Let s talk in English while watch TV , Studio Classroom broadcast on our website, stop all behaviors infringing upon their copyrights, stop manufacturing and selling relevant Ozing electronic learning products, apologize publicly and compensate for the loss of RMB 600,000. The court approved Yangya Zidian s withdrawal of the suit on December 10, 2012.

In September 2012, Beijing Ren ai filed a suit in the People s Court of Chongqing Yuzhong District against Shanghai HJX, Chongqing Xinhua Media Co., Ltd. and Chongqing Heda Xinde Technology Development Co., Ltd., or Chongqing Heda, alleging that all defendants should stop infringing its copyrights, Shanghai HJX should apologize publicly, the defendants should compensate aggregate loss of RMB 500,000 and reasonable expenses of RMB 4,798. The People s Court of Chongqing Yuzhong District ruled that Chongqing Heda should stop infringing Beijing Ren ai s copyrights and compensate Beijing Ren ai RMB 10,200. Other claims of Beijing Ren ai were dismissed. Beijing Ren ai has appealed to higher court and the trial will be held on April 25, 2013.

In September 2012, Julia Banner Alexander filed a suit in Beijing First Intermediate People s Court against Shanghai HJX, alleging Shanghai HJX infringed upon their copyrights of New Concept English. Julia Banner Alexander claimed damages of RMB300,000. After negotiation, Shanghai HJX and Julia Banner Alexander reached an agreement on December 10, 2012. Shanghai HJX has paid RMB180,000 to Julia Banner Alexander and Julia Banner Alexander has withdrawn the suit.

In September 2012, Foreign Language Teaching and Research Press Co., Ltd., or Foreign Language Teaching Press, filed a suit in Beijing Xicheng District People s Court against Shanghai HJX, alleging Shanghai HJX infringed upon their copyrights of New Horizon College English. Foreign Language Teaching Press claimed damages of RMB300,000. After negotiation, Shanghai HJX and Foreign Language Teaching Press reached an agreement on December 10, 2012. Shanghai HJX has paid RMB70,000 to Foreign Language Teaching Press and Foreign Language Teaching Press has withdrawn the suit.

On April 17, 2013, we received a complaint from Beijing Shengshi Huawen Press Technology Co., Ltd., or Shengshi Huawen, alleging that Shanghai HJX and Beijing New China Children s Commodities Store, or New China Store, have infringed upon their copyrights of *the Cambridge Children s English* and *the Cambridge*

Table of Contents

Kindergarten English. Shengshi Huawen claimed that Shanghai HJX and New China Store should: (1) make compensation of RMB500,000; (2) stop selling electronic learning products infringing their copyrights; (3) apologize publicly. The court hearing will be held on May 21, 2013.

We believe that the above legal proceedings will not have a material adverse effect on our financial conditions. See Item 3.D, Key Information Risk Factors We have in the past been, currently are, and in the future may again be, subject to intellectual property rights infringement claims and other litigations 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.

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 four 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 call 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;
- warehouse management system, or WMS, which aims to control the movement and storage of materials within our warehouse;
- 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;
- TV direct sales monitoring system, which facilitates monitoring and analysis of TV direct sales programs, including timing, quality and effectiveness; and
- database backup.

In addition, our four warehouses are connected to a central inventory management system through virtual private network connections. Reports are generated and reconciled daily to provide management with up-to-date inventory information.

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

Table of Contents

under its authority including, among others, the State Administration for Industry and Commerce, or SAIC, the Ministry of Commerce, or MOFCOM, the State Administration for Radio, Film and Television, or SARFT, 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.

In the opinion of our PRC legal counsel, Commerce & Finance, except as disclosed in Item 3.D, Key Information Risk Factors Risks Related to the Regulation of Our Business If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising, 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 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 , (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

Foreign investments in direct sales and wholesale businesses are both principally governed by the Administrative Measures on Foreign Investment in Commercial Sector promulgated by the Ministry of Commerce, 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. On September 12, 2008, MOFCOM authorized its Provincial counterparts to approve the establishment or modification of a foreign-invested commercial enterprise except the one engaged in direct sale via TV, phones, mail, Internet, vender and other non-store methods or distribution of audio-visual products, books, newspapers and magazines which still should be approved by MOFCOM. On August 19, 2010, MOFCOM further authorized its Provincial counterparts to approve for the establishment of a foreign-invested enterprise to engage in direct sale via internet exclusively.

Under the PRC Law on Sino-foreign Equity Joint Venture Enterprises (revised in 2001), the PRC Law on Sino-foreign Cooperative Joint Venture Enterprises (revised in 2000), and the PRC Law on Wholly Foreign-owned Enterprises (revised in 2000), 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.

Table of Contents

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 National Development and Reform Commission 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 National Development and Reform Commission and MOFCOM jointly issued the Guideline Catalog of Foreign Investment Industries (2011 Revision), 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.

Direct investment by foreign investors in the advertising industry in China is 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 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 April 11, 2006, SAIC and MOFCOM also issued a Notice on the Issues Concerning Foreign Investors Establishing Foreign-Invested Advertising Enterprises through Equity Merger and Acquisition requiring that foreign-invested advertising enterprises that are established by foreign investors through equity mergers or acquisitions also satisfy the conditions of the Administrative Regulation on Foreign-Invested Advertising Enterprises.

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 is currently conducted by our consolidated affiliated enterprises owned by Don Dongjie Yang and Weiguo Ge Shanghai Network and Beijing Acorn. As domestic companies, these companies are not subject to the Commercial Sector Measures, but they are controlled by us through a set of contractual arrangements. See Item 4.C, Information on the Company Organizational Structure . In the opinion of our PRC legal counsel, Commerce & Finance:

- The ownership structures of Acorn Information, Shanghai Network and Beijing Acorn are in compliance with existing PRC laws and regulations; and

- Our contractual arrangements among Acorn Information, Shanghai Network and Beijing Acorn and their shareholders are valid, binding and enforceable, and do not and will not result in a violation of existing PRC laws and regulations.

We have been advised by our PRC legal counsel, Commerce & Finance, however, that 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 SAIC and MOFCOM, which regulate foreign investment in direct sales companies, 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 structure for conducting our PRC direct sales business 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 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 If the PRC government takes the view that the agreements that establish the structure for operating our TV and direct sales business 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 SAIC, 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 SAIC s approval based on SAIC s advice that this acquisition was a purely domestic acquisition without any foreign related issues. Our PRC legal counsel, Commerce & Finance, has advised us that 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 If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising, we could be subject to penalties.

We have been further advised by Commerce & Finance that, 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. If the PRC government determines that we did not obtain the requisite approval or that this acquisition violated the 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 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 Acorn Network Technology Development Co., Ltd. and Beijing Acorn Trade Co., Ltd. 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 to the human body, whose operation and safety can be assured through routine inspection. Class II includes those with medium risk to the human body, which warrant a greater degree of regulation. Class III includes those devices that pose a potential high risk to the human body, are implanted in the human body, or are used to support or sustain life, and therefore are subject to tight regulation. All the medical devices that we manufacture belong to Class II above. Under PRC laws and regulations, manufacturers of Class II medical devices must apply to the provincial-level SAFD for a valid Medical Device Manufacturing Enterprise License and Class II medical device operators must hold a valid Medical Device Operation Enterprise License, with limited exceptions. 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. 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, Acorn International Electronic Technology (Shanghai) Co., Ltd. holds a Medical Device Registration Certificate for a neck massager with a valid term of four years from July 21, 2009. Another of our subsidiaries, Shanghai HJX Digital Technology Co., Ltd, holds a valid Medical Device Operation Enterprise License that will expire on March 14, 2015. Another of our subsidiaries, Acorn Trade (Shanghai) Co., Ltd., holds a valid Medical Device Operation Enterprise License that expired on March 20, 2013, and we are currently in the process of renewing this license. Separately, our two direct sale affiliated entities Shanghai Network and Beijing Acorn, hold valid Medical Device Operation Enterprise Licenses, which expire on March 14, 2015 and June 22, 2015, respectively. In addition, Zhuhai Acorn Electronic Technology Co., Ltd. holds a Medical Device Manufacturing Enterprise License expiring on October 25, 2016 and a Medical Device Registration Certificate for an oxygen generating device that expired on May 17, 2015. We are also in the process of renewing other expired licenses and certificates that are required for our operation and products.

For the purposes of strengthening the supervision and management of medical devices and protecting human health and life safety, on May 20, 2011 the Ministry of Health promulgated the Administrative Measures for the Recall of Medical Devices (Trial), or Recall Measures 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.

Table of Contents

Regulation of Internet Content Providers

We currently operate *www.chinadrtv.com* and *www.ozing.com.cn* through which our customers can familiarize themselves with our products. We are required to comply with the Administrative Measures on Internet Content Services issued by the State Council on September 25, 2000, 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 SAFD 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, or a Value-added Telecommunications Business Permit for Internet Information Service if they are deemed to be an 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 SAFD at the provincial level and validated by an Internet Pharmaceuticals Information Service Qualification Certificate issued by SAFD. 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 website of *www.chinadrtv.com* and *www.ozing.com.cn* is not deeded as an operating business, we only need to file with the relevant information industry authorities for record, which we have finished. In addition, we hold an Internet Pharmaceuticals Information Service Qualification Certificate, which will expire on May 3, 2016.

Regulation of Internet Shopping

On May 31, 2010 the State Administration of Industry and Commerce promulgated Provisional Measures on Internet Commodity Trade and Relevant Service which provide rules for internet commodity operators to comply with. Pursuant to these provisional measures, internet commodity operators shall inform consumers of the name, variety, quantity, quality, price, transportation fee, delivery method, payment method, exchange and return of commodity and other main information of the commodity before consumers purchase the same.

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.

Regulations of Internet 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

Table of Contents

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.

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.

On September 25, 2009 CIRC promulgated the Measures for Penalizing Unlawful Conducts in Insurance Intermediary Business Operations, effective on October 1, 2009. In the event that, during the process of investigating and dealing with illegal conducts of insurance companies in relation to intermediary insurance business operations, CIRC becomes aware of illegal conducts of any insurance agents, brokers or insurance assessment institutions, it shall combine the investigation on both matters and deal with them as one case.

The CIRC issued the License for Concurrent-Business Insurance Agency to Shanghai Network on Jan 10, 2012. 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 (1994) and the Advertising Administrative Regulations (1987) and Implementing Rules on the Advertising Administrative Regulations (2004 Revision). SARFT 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, SARFT 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

Since 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

Table of Contents

engaging in long-term channel leasing agreements as in some other countries. In addition to regulating TV station ownership, SARFT also sets regulatory standards on the amount of advertising time allowed on TV broadcasting.

Airtime used to broadcast TV direct sales programs and TV home shopping programs is typically considered to be advertising time. On September 10, 2009, the State Administration of Radio, Film and Television, or SARFT, issued the Circular on Strengthening the Administration of TV Direct Sales Advertising and Home Shopping Programs, which requires that TV direct sales advertising programs not be broadcast on some specialized TV channels, including news channels and international channels, and TV home shopping channels and not be broadcast on satellite TV channels during the period from 6:00pm to 12:00pm every day. The Administrative Measures on Advertising on Television or Radio issued by the SARFT on September 8, 2009 and effective as of January 1, 2010 which was amended on November 15, 2011 further requires 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; no commercial advertising shall be inserted in whatever form during broadcasting of an episode (calculated as 45 minutes) of a television drama. Violation of these time restrictions may result in a warning, an order to correct the violation, a fine of up to RMB20,000, the suspension of broadcasting relevant to advertising, the suspension of the operation of the TV channel where the relevant advertising is broadcast, or even the withdrawal of the TV station s operating license.

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, comparison with other similar products in terms of effectiveness or safety, and reference to medical research institutes, academic institutions, medical organizations, experts, doctors, or patients regarding the effectiveness or safety of the products advertised. 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, SARFT 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 SARFT, 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 SARFT on September 8, 2009 and effective as of January 1, 2010 which was amended on November 15, 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, the State Administration for Industry and Commerce, the SFDA 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 SARFT 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. See Item 3.D, Key Information Risk Factors Risks Related to the Regulation of Our Business 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. Moreover, the SAFD issued a circular on October 31, 2005 announcing that advertising placed in several local newspapers by us and one of our distributors for our sleeping aid products and oxygen generating devices violated the relevant laws by including unapproved content. These violations for the sleeping aid products advertising were considered by SAFD to be a serious violation. The local SAFDs have ordered such advertising to be discontinued for use. As of 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. See Item 3.D, Key Information Risk Factors Risks Related to the Regulation of Our Business We and our distributors are subject to various laws regulating our advertising,

Table of Contents

including the content of our TV direct sales programs, 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 .

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, and the State Reform and Development Commission.

On November 19, 2012, the SAFE promulgated the Notice of the SAFE on Further Improving and Adjusting the Foreign Exchange Policies on Direct Investment, or the Notice, which shall come into force as of December 17. 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.

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 October 21, 2005, SAFE issued the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special

Purpose Companies, or Notice 75, which became effective on November 1, 2005. Notice 75 replaced the two rules issued by SAFE in January and April 2005 mentioned above. According to Notice 75:

- prior to establishing or assuming control of an offshore company for the purpose of financing that offshore company with assets or equity interests in an onshore enterprise in the PRC, each PRC resident, whether a natural or legal person, must complete the overseas investment foreign exchange registration procedures with the relevant local SAFE branch;

- an amendment to the registration with the local SAFE branch is required to be filed by any PRC resident that directly or indirectly holds interests in that offshore company upon either (1) the injection of equity interests or assets of an onshore enterprise to the offshore company, or (2) the completion of any overseas fund raising by such offshore company; and

- an amendment to the registration with the local SAFE branch is also required to be filed by such PRC resident when there is any material change involving a change in the capital of the offshore company, such as (1) an increase or decrease in its capital, (2) a transfer or swap of shares, (3) a merger or division, (4) a long-term equity or debt investment, or (5) the creation of any security interests over the relevant assets located in China.

Moreover, Notice 75 applies retroactively. As a result, PRC residents who have established or acquired control of offshore companies that have made onshore investments in the PRC in the past are required to complete the relevant overseas investment foreign exchange registration procedures by March 31, 2006. Under the relevant rules, failure to comply with the registration procedures set forth in Notice 75 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including the payment of dividends and other distributions to its offshore parent or affiliate and the capital inflow from the offshore entity, and may also subject relevant PRC residents to penalties under PRC foreign exchange administration regulations.

On May 20, 2011 SAFE promulgated the Implementing Rules for Foreign Exchange Administration Concerning Financing and Round-Trip Investment by Domestic Residents through Offshore Special-Purpose Companies which became effective on July 1, 2011 (the Implementing Rules). The Implementing Rules provide in detail the procedures, required documents and review standard of foreign exchange registration regarding financing and round-trip investment by domestic residents through offshore special-purpose companies.

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 Notice 75. 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 Notice 75 and the Implementing Rules, 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 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

Table of Contents

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, SAIC, the 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. 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;
- The Wholly Foreign-Owned Enterprise Law Implementing Rules (1990), as amended in 2001;
- The Sino-foreign Joint Equity Enterprise Law (1979), as amended in 2001;
- The Sino-foreign Joint Equity Enterprise Law Implementing Rules (1983), as amended in 2001; and
- Company Law of the PRC (2005).

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.

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 unifiedly 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 State Administration of Taxation on March 28, 2005 and the Notice on Issues of Individual Income Tax Concerning Share Incentive Plan issued by the State Administration of Taxation 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, pursuant to which relevant PRC government authorities enhanced their enforcement of labor laws and regulations. On December 28, 2012 the Labor Contract Law was amended to impose more stringent requirements on labor dispatch which will become 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.

On April 28, 2012, the State Council announced the Special Provisions on Labor Protection of Female Employees, or Female Protection Provisions. As stated in the Female Protection Provisions, a female employee shall be entitled to 98 days of maternity leave, among which 15 days of leave will be available before her giving birth. No employer may lower the wages, dismiss or terminate the employment agreement with a female employee as a consequence of her pregnancy, giving birth or breast-feeding. The Female Protection Provisions also provide rules of the maternity allowance and the relevant medical expenses for female employees who have and have not participated in maternity insurance respectively.

C. Organizational Structure

We commenced operations in 1998 through Beijing Acorn, and in 2000, we established and commenced business operations for two other operating companies, Shanghai Acorn Network Co., Ltd., or Shanghai Acorn, and Shanghai Acorn Trade and Development Co., Ltd., or Shanghai Trade.

Table of Contents

Prior to January 1, 2005, our business was operated through Beijing Acorn, Shanghai Acorn and Shanghai Trade, including their subsidiaries. Each of these three operating companies, referred to as the combined entities , was under common management, was operated on an integrated basis and was beneficially owned by the same shareholders and, with limited exception, in the same shareholding percentages. To enable us to raise equity capital from investors outside of China, we established a holding company structure by incorporating China DRTV in the British Virgin Islands on March 4, 2004. In 2004, China DRTV formed four PRC subsidiaries and two consolidated PRC affiliated entities. As part of a restructuring to implement an offshore holding company structure to comply with PRC laws imposing restrictions on foreign ownership in direct sales, wholesale distributor and advertising businesses, each of the combined entities, including their subsidiaries, transferred to China DRTV s newly created consolidated subsidiaries and affiliated entities, by means of an asset transfer and liability assumption, substantially all their assets and liabilities at their net book values, *except that* (a) the assets and liabilities of one of the combined entities subsidiaries were transferred through the transfer to China DRTV of all of that subsidiary s capital stock, and (b) after one of the three pre-restructuring operating companies, Beijing Acorn, transferred certain of its assets to two of China DRTV s subsidiaries, its shareholders transferred their equity interests in Beijing Acorn to two PRC individuals, with Beijing Acorn becoming an additional China DRTV affiliated entity. Commencing on January 1, 2005 our business was conducted through China DRTV and its subsidiaries and, until recently, our three affiliated entities. Other than Beijing Acorn and the other transferred subsidiary, each of the pre-restructuring companies previously engaged in the business was liquidated. We have determined that no change in basis in the assets transferred in connection with the restructuring is appropriate as the transfers constituted a transfer of net assets by entities under common control.

In connection with our initial public offering, we incorporated Acorn International, Inc. in the Cayman Islands on December 20, 2005 as our listing vehicle. Acorn International Inc. became our ultimate holding company when it issued shares to the existing shareholders of China DRTV on March 31, 2006 in exchange for all of the shares that these shareholders held in China DRTV. In September 2007, we entered into a share purchase agreement to acquire MK AND T Communications Limited. The acquisition was completed in November 2008. In October 2007, we formed two Hong Kong subsidiaries wholly-owned by China DRTV, Bright Rainbow Investments Limited and Emoney Investments Limited. On December 13, 2007, we formed Acorn Trade (Shanghai) Co., Ltd., a PRC subsidiary wholly-owned by China DRTV, through which we conduct our wholesale distribution business. Prior to this, our wholesale distribution business was conducted through our two affiliated entities, Shanghai Network and Beijing Acorn. In April, 2008, we transferred 100% of the ownership interest in Shanghai HJX to Bright Rainbow Investments Limited. In December 2008, we acquired 100% of the equity interests of Yiyang Yukang, a mobile phone producer and distributor in China and former third-party supplier of our mobile phone products, which is now a subsidiary of the Company. In February 2010, Emoney Investments Limited was deregistered.

Shanghai Network and Beijing Acorn, our two affiliated entities, are currently owned by two PRC citizens, Don Dongjie Yang, our co-founder, chief executive officer and director, and Weiguo Ge, an assistant general managers of our finance department. Shanghai Network is primarily engaged in our TV direct sales business throughout China except for Beijing. Beijing Acorn is primarily engaged in our TV direct sales business in Beijing. We have entered into contractual arrangements with these two affiliated entities pursuant to which our wholly owned subsidiary, Acorn Information Technology (Shanghai) Co., Ltd., provides technical support and management services to these affiliated entities. In addition, we have entered into agreements with these two affiliated entities and their shareholders, Don Dongjie Yang and Weiguo Ge, providing us with the ability to effectively control each of these affiliated entities. Accordingly, we have consolidated historical financial results of these two affiliated entities in our financial statements as variable interest entities pursuant to U.S. GAAP. Mr. Yang and Mr. Ge collectively hold 12.93% of the outstanding shares of our Company as of the date of this Form 20-F.

In September 2007, we acquired the legal ownership of Shanghai Acorn Advertising Broadcasting Co., Ltd, or Shanghai Advertising, which was previously one of our affiliated entities owned by Don Dongjie Yang and David Chenghong He. As James Yujun Hu and Guoying Du who used to be the designees under the contractual arrangements resigned from the Company in 2010, we released the above persons from rights and obligations under the contractual arrangements and new Powers of Attorney were entered into, pursuant to which, Irene Lin Bian and Lifu Chen have been appointed by Don Dongjie Yang and David Chenghong He who were shareholders of two affiliated entities at that time as new designees to exercise their shareholders rights in Shanghai Network and Beijing Acorn, respectively, including their voting rights in the shareholders meeting. David Chenghong He resigned from the Company in February 2011, and the contractual arrangements previously entered into by David Chenghong He were all terminated and Irene Lin Bian became the 25% shareholder in our two affiliated entities and entered into a new set of contractual arrangements. Under the new set of contractual arrangements, Lifu Chen and Weiguo Ge were appointed by Don Dongjie Yang and Irene Lin Bian as new designees to exercise their shareholders rights in Shanghai Network and Beijing Acorn, respectively, including their voting rights in the shareholders meeting. On November 29, 2011, shortly before Irene Lin Bian left the Company, the contractual arrangements previously entered into by Irene Lin Bian were all terminated and Weiguo Ge became the 25% shareholder of our two affiliated entities and entered into a new set of contractual arrangements. Pursuant to the new powers of attorney under the new set of contractual arrangements, Lifu Chen and Yongqiang Zhu was appointed by Don Dongjie Yang and Weiguo Ge as new designees to exercise their shareholders rights in Shanghai Network and Beijing Acorn, respectively, including their voting rights in the shareholders meeting.

In the opinion of our PRC legal counsel, Commerce & Finance, except as disclosed in Item 3.D., Key Information Risk Factors Risks Related to the Regulation of Our Business If the PRC government takes the view that we did not obtain the necessary approval for our acquisition of Shanghai Advertising, 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 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 , (1) the ownership structures of our directly owned PRC subsidiaries comply with existing PRC laws and regulations and (2) the ownership structures of our two affiliated entities and our contractual arrangements with these 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.

We have been advised by our PRC legal counsel, Commerce & Finance, however, that there are uncertainties regarding the interpretation and application of current and future PRC laws and regulations with respect to these matters. Accordingly, we cannot assure you that the PRC regulatory authorities, in particular SAIC and MOFCOM, which regulate foreign investment in direct sales companies, will not in the future take views that are contrary to the above opinions of our PRC legal counsel. If the current agreements that establish the structure for conducting our PRC direct sales business 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 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 If the PRC government takes the view that the agreements that establish the structure for operating our TV and other direct sales business in China do not comply with PRC governmental restrictions on foreign investment in these areas, we could be subject to severe penalties .

As part of our reorganization, we deregistered U King Communications Equipment (Hong Kong) Limited in May 2011, transferred 100% of the ownership interest in Shanghai Advertising to MK AND T Communications Limited in October 2011 and disposed of our shareholding in Acorn Hong Kong Holdings Limited in December 2011. In addition, we deregistered our wholly-owned subsidiary, Shanghai Acorn Enterprise Management Consulting Co., Ltd. in January 2013, and is currently in the process of deregistering Beijing HJZX Software Technology Development Co., Ltd., which is expected to be completed in 2013.

Table of Contents

The following diagram illustrates our current corporate structure and the place of formation, ownership interest and affiliation of each of our subsidiaries and the two affiliated entities as of the date of this Form 20-F[(1)]:

Table of Contents

(1) For risks related to our current corporate structure, see Item 3.D, Key Information Risk Factors Risks Related to the Regulation of Our Business .

(2) Agreements that provide us with effective control over Shanghai Acorn Network Technology Development Co., Ltd. and Beijing Acorn Trade Co., Ltd. include equity pledge agreements, irrevocable powers of attorney, a loan agreement, operation and management agreements, exclusive purchase agreements and spouse consent letters. We may modify our contractual arrangements from time to time to facilitate our operations. For previous changes in our contractual arrangements, please see Item 3.C, Organizational Structure for further information.

(3) The economic benefits of Shanghai Acorn Network Technology Development Co., Ltd. and Beijing Acorn Trade Co., Ltd. accrue to Acorn Information Technology (Shanghai) Co., Ltd.

(4) The Zhuhai Sunrana Bio-Tech Co., Ltd. is currently under the liquidation process.

Material Operating Entities

MOFCOM, or its local counterpart, reviews the application and issues the requisite approval for business operations by foreign entities. Our direct sales business is considered commercial trading and, until 2004, foreign investment in commercial trading was highly restricted by PRC regulations. By December 2004, MOFCOM had significantly reduced these restrictions. Nevertheless, to directly operate our direct sales business, we still need to obtain MOFCOM s approval. Therefore, our direct sales business is currently conducted by our consolidated affiliated entities, Shanghai Network and Beijing Acorn, which hold the necessary licenses to conduct our direct sales business, through contractual arrangements between Acorn Information, our wholly owned subsidiary in China, and these two consolidated affiliated entities. Our wholesale business is currently conducted by Acorn Trade (Shanghai) Co., Ltd.

Our direct sales business, and our advertising operations in support of our direct sales business, are regulated by SAIC. All of our advertising business operations, which include design, production and publication of TV and other advertising, are conducted by Shanghai Advertising, which used to be one of our affiliated entities. We acquired 100% of the legal ownership of Shanghai Advertising through Shanghai Acorn Enterprise Management Consulting Co., Ltd. in September 2007, and subsequently transferred the entire equity interest in Shanghai Advertising to MK AND T Communications Limited as part of our reorganization. The Pudong Administration of Industry and Commerce in Shanghai issued a new business license for Shanghai Advertising to conduct our advertising operations following the acquisition.

In addition, Shanghai HJX, Acorn International Electronic Technology (Shanghai) Co., Ltd. and Zhuhai Acorn Electronic Technology Co., Ltd. and Acorn Trade (Shanghai) Co., Ltd. manufacture and distribute through our nationwide distribution network most of our electronic learning products, electronic dictionary products, posture correction products and oxygen generating devices, and each provides technical support and after-sales services for such products. The direct sales of our consumer electronics products and other fitness products are primarily conducted through Shanghai Network and Beijing Acorn.

Contractual Arrangements with the Consolidated Affiliated Entities and their Shareholders

Our relationships with the two affiliated entities and their shareholders are governed by a series of contractual arrangements. Under PRC law, each of the affiliated entities is an independent legal person and none of them is exposed to liabilities incurred by the other party. Other than pursuant to the contractual arrangements between our wholly owned subsidiary, Acorn Information, and these two affiliated entities, these affiliated entities do not transfer any other funds generated from their operations to us. These contractual arrangements are as set forth below.

Each of our contractual arrangements with these two affiliated entities and their shareholders can only be amended with the approval of our audit committee or another independent body of our board of directors. See Item 7.B, Major Shareholders and Related Party Transactions Related Party Transactions for further information on our contractual arrangements with these parties.

Table of Contents

Agreements that Provide Effective Control and an Option to Acquire Shanghai Network and Beijing Acorn

These agreements provide us with effective control over these two affiliated entities and their shareholders, Don Dongjie Yang, our co-founder, chief executive officer and director, and Weiguo Ge, one of the assistant general managers of our finance department. They include irrevocable powers of attorney, a loan agreement, equity pledge agreements, operation and management agreements and spouse consent letters. Under the exclusive purchase agreements, we also have exclusive options to purchase the equity interests of the affiliated entities.

Irrevocable Powers of Attorney. Under irrevocable powers of attorney, each of the two shareholders of Shanghai Network and Beijing Acorn, Don Dongjie Yang and Weiguo Ge, has granted to designees of Acorn Information, Lifu Chen, one of our senior vice presidents, and Yongqiang Zhu, one of our senior vice presidents, the power to exercise all voting rights of such shareholder in the shareholders meetings, including but not limited to the power to determine the sale or transfer of all or part of such shareholder s equity interest in, and appoint the directors of, Shanghai Network and Beijing Acorn. These irrevocable powers of attorney have terms of ten years and will automatically renew for another ten years unless terminated by the above-mentioned designees of Acorn Information in writing three months prior to their expiry.

Loan Agreement. Under the loan agreement among Acorn Information and the shareholders of these two affiliated entities, Don Dongjie Yang and Weiguo Ge, Acorn Information made a loan to Don Dongjie Yang and Weiguo Ge in an aggregate amount of RMB 162.5 million and agreed to make additional loans not exceeding RMB 30.4 million to Don Dongjie Yang and Weiguo Ge. The loan is to be used primarily for capital investments by the shareholders in Shanghai Network and Beijing Acorn. The loan can only be repaid by the shareholders transfer of their interests in Shanghai Network and Beijing Acorn to Acorn Information or its designee when permissible under PRC law. The initial term of the loan is ten years and will automatically be renewed for another ten years absent a written termination notice from Acorn Information.

Operation and Management Agreements. Under the operation and management agreements among Acorn Information, the two shareholders and each of the affiliated entities, the parties have agreed that Acorn Information will provide guidance and instructions on daily operations and financial affairs of each of these two affiliated entities. The agreements also state that each of the directors, general managers and other senior management personnel of these affiliated entities will be appointed as nominated by Acorn Information. Acorn Information has the authority to exercise the voting rights on behalf of the two shareholders at the shareholder meetings of the two affiliated entities. Acorn Information has agreed to provide security for contracts, agreements or other transactions entered into by these two affiliated entities with third parties, provided that these affiliated entities shall provide counter-security for Acorn Information using their accounts receivable or assets. In addition, each of these affiliated entities agreed not to enter into any transaction that could materially affect its respective assets, obligations, rights or operations without prior written consent from Acorn Information. The terms of these agreements are ten years and will automatically renew for another ten years absent a written termination notice by Acorn Information.

Equity Pledge Agreements. Under the equity pledge agreements among Acorn Information and the two shareholders of the affiliated entities, each of Don Dongjie Yang and Weiguo Ge has pledged all of his equity interests in Shanghai Network and Beijing Acorn to Acorn Information to guarantee the performance of the two affiliated entities under the operation and management agreements and the exclusive technical services agreements as described below, as well as their personal obligations under the loan agreements. Each of the shareholders also agrees not to transfer, assign or, pledge his interests in any of these affiliated entities without the prior written consent of Acorn Information. If any of these affiliated entities or either of the two shareholders breaches its respective contractual obligations thereunder, Acorn Information, as pledgee, will be entitled to certain rights, including but not limited to the right to sell the pledged equity interests. The terms of these agreements are ten years and will automatically renew for another ten years absent written termination notice by Acorn Information three months prior to their expiry.

Table of Contents

Exclusive Purchase Agreements. Pursuant to the exclusive purchase agreements among Acorn Information and each of Shanghai Network and Beijing Acorn and their shareholders, Don Dongjie Yang and Weiguo Ge, each of the two shareholders has irrevocably granted Acorn Information or its designee an exclusive option to purchase at any time if and when permitted under PRC law, all or any portion of their equity interests in Shanghai Network and Beijing Acorn for a price that is the minimum amount permitted by PRC law. The terms of these agreements are ten years and will automatically renew for another ten years absent a written termination notice by Acorn Information three months prior to their expiry.

Spouse Consent Letters. Pursuant to the spouse consent letters, the spouse of each of the shareholders of these two affiliated entities acknowledges that she is aware of, and consents to, the execution by her spouse of irrevocable powers of attorney, equity pledge agreements and the exclusive purchase agreements described above. With respect to establishment, grant and performance of the above irrevocable powers of attorney, equity pledge and the exclusive purchase, each spouse further agrees that, whether at present or in the future, she will not take any actions or raise any claims or objection.

Technical Services Agreements that Transfer Economic Benefits from Shanghai Network and Beijing Acorn to Us

Acorn Information has entered into a technical service agreement with each of the affiliated entities to transfer economic interests in these entities to us. Pursuant to the technical service agreements, Acorn Information is the exclusive provider of technical support and consulting services to the two affiliated entities in exchange for service fees. Under these agreements, each of the affiliated entities may not, among other things, dispose of its assets, dissolve, liquidate, merge with any third parties, provide security to any third parties, distribute dividends, engage in transactions with any of its affiliates, make external investment or conduct any business outside of the ordinary course of their respective businesses without the prior consent of Acorn Information. The term of these agreements is ten years and will automatically renew for another ten years unless terminated by Acorn Information.

D. Property, Plant and Equipment

We are headquartered in Shanghai and own an office space of 3,852 square meters. In addition, we have leased an aggregate of approximately 19,315 square meters of office and call center spaces in Beijing, Shanghai and Wuxi. Our leases are typically for a term from one to five years. Our four central warehousing hubs cover approximately 40,410 square meters, among which 4,940 square meters are subject to varying lease terms. We typically enjoy a priority right to renew our leases for our warehouses.

Our manufacturing facilities in Beijing, Shanghai, Shenzhen and Zhuhai occupy an aggregate of approximately 5,808 square meters. Our manufacturing facilities in Zhuhai are used for the production of our oxygen generating device product line, our manufacturing facilities in Shanghai are used for the production of our posture correction product lines, and our manufacturing facility in Shenzhen is used for the production of our electronic learning product line.

Uncertainty exists as to our right to use the land on which our manufacturing facilities are built in Beijing. For additional information regarding this uncertainty, see Item 3.D, Key Information Risk Factors Risks Related to Our Business Our leases of land and manufacturing facilities in Beijing may not be in full compliance with PRC laws and regulations and we may be required to relocate our facilities, which may disrupt our manufacturing operations and result in decreased net revenues .

During the first quarter of 2009, we obtained a fifty-year land use right of a piece of land in Qingpu district of Shanghai for aggregate consideration of approximately RMB51.2 million (approximately $7.5 million). We have completed the construction of a warehouse and a factory for keeping our inventories and manufacturing our proprietary branded products, the building ownership certificates of which had been obtained on December 20, 2012.

Table of Contents

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion of our financial condition and results of operations is based upon and should be read in conjunction with our consolidated financial statements and their related notes included in this annual report on Form 20-F. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. For more information regarding forward-looking statements, see Forward-Looking Statements. In evaluating our business, you should carefully consider the information provided under Item 3.D, Key Information Risk Factors. We caution you that our businesses and financial performance are subject to substantial risks and uncertainties.

A. Operating Results

Overview

We are a media and branding company in China, operating one of China s largest TV direct sales businesses in terms of revenues and TV airtime. We have strong media resources, through which we offer and market a diverse portfolio of proprietary products. We have built a proven track record of developing, promoting and selling proprietary-branded products, as well as products from established third parties. We sell our products primarily through our TV direct sales platform, other direct sales platform which include outbound calls, Internet sales, catalog sales and third-party bank channel sales, as well as our nationwide distribution network. Our core strategy is to generate sales by building proprietary brands via buying and utilizing all forms of media.

We believe our nationally televised TV direct sales programs allow us to build strong product brand awareness among China s consumers and to generate significant demand for the products that we market within a short period of time. Our other forms of media resources enable us to reach out to a larger customer base and to lessen our reliance on advertising expenditures for TV time purchases. Our nationwide distribution network, coupled with local marketing efforts, helps further enhance the awareness of, and demand for, marketed products, thereby broadening our customer reach and enhancing our product penetration on a nationwide basis.

Our net revenues and operating income in any period are largely driven by our direct sales platforms and distribution network as well as our product mix, advertising expenses, and promotional events occurring in the period. Our net revenues, which include direct sales net revenues and distribution net revenues, were $293.2 million, $362.1 million and $242.6 million, in 2010, 2011 and 2012, respectively. Direct sales net revenues, which include both net proceeds from products sold through our TV direct sales programs and net proceeds from products sold through our other direct sales platforms, increased from $195.8 million in 2010 to $291.5 million in 2011, and decreased to $193.6 million in 2012. The significant decrease in our direct sale net revenues in 2012 was primarily due to the significant drop in our mobile phone sales. Distribution net revenues, which are derived from sales of products to our distributors, decreased from 97.4 million in 2010 to $70.5 million in 2011, and to $49.0 million in 2012. In addition, we recorded operating losses of $21.9 million and $12.8 million in 2012 and 2010, respectively, compared to operating income of $1.1 million in 2011.

Our longer term goal is to become the leading media and branding company in China and to capitalize on our integrated multi-media platform with an aim to become partners of choice for both well-established and promising new businesses to market and distribute their products in China. To achieve this goal, our management has adopted a new performance review system since 2010 which focuses on the optimization of our media return and spending. In addition, we will continue to grow our business across product lines and platforms, including Yierjian abdominal trainer and Ozing electronic learning products, as well as our TV and other direct sales platforms. We also plan to further enhance our customers brand loyalty through a more effective business strategy, higher product quality, and better customer service, thereby achieving higher productivity and profitability.

Table of Contents

Factors Affecting Our Results of Operations

We have benefited from a number of trends that are currently accelerating the growth of the direct sales industry in China, including, among other things, overall economic growth that has resulted in increased disposable income and discretionary consumer spending. Company-specific factors that may affect our future financial condition and results of operations include, among other things, the following:

the mix of product lines selected by us for marketing through our various sales platforms:
Although we maintain and offer a diverse product portfolio, we generally focus on marketing and selling four to six featured product lines at any one time through our TV and other direct sales platform, and a limited number of products through our nationwide distribution network. Consequently, we have been, and expect to continue to be, dependent on a limited number of featured product lines to generate a large percentage of our net revenues. For example, sales of our mobile phone products, our top selling product line in 2012, contributed to $64.7 million in our net revenues, representing 26.6% of our total gross revenues in 2012. Among these featured product lines, some of which generally enjoys higher profit margin, such as our fitness and cosmetics product lines, while some of which generally have lower profit margin, such as our mobile phone product line. Currently, our featured product lines mainly include mobile phone products, fitness products, electronic learning products, collectible products and health products. We expect that our fitness product line featuring our Yierjian abdominal trainer and new models of Ozing electronic learning products to be our major revenue drivers in 2013.

the mix of our TV versus other direct sales platforms:
We sell our products through our TV direct sales platform, other direct sales platform and our nationwide distribution network. Our direct sales (including both TV and other direct sales) accounted for 66.8%, 80.5% and 79.8%, respectively, of our net revenues in 2010, 2011 and 2012, respectively, while our distribution sales accounted for 33.2%, 19.5% and 20.2%, respectively, of our net revenues in 2010, 2011 and 2012, respectively. We expect to continue to focus on our TV and other direct sales platforms, which we believe to be our core competency.

new product introduced by us and our ability to identify new products:
Our ability to maintain or grow our revenue depends on our ability to successfully identify, develop, introduce and distribute in a timely and cost-effective manner new and upgraded product offerings. We employ a systematic identification and development process. After a potential featured product has been identified and tested, we evaluate a number of key benchmarks, particularly estimated profitability relative to our media expenses, in determining whether to conduct full-scale sales and marketing. We also seek to diversify our product offerings by adding products that offer recurring revenue opportunities. To help us identify suitable new products, we entered into an exclusive partnership agreement on July 21, 2011 with GIS, a full-service international direct-response television distributor, pursuant to which GIS will search for and identify products of interest for us and obtain rights to such products on our behalf. As of the date of this Form 20-F, we identified three new products through GIS, among which one product had been marketed by us in 2012.

the amount and timing of operating expenses incurred by us, in particular our media procurement expenses:
Our revenues are driven significantly by our spending on advertising, particularly our TV direct sales programs. Our total advertising expenses increased from $58.5 million in 2010 to $68.6 million in 2011 and then decreased to $58.3 million in 2012. The largest component of our total advertising expenses, constituting over 90% of total advertising expenses in each of 2010, 2011 and 2012, is purchased TV advertising time, which correlates to the conversion rate of our inbound calls. The primary performance metric we track and analyze on a daily basis is the conversion rate of our inbound calls. The conversion rate for inbound calls, which is the percentage of inbound calls that result in product purchase orders, was 25.4%, 31.4% and 36.2%, in 2010, 2011 and 2012, respectively. The increase in conversion rate in 2012 was primarily due to increased sales of fitness

products that generally have higher conversion rates, as well as the lower average selling prices of products sold through inbound calls. We believe that with our more focused and targeted media spending, we could further improve the conversion rate of our inbound calls, thereby increase our net revenues.

Our advertising cost per minute varies depending on the channels. Certain CCTV channels, which generally have a broader reach, are more expensive. Some TV channels increase their rates annually. In addition, we have experienced more significant rate increases on some of our national satellite TV channels, compared to our other TV channels, as their reach and ratings have increased. In order to maximize the effectiveness of the media spending under the increasing rate environment and to enhance the media return, we switched to some TV channels with higher media returns and allocated more non-prime time with lower rates. Our average per minute advertising cost for TV direct sales programs in 2010, 2011 and 2012 was approximately $215, $342 and $292, respectively. In 2012, our top five TV channels in terms of amount of our advertising expenditures accounted for approximately 79.4% of our total advertising expenditures of TV direct sales programs and constituted approximately 62.4% of the total TV airtime of our TV direct sales programs.

In addition to the factors above, intensified competition in the direct sales industry in China presents new challenges to our business. Related challenges include the evolving nature of the TV direct sales industry and our business model and a continuously evolving competitive landscape. To address these challenges, among other things, we regularly evaluate developments and the competitive landscape in the consumer retail market in China (including the TV direct sales market in China). In turn, as appropriate, we adjust our product offerings, sales and marketing efforts and business strategy. We undertake these adjustments in connection with constant evaluation of our media allocation for each product to maximize return on our media expenditures. For example, we track and analyze data generated through our call center operations. Using this data, we adjust the products we promote on TV, the frequency and time slots of our TV direct sales programs, as well as the TV channels on which we broadcast our programs on a weekly basis.

For a detailed discussion of other factors that may cause our results of operations to fluctuate, see Item 3.D, Key Information Risk Factors Risks Relating to Our Business.

Revenues

	For the years ended December 31,					
	2010		2011		2012	
	Amount	% of total revenue, net	Amount	% of total revenue, net	Amount	% of total revenue, net
	(in U.S. dollars, except percentage)					
Revenues:						
Direct sales, net	$ 195,821,308	66.8%	$ 291,524,509	80.5%	$ 193,614,500	79.8%
Distribution sales, net	97,419,877	33.2%	70,533,404	19.5%	48,959,174	20.2%
Total revenues, net	$ 293,241,185	100.0%	$ 362,057,913	100.0%	$ 242,573,674	100.0%

Our net revenues consist of direct sales net revenues generated from our TV and other direct sales platforms and distribution sales net revenues. The percentage of our total net revenues attributable to direct sales and distribution sales revenues varies from period to period based on, among other things, our TV airtime dedicated to our proprietary or third-party products in any given period. The decrease in distribution sales net revenues as a percentage of our net revenues from 2010 to 2011 primarily reflected our strategy to focus on direct sales of our proprietary products since 2010, while such percentage remained relatively stable in 2012 primarily due to the lower-than-expected sales performance by our direct sales platforms.

Direct sales net revenues represent product sales through our TV direct sales programs and our other direct sales platforms, including outbound calls, Internet sales, catalog sales and third-party bank channel sales. To

Table of Contents

date, a significant portion of our direct sales net revenues have been generated from our TV direct sales platform. We plan to continue to develop other direct sales platform, in particular Internet sales and outbound calls, to increase our revenues in 2013.

Distribution net revenues represent product sales to the distributors that constitute our nationwide distribution network. We sell products to our distributors at a discount to the retail price for the same product.

Our total net revenues are presented net of certain adjustments, including sales and business taxes, cash rebates on distribution sales, costs of cash coupon discounts and membership points on direct sales. We net the cash rebates used in connection with promotional distribution sales activities and the cash coupon discounts and membership points used in connection with our customer loyalty program for direct sales against revenue at the time revenue is recorded.

Cost of Revenues

Cost of revenues represents our direct costs to manufacture, purchase or develop products sold by us to consumers or our distributors. For a particular product, the related cost of revenues is the same regardless of whether sold by us directly to consumers or to our distributors. The most significant factor in determining cost of revenues as a percentage of revenue in any period is our product mix for the period. For example, our mobile phone or electronic learning products currently have a higher per unit cost of revenues as compared to other products such as our fitness or cosmetics products, which often results in a lower gross margin for such products.

Cost of revenues does not include advertising or other selling and marketing expenditures. These expenditures are incurred for the benefit of each of our sales and distribution platforms and, as such, are treated as operating expenses and not as cost of revenues. As described below under Critical Accounting Policies , however, certain payments received under our joint sales arrangements may reduce our cost of revenues or advertising expenses.

Operating (Expenses) Income

Our operating (expenses) income consist of advertising expenses, other selling and marketing expenses, general and administrative expenses and other operating income, net.

Advertising Expenses

Advertising expenses consist primarily of the expenses of purchasing our advertising media, mostly the expense of TV advertising time and, to a significantly lesser extent, other media, primarily Internet, print and radio advertising. Advertising expenses also include payments to reimburse certain of our distributors for a portion of their local TV airtime, print media and other advertising-related expenses in support of our products distributed by them. To date, we have not deferred any advertising expenses, and all such advertising expenses have been recognized as incurred.

We use our purchased TV advertising time to broadcast our TV direct sales programs and our product-oriented promotional advertising. Our advertising expenses primarily include the cost of the TV advertising time used to broadcast our TV direct sales programs. We also promote brands through print and other media, primarily Internet, print and radio advertising. We enter into our advertising agreements near the end of each year and consequently the balance of our prepayment for advertising is usually at its highest level at the year-end. In 2012, we generally entered into advertising agreements with more flexible terms to help optimize our media spending.

Table of Contents

Other Selling and Marketing Expenses

Other selling and marketing expenses consist primarily of costs related to product delivery and handling, salary and benefits for our call center sales and marketing personnel, and the production of our TV direct sales programs and other advertising. We rely significantly on EMS and local delivery companies to deliver our products and to collect payments in connection with our products delivered on a cash on delivery, or COD, payment method. In general, we are responsible for the delivery and handling fee regardless of whether the delivery is successful.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation and benefits for general management, finance and administrative personnel costs, depreciation and amortization with respect to equipment used for general corporate purposes, professional fees, research and development expenditures, allowances for doubtful accounts and other expenses for general corporate purposes.

Other Operating Income, Net

Other operating income, net consists primarily of government subsidies. We receive government subsidies from local government agencies for certain taxes paid by us, including value-added, business and income taxes, as well as part of the incentives provided by local government for our investment in the local district.

Taxation

We are incorporated in the Cayman Islands and are not subject to tax in this jurisdiction. Our subsidiaries China DRTV and Smooth Profit are incorporated in BVI and are not subject to tax in this jurisdiction. Our subsidiaries Bright Rainbow Investments Limited and MK AND T Communications Limited are incorporated in Hong Kong and are subject to statutory income tax on their Hong Kong sourced income. Our other subsidiaries and affiliated companies are PRC companies. In addition to enterprise income tax, our PRC subsidiaries and affiliated companies are subject to a 17% value added tax, or VAT, on sales in accordance with relevant PRC tax laws. VAT taxes payable are accounted for through the balance sheet and do not have an income statement effect. The statutory income tax rate applicable to PRC companies is 25% for calendar years starting on or after January 1, 2008.

On March 16, 2007, the PRC government promulgated Law of the People s Republic of China on Enterprise Income Tax (New EIT Law), which is effective from January 1, 2008. Under the New EIT Law, domestically owned enterprises and foreign-invested enterprises are subject to a uniform tax rate of 25%. While the New EIT Law equalizes the tax rates for domestically-owned and foreign-invested companies, preferential tax treatment would continue to be given to companies in certain encouraged sectors and to enterprises classified as high and new technology companies, whether domestically-owned or foreign-invested enterprises. The New EIT Law also provides a five-year transition period starting from its effective date for those enterprises which were established before the promulgation date of the New EIT Tax Law and which were entitled to a preferential tax treatment such as a reduced tax rate or a tax holiday. The tax rate of such enterprises will transition to the uniform tax rate of 25% within a five-year transition period and the tax holiday, which has been enjoyed by such enterprises before the effective date of the New EIT Law, may continue to be enjoyed until the end of the holiday.

For 2010, 2011 and 2012, several of our PRC subsidiaries and affiliated companies benefited from the following special tax rates or incentives:

Shanghai Advertising and Acorn Information, both registered in Pudong New District, Shanghai of the PRC, were subject to 22% Enterprise Income Tax, or EIT, in 2010, 24% EIT in 2011 and 25% EIT in 2012 pursuant to the local tax preferential arrangement.

Table of Contents

Shanghai HJX, Acorn Electronic, Beijing Youngleda, Yiyang Yukang and Zhuhai Acorn, as foreign-invested manufacturing enterprises which are scheduled to operate for at least ten years, are entitled to a two-year exemption and three-year 50% reduction starting from the first profit making year after absorbing all prior years tax losses, which can be carried forward for five years (the Tax Holiday). Under the New EIT Law, enterprises not generating profits before 2008 are required to commence the Tax Holiday beginning January 1, 2008.

Acorn Information, as a recognized software company, has been eligible for the Tax Holiday since 2005.

HJZX Software, as a recognized software company, has been eligible for the Tax Holiday since 2009.

We have adopted the provisions of ASC740-10, Income Taxes Overall (previously FASB Interpretation No. 48, Accounting For Uncertainty in Income Taxes an Interpretation of SFAS No. 109). Based on our analyses under ASC740-10, we have made our assessment of the level of authority for each tax position (including the potential application of interest and penalties) based on the technical merits of the position, and have measured the unrecognized benefits associated with the tax positions accordingly. As of December 31, 2010, 2011 and 2012, we had unrecognized tax benefits of approximately $3.1 million, $2.5 million and nil, respectively.

Critical Accounting Policies

We prepare our financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of net revenues and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our financial statements as their application places the most significant demands on our management s judgment.

Revenue Recognition

We recognize net revenue for sales through our direct sales platforms upon delivery of the products to, and acceptance by, our customers (F.O.B Destination). These revenues are recognized net of sales tax incurred. We rely significantly on EMS and local delivery companies to deliver products sold through our direct sales platforms. It generally takes one to seven days for a product to be delivered by EMS and local delivery companies, with these companies regularly reporting to us product delivery status. For unsuccessful deliveries, EMS and local delivery companies are required to return the undelivered products to us. It generally takes EMS two to four weeks, and local delivery companies seven to ten days, to return the undelivered products to us. Direct sales revenues are adjusted in the current accounting period based on actual unsuccessful product deliveries experience reported by EMS and local delivery companies.

We recognize net revenues for products sold through our nationwide distribution network when products are delivered to and accepted by our distributors (F.O.B. Destination). In most cases, the distributors are required to pay in advance for our products. Some distributors are given customary credit terms within the industry based on their creditworthiness. The distributor agreements do not provide discounts, chargebacks, price protection and stock rotation rights. However, certain distributor agreements provided performance-based cash rebates which were net against revenue at the time revenue was recorded. Accordingly, we record the revenues when products are delivered to and accepted by the distributors as there are no future remaining obligations. In 2010, 2011 and 2012, the costs associated with cash rebates were insignificant.

Table of Contents

Impairment of Long-lived Assets

We evaluate our long-lived assets and finite-lived intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, we measure impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, we recognize an impairment loss based on the fair value of the assets. The determination of fair value of the intangible and long lived assets acquired involves certain judgments and estimates. These judgments can include, but are not limited to, the cash flows that an asset is expected to generate in the future. This analysis also relies on a number of factors, including changes in strategic direction, business plans, regulatory developments, economic and budget projections, technological improvements, and operating results. Any write-downs would be treated as permanent reductions in the carrying amounts of the assets and an operating loss would be recognized.

Share-based Compensation

The costs of share-based payments are recognized in our consolidated financial statements based on their grant-date fair value over the requisite service period. The fair value of our restricted share units is based on the quoted market price of our ADS on the grant date. Determining the value of our share-based compensation expense in future periods also requires the input of highly subjective assumptions around estimated forfeitures. We estimate our forfeitures based on past employee retention rates, our expectations of future retention rates, and we will prospectively revise our forfeiture rates based on actual history.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts primarily based on the age of receivables and factors surrounding the credit risk of specific customers. If there is a deterioration of a major customer s creditworthiness or actual defaults are higher than our historical experience, we may need to maintain additional allowances.

Valuation of Deferred Tax Assets

Deferred tax assets are reduced by a valuation allowance when, in the assessment of management, it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. Current income taxes are provided for in accordance with the laws of the relevant taxing authorities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on the characteristics of the underlying assets and liabilities, or the expected timing of their use when they do not relate to a specific asset or liability.

We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of these deferred tax assets by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carry-forward periods available to us for tax reporting purposes and other relevant factors.

We recognize the impact of an uncertain income tax position at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. We classify interests and penalties related to income tax matters in income tax expense.

Table of Contents

Results of Operations

The following table sets forth our condensed consolidated statements of operations by amount and as a percentage of our total net revenues for 2010, 2011 and 2012:

	For the years ended December 31,					
	2010		2011		2012	
	Amount	% of total revenues, net	Amount	% of total revenues, net	Amount	% of total revenues, net
	(in thousands, except for percentages)					
Condensed Consolidated Statements of Operations Data						
Revenues:						
Direct sales, net	$ 195,821	66.8%	$ 291,525	80.5%	$ 193,615	79.8%
Distribution sales, net	97,420	33.2%	70,533	19.5%	48,959	20.2%
Total revenues, net	293,241	100.0%	362,058	100.0%	242,574	100.0%
Cost of revenues:						
Direct sales	106,990	36.5%	160,360	44.3%	96,472	39.8%
Distribution sales	74,732	25.5%	45,584	12.6%	35,475	14.6%
Total cost of revenues	181,722	62.0%	205,944	56.9%	131,947	54.4%
Gross profit	111,519	38.0%	156,114	43.1%	110,627	45.6%
Operating (expenses) income						
Advertising expenses	(58,470)	(19.9)%	(68,563)	(18.9)%	(58,338)	(24.0)%
Other selling and marketing expenses	(43,377)	(14.8)%	(59,854)	(16.5)%	(50,346)	(20.8)%
General and administrative expenses	(25,434)	(8.7)%	(31,681)	(8.8)%	(27,071)	(11.2)%
Other operating income, net	2,977	1.0%	5,084	1.4%	3,277	1.4%
Total operating (expenses) income	(124,304)	(42.4)%	(155,014)	(42.8)%	(132,478)	(54.6)%
Income (loss) from operations	(12,785)	(4.4)%	1,100	0.3%	(21,851)	(9.0)%
Other (expense) income	4,826	1.6%	7,822	2.2%	5,755	2.4%
Total income tax (expense) benefit	1,539	0.5%	(3,111)	(0.9)%	(1,822)	(0.8)%
Equity in losses of affiliates	(797)	(0.2)%	(772)	(0.3)%		
Income from extraordinary items, net of tax	828	0.3%				
Net income (loss)[1]	(6,389)	(2.2)%	5,039	1.4%	(17,918)	(7.4)%
Net income (loss) attributable to non-controlling interest	(20)	(0.0)%	84	0.0%	(8)	(0.0)%
Net income (loss) attributable to Acorn International, Inc.	(6,409)	(2.2)%	5,123	1.4%	(17,926)	(7.4)%

	For the years ended December 31,		
	2010	2011	2012

	Amount	% of total revenues, net	Amount	% of total revenues, net	Amount	% of total revenues, net
			(in thousands, except for percentages)			
(1) Includes share-based compensation of:						
General and administrative expenses	(215)	(0.0)%	(130)	(0.0)%	(424)	(0.2)%

Table of Contents

The table below summarizes our gross revenues for 2010, 2011 and 2012, broken down by product categories:

	2010 $ 000	Sales %	2011 $ 000	Sales %	2012 $ 000	Sales %
Mobile phones	125,074	42.6	165,958	45.7	64,713	26.6
Fitness products	403	0.1	12,064	3.3	62,630	25.7
Electronic learning products	69,535	23.7	62,539	17.2	41,345	17.0
Collectible products	18,040	6.1	33,194	9.1	20,427	8.4
Health products	12,950	4.4	13,348	3.7	10,692	4.4
Consumer electronics products	14,035	4.8	24,249	6.7	8,490	3.5
Cosmetics products	26,233	8.9	24,857	6.8	7,089	2.9
Auto products	9,753	3.3	1,189	0.3	452	0.2
Other products	17,503	6.1	25,601	7.2	27,442	11.3
Total gross revenues	293,526		362,999		243,280	
Less: sales taxes	(285)		(941)		(706)	
Total revenues, net	293,241		362,058		242,574	

Comparison of Years Ended December 31, 2010, December 31, 2011 and December 31, 2012

Revenues

Our total net revenues, which include direct sales net revenues and distribution sales net revenues, increased 23.5% from $293.2 million in 2010 to $362.1 million in 2011 and decreased 33.0% to $242.6 million in 2012. The decrease in our net revenues in 2012 was primarily due to weak demand and intense competition in China s mobile phone market and lower sales of Ozing electronic learning products as we transitioned the business to focus on Ozing models with mobile internet interactive features and provided higher discounts to our older models of our Ozing electronic learning products in the latter half of the year, partially offset by a strong growth in our fitness products which generally have higher margin.

The increase of $68.8 million in total net revenues in 2011 primarily reflected increased sales of Gionee branded mobile phones and our collectables products through our direct sales platforms, partially offset by decreased distribution sales net revenues as a result of decreased sales of Yukang branded mobile phones, as well as the decreased sales in Ozing electronic learning products due to a slowdown in the electronic learning products market.

In 2010, 2011 and 2012, approximately 66.8%, 80.5% and 79.8% of our total net revenues, respectively, were generated through our direct sales platforms while approximately 33.2%, 19.5% and 20.2% of our total net revenues were generated from our nationwide distribution network, respectively.

Table of Contents

The following table sets forth our three best-selling product lines for our direct sales platforms by net revenues and as a percentage of applicable total direct sales gross revenues for the periods indicated, together with reconciliation to direct sales net revenues:

		2010			2011			2012		
Product	Brand	Revenues	percentage	Rank	Revenues	percentage	Rank	Revenues	percentage	Rank
		(in thousands, except percentages and ranks)								
Direct Sales:										
Mobile phone products	Gionee, K-touch, U-king, Lenovo, Nokia & Konka	$ 101,907	52.0%	1	$ 164,519	56.3%	1	$ 64,475	33.2%	1
Fitness products	Yierjian							$ 61,936	31.9%	2
Collectibles products		$ 18,040	9.2%	3	$ 33,194	11.4%	2	$ 20,193	10.4%	3
Cosmetics products	Aoya, Cobor, Dr Cell, Softto and CMM	$ 26,110	13.3%	2	$ 24,857	8.5%	3			
Direct Sales-total top three		**$ 146,057**	**74.5%**		**$ 222,570**	**76.1%**		**$ 146,604**	**75.5%**	
Other products revenues		$ 50,041	25.5%		$ 69,720	23.9%		$ 47,617	24.5%	
Total direct sales gross revenues		$ 196,098	100%		$ 292,290	100%		$ 194,221	100%	
Total sales tax		$ (277)			$ (765)			$ (606)		
Total direct sales net revenues		$ 195,821			$ 291,525			$ 193,615		

Direct sales net revenues, which include both net proceeds from products sold through our TV direct sales platform and net proceeds from products sold through our other direct sales platforms, increased 48.9% from $195.8 million in 2010 to $291.5 million in 2011 and decreased 33.6% to $193.6 million in 2012. The net decrease of $97.9 million in direct sales net revenues in 2012 primarily reflected a $100.0 million, or 60.8%, decrease in sales of mobile phones as compared to 2011. While mobile phone products remained our best-selling direct sales products, these products accounted for only 33.2% of our direct sales net revenues in 2012 as compared to 56.3% in 2011. Our top three products sold through our direct sales platforms in 2012 were mobile phones, fitness and collectibles products, which collectively accounted for $146.6 million, or 75.5%, of our direct sales gross revenues in 2012.

The net increase of $95.7 million in direct sales net revenues in 2011 primarily reflects our 61.4% increase in sales of mobile phones, led by sales of the Gionee A320 mode, which accounted for 56.3% of direct sales net revenues in 2011, offset by the decline in electronic learning products. Our top three direct sales products in 2011 were mobile phone, cosmetics and collectibles, which accounted for $222.6 million, or 76.1% of our direct sales net revenues in that year.

In addition, our net revenues from other direct sales channels increased from approximately $108.9 million in 2010 to approximately $162.0 million in 2011 and decreased to approximately $91.8 million in 2012. The $70.2 million decrease in net revenues generated from other direct sales channels in 2012 primarily resulted from the decreased sales of our mobile phone products. Our net revenues generated from other direct sales channels accounted for 55.6%, 55.6% and 47.4%, respectively, of our total direct sales net revenues in 2010, 2011 and 2012. The decrease in 2012 was primarily due to we gradually shifted our focus of other direct sales channels from third party bank channels to outbound calls and Internet sales. With our new focus on outbound calls and Internet sales, we expect the relative contribution of other direct sales platforms will increase over time.

Table of Contents

The following table sets forth our three best-selling product lines for our distribution network by net revenues and as a percentage of applicable total distribution sales gross revenues for the periods indicated, together with reconciliation to distribution sales net revenues:

			2010			2011			2012	
Product	**Brand**	**Revenues**	**percentage**	**Rank**	**Revenues**	**percentage**	**Rank**	**Revenues**	**percentage**	**Rank**
					(in thousands, except percentages and ranks)					
Distribution Sales:										
Electronic learning and dictionary products	Ozing & Meijin	$ 63,529	65.2%	1	$ 58,875	83.3%	1	$ 40,294	82.1%	1
Health products	Zehom	$ 4,412	4.5%	3	$ 5.847	8.3%	2	$ 3,983	8.1%	2
Posture correction products	Babaka				$ 3,967	5.6%	3	$ 3,536	7.2%	3
Mobile phone products	Gionee, K-touch, U-king, Lenovo, Nokia & Konka	$ 23,168	23.8%	2						
Distribution sales-total top three		**$ 91,109**	**93.5%**		**$ 68,689**	**97.2%**		**$ 47,813**	**97.4%**	
Other products revenues		$ 6,319	6.5%		$ 2.019	2.8%		$ 1,247	2.6%	
Total distribution sales gross revenues		$ 97,428	100%		$ 70,708	100%		$ 49,060	100%	
Total sales tax		$ (8)			$ (175)			$ (101)		
Total distribution sales net revenues		$ 97,420			$ 70,533			$ 48,959		

Distribution sales net revenues, which are derived from sales of products to our distributors, decreased 27.6% from $97.4 million in 2010 to $70.5 million in 2011 and further decreased 30.6% to $49.0 million in 2012. The net decrease of $21.6 million in our distribution net revenues in 2012 was primarily due to decreased market demand and price discounts offered to distributors on older models of electronic learning products prior to the launch of new models incorporating mobile internet interactive features in the second half of 2012. Our top three distribution sales products in 2012 were our electronic learning products, health products and posture correction products, which accounted for $47.8 million, or 97.4 %, of our distribution sales gross revenues in 2012.

The decrease of $26.9 million in distribution sales net revenues in 2011 was primarily due to the decreased sales of Yukang branded mobile phones, decreased sales of Ozing electronic learning products due to less market demand and decreased sales of auto products through our distribution channels.

Cost of Revenues

Our cost of revenues is primarily dependent upon the mix of products and units sold during the relevant period.

Our total cost of revenues increased from $181.7 million in 2010 to $205.9 million in 2011 and decreased to $131.9 million in 2012 in line with the increase or decrease of our sales level. As a percentage of total net revenues, total cost of revenues was 62.0%, 56.9% and 54.4% in 2010, 2011 and 2012, respectively. The fluctuations in cost of revenues in 2011 and 2012 were primarily as a result of the increase and decrease in sales and a shift in the product mix in 2011 and 2012, respectively.

Direct sales cost of revenues increased 49.9% from $107.0 million in 2010 to $160.4 million in 2011, and decreased 39.8% to $96.5 million in 2012. The fluctuations in 2011 and 2012 primarily reflected the increase and decrease in direct sales in 2011 and 2012, respectively, in particular sales of mobile phone products which generally have higher per-unit costs.

Distribution sales cost of revenues decreased from $74.7 million in 2010 to $45.6 million in 2011, representing a 39.0% decrease in 2011, and further decreased to $35.5 million in 2012, representing a 22.2% decrease in 2012. The decrease in 2012 primarily reflected the decreased sales of electronic learning products. The decrease in 2011 primarily reflected the decreased sales of our mobile phone products.

Gross Profit and Gross Margin

The following table sets forth gross profits and gross margins (being gross profit divided by the related net revenues) for our direct sales and distribution sales platforms:

	For the years ended December 31,					
	2010		2011		2012	
	Gross profit	Gross margin	Gross profit	Gross margin	Gross profit	Gross margin
	(in thousands, except percentages)					
	(in U.S. dollars)					
Direct sales	$ 88,831	45.4%	$ 131,165	45.0%	$ 97,143	50.2%
Distribution sales	22,688	23.3%	24,949	35.4%	13,484	27.5%
Total	$ 111,519	38.0%	$ 156,114	43.1%	$ 110,627	45.6%

Our total gross profits increased from $111.5 million in 2010 to $156.1 million in 2011 and then decreased to $110.6 million in 2012. Our overall gross margin increased from 38.0% in 2010 to 43.1% in 2011 and further increased to 45.6 % in 2012. Changes in our gross margins from period to period are driven by changes in our product mix and the platforms through which we sell them. The increase in gross margin in 2012 was largely due to a shift in product mix to include more sales of fitness products in direct sales, which generally have higher margins, as well as the decreased sales in mobile phone products that generally have lower margins. The increase in gross margin in 2011 was largely due to a shift in product mix to include less sales of mobile phone products in distribution, which generally have lower margins.

We are generally able to maintain stable margins for our individual product lines. Although we discount the prices of individual products as competition enters the market over time, this discounting is typically done in conjunction with our introduction of an upgraded or replacement product with improved features and functions and similar or better pricing. If we are unable to maintain satisfactory gross profits relative to our expenses, we replace or cease marketing such product.

In addition to product mix-related variations, the difference between the sales price charged by us to our TV direct sales customers and what we charge our distributors for the same product accounts for a large portion of the difference in gross margins on direct sales and on distribution sales.

Gross margin on direct sales remained stable at around 45.0% in 2010 and 2011 and increased to 50.2% in 2012. The increase in gross margin on direct sales in 2012 was primarily due to a shift in product mix to include more sales of fitness products, which generally have higher margin.

Gross margin on distribution sales increased from 23.3% in 2010 to 35.4% in 2011 and then decreased to 27.5% in 2012 due primarily to the gross margin decrease in electronic learning products due to fierce competition and greater discounts provided to distributors for promotion of the older models of our Ozing electronic learning products. The increased gross margin on distribution sales in 2011 was primarily due to decrease in mobile phone sales in distribution, which generally have lower margins.

Operating (Expense) Income

Our total operating (expense) income increased from $124.3 million in 2010 to $155.0 million in 2011 and decreased to $132.5 million in 2012. Of the total decrease in 2012, $10.2 million was attributable to the decrease

Table of Contents

in advertising expenses; $9.5 million reflected the decrease in other selling and marketing expenses; and $4.6 million reflected the decrease in general and administrative expenses. These decreases were partially offset by a $1.8 million decrease in other operating income, net. Of the total increase in 2011, $10.1 million was attributable to the increase in advertising expenses; $16.5 million reflected the increase in other selling and marketing expenses; and $6.2 million reflected the increase in general and administrative expenses. Total operating expense, as a percentage of total net revenue, increased from 42.4% in 2010, to 42.8% in 2011 and further to 54.6 % in 2012.

Advertising Expenses

Our advertising expenses increased from $58.5 million in 2010 to $68.6 million in 2011 and then decreased to $58.3 million in 2012. As a percentage of total net revenues, advertising expenses decreased from 19.9% in 2010 to 18.9% in 2011, and then increased to 24.0% in 2012. The overall decrease in advertising expenses in 2012 was primarily as a result of switching to some TV channels with higher media returns and allocating more non-prime time with lower rates, and the increase in advertising expenses as a percentage of our net revenues reflected our lower media efficiency in 2012 which was primarily due to the decline in our sales and higher overall media prices. The overall increase in advertising expenses in 2011 primarily reflects our increased media procurement in accordance with our new media strategy.

Advertising expenses related to purchased TV advertising time increased by 16.3% from $54.7 million in 2010 to $63.6 million in 2011 and decreased by 14.3% to $54.5 million in 2012. The decrease of purchased TV advertising expenses in 2012 was mainly due to a shift in our TV channel mix to include channels with higher media returns and allocating more non-prime time with lower rates. The $10.1 million increase of purchased TV advertising expenses in 2011 was mainly due to the sharply increase of average per minute advertising cost from $215 in 2010 to $342 in 2011.

Other Selling and Marketing Expenses

Our other selling and marketing expenses increased 38.0% from $43.4 million in 2010 to $59.9 million in 2011 and then decreased 15.9% to $50.3 million in 2012. Our other selling and marketing expenses as a percentage of total net revenues were 14.8%, 16.5% and 20.8% in 2010, 2011 and 2012, respectively. The decrease of other selling and marketing expenses in 2012 is related to salaries and commissions for our call center personnel, advertising program production cost, catalog publishing cost and telephone and short message and distribution promotion cost, which are in line with the decreased sales in 2012. The increase in 2011 is related to the increased delivery costs, higher salaries and commissions paid to our call center personnel and expenses of SMS, which is in line with our increased sales in 2011.

General and Administrative Expenses

Our general and administrative expenses increased 24.6% from $25.4 million in 2010 to $31.7 million in 2011, and then decreased 14.6% to $27.1 million in 2012. Our general and administrative expenses as a percentage of total net revenues was 8.7%, 8.8% and 11.2% in 2010, 2011 and 2012, respectively. Of the total $4.6 million decrease in general and administrative expenses in 2012, $3.6 million was attributable to a decrease in bad debt charges, and an additional $0.5 million was attributable to a decrease in consulting service expenses. Of the total $6.2 million increase in general and administrative expenses in 2011, $1.6 million was attributable to an increase in consulting service expenses and $4.2 million was attributable to an increase in bad debt charges. The increase in bad debt provision in 2011 was primarily related to bad debt allowance provided for the receivable from certain local delivery companies which became insolvent in 2011.

Other Operating Income, Net

Other operating income, net, consisting of government subsidy and miscellaneous commission income, was $3.0 million, $5.1 million and $3.3 million, in 2010, 2011 and 2012, respectively. A majority of other operating income net in those periods related to our receipt of subsidies from local government agencies for certain taxes paid, including value-added, business and income taxes as well as part of the incentives provided by local government for our investment in local district. The subsidy income in 2010, 2011 and 2012 amounted to $2.6 million, $3.0 million and $3.0 million, respectively. We may not be able to enjoy such government subsidies in the future. See Item 3.D, Key Information Risk Factors The discontinuation of any of the preferential tax treatments and government subsidies available to us in the PRC could materially and adversely affect our results of operations and financial condition .

Income (Loss) from Operations

We recorded losses from operations $12.8 million and $21.9 million in 2010 and 2012, respectively, and we recorded an income from operations of $1.1 million in 2011. As a percentage of total net revenues, our losses (income) from operations were (4.4) %, 0.3 %, (9.0) % in 2010, 2011 and 2012, respectively.

Other Income

Our other income was $4.8 million, $7.8 million and $5.8 million, in 2010, 2011 and 2012, respectively. In 2010, 2011 and 2012, our other income included $1.3 million, $2.1 million and $3.3 million, in interest income, respectively, and $3.4 million, $5.9 million and $0.6 million in investment gain respectively. In addition, $1.9 million other income from sale of our E-Roda trademark was recorded in 2012.

We recorded a $0.2 million investment loss in 2010, $0.3 million investment gain in 2011, respectively, due to the change in fair value of the embedded derivative in our investment in an index-linked structured note. See Item 5.A. Critical Accounting Policies Derivative Instruments for details. As of December 31, 2011, we have disposed the index-linked structure note held by us. We did not have any investment related to such derivative in 2012.

Income Tax Benefit (Expenses)

We had a net tax benefit of $1.5 million in 2010, and a net tax expense of $3.1 million and $1.8 million in 2011 and 2012, respectively. Our effective income tax rate for 2010, 2011 and 2012 was 19%, 35% and (11)%, respectively.

Equity in losses of affiliates

In July 2008, we invested 30.0% equity interests in Kela (Hong Kong) Jewelry Investment Limited (Kela) for cash of $1.2 million. In October 2009, we increased our investment in Kela from 30.0% to 35.0%. In July 2010, our investment in Kela decreased from 35.0% to 22.1% as a result of dilution due to issuance of additional shares by Kela to new investors. As we had the ability to exercise significant influence over Kela, we accounted for this investment using the equity method of accounting. In May 2011, we sold all our equity interests in Kela to another shareholder of Kela, a third party of our Company, for cash of RMB39.6 million ($6.1 million USD equivalent). The gain on the disposition of the investment in Kela in 2011 was $5,421,753 and was recognized in other income in the consolidated statement of operations. Our equity in losses of Kela in 2010 and 2011 were $443,123 and $28,567, respectively, and were recognized in equity in losses of affiliates in the consolidated statements of operations.

In June 2009, we invested 26.0% equity interests in KYOBI Cosmetics (Hong Kong) Co., Limited (KYOBI) for cash of RMB8.0 million ($1.2 million USD equivalent). As we had the ability to exercise significant influence over KYOBI, we accounted for this investment using the equity method of accounting. Our equity in losses of KYOBI in 2009 was $403,986 and was recognized in other expenses in the consolidated statement of operations. In April 2010, we sold all its equity interests in KYOBI to another shareholder of KYOBI, a third party of our Company, for cash of RMB8.0 million ($1.2 million USD equivalent). The gain on the disposition of the investment in KYOBI in 2010 was $404,750 and was recognized in other income in the consolidated statement of operations.

In January 2010, Shanghai An-Nai-Chi, a company which previously was a 51.0% equity-owned consolidated subsidiary of our Company, received a cash injection of $1.5 million from a third party of our Company. After the cash injection, we retained 33.2% equity interests in Shanghai An-Nai-Chi and no longer had control in Shanghai An-Nai-Chi. As we held one out of five board seats on the Board of Shanghai An-Nai-Chi and had significant influence over financial and operating decision-making after deconsolidation, we accounted for the retained 33.2% equity interests using the equity method of accounting. The retained investment was re-measured at fair value of $1.1 million on the date we deconsolidated Shanghai An-Nai-Chi. Our equity in losses of Shanghai An-Nai-Chi in 2010 and 2011 were $353,598 and $743,153, respectively, and were recognized in equity in losses of affiliates in our consolidated statement of operations. The carrying amount of the investment in Shanghai An-Nai-Chi has been reduced to zero as of December 31, 2011. Therefore, we did not recognize any equity in losses of Shanghai An-Nai-Chi in 2012 as the Company has not obligations to fund losses.

Income from extraordinary items, net of tax

We recorded an income from extraordinary items of $0.8 million in 2010, which reflects an extraordinary gain as a result of a reversal of the business combination liability as no earn-out payment in relation to the acquisition of Yiyang Yukang was made in 2010.

Net Income (Loss) Attributable to Non-controlling Interests

Net income (loss) attributable to non-controlling interests consist of the 49% or less outside ownership interests in our majority-owned subsidiaries. In 2010, 2011 and 2012, the non-controlling interests totaled $19,589, $(83,843) and $7,679, respectively.

Net Income (Loss) Attributable to Acorn International, Inc

As a result of the foregoing, net income increased from a net loss of $6.4 million in 2010 to a net income of $5.1 million in 2011 and decreased to a net loss of $17.9 million in 2012. As a percentage of total net revenues, net income (loss) were (2.2) %, 1.4% and (7.4) % in 2010, 2011 and 2012, respectively.

B. Liquidity and Capital Resources