ASIAINFO HOLDINGS INC
Form 10-Q
May 14, 2002

==

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

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

FOR THE TRANSITION PERIOD FROM ---- TO ----

Commission File Number 001-15713

ASIAINFO HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	752506390
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4TH FLOOR, ZHONGDIAN INFORMATION TOWER
6 ZHONGGUANCUN SOUTH STREET, HAIDIAN DISTRICT
BEIJING 100086, CHINA
(Address of principal executive office, including zip code)

+8610 6250 1658
(Registrant's telephone number, including area code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [_]

The number of shares outstanding of the Registrant's common stock as of May 10, 2002 was 43,421,854

==

ASIAINFO HOLDINGS, INC.

FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2002
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In US Dollars thousands, except per share amounts)

	Three Months Ended March 31,	
	2001	2002
	(unaudited)	
Revenues:		
Network solutions.........................	$ 29,909	$ 21,731
Software solutions........................	5,870	6,806

Total revenues	35,779	28,537
Cost of revenues:		
Network solutions	23,643	15,253
Software solutions	857	1,996
Total cost of revenues	24,500	17,249
Gross profit	11,279	11,288
Operating expenses:		
Sales and marketing (excluding stock-based compensation: 2001: $211; 2002: $27 and amortization of acquired intangible assets: 2001: nil; 2002: $225)	5,627	3,569
General and administrative (excluding stock-based compensation: 2001: $158; 2002: $92 and amortization of acquired intangible assets: 2001; nil; 2002: $32)	3,606	3,545
Research and development (excluding stock-based compensation: 2001: $68; 2002: $33 and amortization of acquired intangible assets: 2001: nil; 2002: $61)	1,632	2,264
Amortization of deferred stock compensation	437	152
In-process research and development	-	350
Amortization of acquired intangible assets	-	318
Total operating expenses	11,302	10,198
(Loss) income from operations	(23)	1,090
Other income (expense):		
Interest income	2,386	734
Interest expense	(327)	(44)
Other (expenses) income, net	(7)	1
Total other income, net	2,052	691
Income before income taxes, minority interests and equity in loss of affiliate	2,029	1,781
Income tax expense	471	267
Income before minority interests	1,558	1,514
Minority interests in (income) loss of consolidated subsidiaries	(179)	35
Equity in loss of affiliate	-	(127)
Net income	$ 1,379	$ 1,422
Net income per share:		
Basic	$ 0.03	$ 0.03
Diluted	$ 0.03	$ 0.03
Shares used in computation:		
Basic	40,967,627	42,430,509

Diluted..................................	45,148,897	45,884,452

See notes to condensed consolidated financial statements.

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In US Dollars thousands, except per share amounts)

	December 31,	March
	2001	200
		(unaudi
ASSETS		
Current Assets:		
Cash and cash equivalents...........................	$ 110,635	$ 10
Restricted cash.....................................	13,475	1
Short-term investments..............................	27,184	1
Accounts receivable, trade (net of allowance for doubtful accounts of $1,094 and $2,407 at December 31, 2001 and March 31, 2002, respectively)	66,723	8
Inventories - hardware and parts....................	1,180	
Other receivables...................................	10,533	
Deferred income taxes - current.....................	1,689	
Prepaid expenses and other current assets...........	1,417	
Total current assets..............................	232,836	23
Property and equipment - net..........................	5,376	
Goodwill..	2,188	3
Other acquired intangibles - net......................	-	
Investment in affiliate...............................	5,272	
Deferred income taxes.................................	188	
Total Assets......................................	$ 245,860	$ 29
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Short-term bank loans...............................	$ 2,924	$
Accounts payable....................................	23,789	2
Other payables......................................	1,682	2
Deferred revenue....................................	4,279	
Accrued employee benefits...........................	9,088	
Accrued expenses....................................	11,431	1
Income taxes payable................................	4,743	
Other taxes payable.................................	2,524	
Total current liabilities.........................	60,460	8
Deferred income taxes.................................	-	
Total Liabilities.................................	60,460	8
Minority interest.....................................	610	

Stockholders' Equity:		
Common stock, 100,000,000 shares authorized, $0.01 par value, shares issued and outstanding: 2001: 42,132,818; 2002: 42,663,941	421	
Additional paid-in capital	178,649	19
Deferred stock compensation	(512)	
Retained earnings	6,204	
Accumulated other comprehensive income	28	
Total stockholders' equity	184,790	20
Total Liabilities and Stockholders' Equity	$ 245,860	$ 29

See notes to condensed consolidated financial statements.

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In US Dollars thousands, except per share amounts)

	Three Months Ended March 31, 2001	2002
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 1,379	1,422
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	556	668
Amortization of goodwill	264	-
Amortization of other acquired intangible assets	-	318
In-process research and development	-	350
Amortization of deferred stock compensation	437	152
Deferred income taxes	(35)	(24)
Minority interest in income (loss) of consolidated subsidiaries	179	(35)
Equity in loss of an affiliate	-	127
Loss on disposal of property and equipment	6	12
Bad debt expense	(99)	998
Changes in operating assets and liabilities, net of effects of business acquired:		
Restricted cash	(1,745)	1,893
Accounts receivable	10,257	(5,089)
Inventories	8,615	(957)
Other receivables	(1,116)	1,086
Prepaid expenses and other current assets	(514)	(956)
Accounts payable	(10,298)	(3,952)
Other payables	(646)	(1,158)
Deferred revenue	(8,363)	1,408
Accrued employee benefits	(2,126)	257
Accrued expenses	(1,067)	1,521

Income taxes payable	469	291
Other taxes payable	(7)	18
Net cash (used in) operating activities	(3,854)	(1,650)
Cash flows from investing activities:		
(Increase) decrease in short-term investments	(19,501)	8,542
Purchases of property and equipment	(875)	(397)
Proceeds on disposal of property and equipment	1	-
Increase in loan receivable	-	(3,572)
Purchase of a subsidiary, net of cash acquired	-	(4,637)
Net cash (used in) provided by investing activities	(20,375)	(64)

ASIAINFO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS--(CONTINUED)
(In US Dollars thousands, except per share amounts)

	Three Months Ended March 31,	
	2001	2002
	(unaudited)	
Cash flows from financing activities:		
Increase in short-term bank loans	$ 15,705	701
Repayment of short-term bank loans	(12,914)	(2,754)
Proceeds on exercise of stock options	566	736
Net cash provided by (used in) financing activities	3,357	(1,317)
Net (decrease) in cash and cash equivalents:	(20,872)	(3,031)
Cash and cash equivalents at beginning of period	48,834	110,635
Effect of exchange rate changes on cash and cash equivalents	3	16
Cash and cash equivalents at end of period	$ 27,965	107,620
Supplemental cash flow information:		
Cash paid during the period:		
Interest	$ 324	42
Income taxes	$ 38	-

Non-cash investing activity:

In February 2002, the Company acquired 100% of the outstanding equity shares of Bonson for cash of $33,387, $624 of which represented acquisition costs, and the issuance of 1,031,686 shares of common stock with a fair market value at the time the acquisition was announced of approximately $18,003. Of the cash amount, $23,004 was payable as of March 31, 2002. In connection with the acquisition, the Company acquired tangible assets with a fair value of $28,364 and assumed liabilities of $17,737 (see Note 10).

See notes to consolidated financial statements.

-6-

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three Months Ended March 31, 2001 and 2002
(In US Dollars thousands, except per share amounts)

1. GENERAL AND BASIS OF PREPARATION

AsiaInfo Holdings, Inc. (the "Company") is incorporated in the State of Delaware, in the United States ("US"). The Company principally operates through the following directly owned subsidiaries, or their respective subsidiaries: AsiaInfo Technologies (China), Inc. ("AI Technology") (100% owned), Guangdong Wangying Information Technology Co., Ltd. ("Wangying") (40% owned, but controlled by the Company), both incorporated in the People's Republic of China ("China" or the "PRC"), Marsec Holdings, Inc. ("Marsec") (79% owned), and Bonson Information Technology Holdings Limited, ("Bonson") (100% owned), both incorporated in the Cayman Islands.

On March 2, 2000, the Company completed an initial public offering of 5,750,000 shares of its common stock, raising net proceeds of $126,610. The Company's common stock is traded on The Nasdaq National Market in the United States.

The Company acts as a holding company and sources network-related equipment in the United States for sale to customers in the PRC.

AI Technology was established as a wholly foreign owned enterprise with an initial operating term of 15 years commencing May 2, 1995 (date of establishment). Its principal activities are conducted in the PRC and comprise the provision of Internet-related information technology professional services and software products. In November 2001, the Company merged its wholly owned subsidiary, Zhejiang AsiaInfo Telecommunication Technology Co., Ltd. ("AI Zhejiang"), into AI Technology. AI Zhejiang's activities were performed in the PRC and comprised the development and sale of communication hardware and software as well as providing related technology services. AI Zhejiang was acquired in April 1999, and its results of operations are included in the Company's financial statements from the date of acquisition.

On December 31, 2001, AI Technology formed a wholly owned subsidiary, AsiaInfo Technologies (Chengdu), Inc., with an initial operating term of 15 years to provide hardware procurement support for network solution projects.

Wangying was established on September 6, 2000 with an initial operating term of 4 years for a particular customer project in the PRC.

Marsec, through its wholly owned subsidiary, provides internet security consulting and services in the PRC. In September 2001, the Company exercised warrants to purchase 200,000 additional voting preferred shares of Marsec at $3.50 a share increasing its investment in Marsec from 75% to 79%.

On April 27, 2001, the Company invested $6,157 to acquire a 14.25% interest (voting preferred shares) in Intrinsic Technology (Holdings), Ltd. ("Intrinsic"), a Cayman Islands company engaged in wireless infrastructure solutions development through two wholly-owned subsidiaries in the PRC.

In 2000, the Company dissolved its subsidiary AsiaInfo-CTC Network Systems Inc.

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

In February 2002, the Company acquired 100% of the outstanding equity shares of Bonson, a leading developer of wireless telecommunications software and solutions, operating through its subsidiary Guangzhou Bonson Technology Limited based in Guangzhou, China, for cash of $32,763 and the issuance of 1,031,686 shares of common stock. (See Note 10).

The consolidated financial statements of the Company include the accounts of the Company and its subsidiaries. Intercompany transactions and balances have been eliminated. Investments in 50% or less owned affiliates over which the Company exercises significant influence, but not control, are accounted for using the equity method.

In the Company's opinion, all adjustments necessary for a fair presentation of the unaudited results of operations for the three months ended March 31, 2001 and 2002 are included in the accompanying condensed financial statements. All such adjustments are accruals of a normal and recurring nature. The results of operations for the periods are not necessarily indicative of the results of operations for the full year. The financial statements are unaudited.

Revenue from network solutions contracts, which includes the procurement of hardware on behalf of customers, systems design, planning, consulting and system integration is recognized based on the percentage of completion method. Labor costs and direct project expenses are used to determine the stage of completion except for revenues associated with the procurement of hardware. Such hardware-related revenues are recognized upon delivery. Estimates of hardware warranty costs are included in determining project costs.

Software solutions revenues represent license fees and related services that allow customers to use the Company's software products in perpetuity up to a maximum number of users. Contract revenue from software license fees and software implementation services, which generally represent customer orders requiring significant production, modifications, or customization of the software, is recognized in conjunction with the revenues of the related solutions project over the installation and customization period based on the percentage of completion of the project as measured by labor costs and direct project expenses.

Revenue from packaged software license fees through resellers is recognized upon the delivery and installation of the software. Costs related to insignificant obligations for a period up to one year, which include telephone support, are accrued at the time the revenue is recorded. Software revenues include the benefit of the rebate of value added taxes on sales of software received from the tax authorities as part of the PRC government's policy of encouragement of software development in the PRC. The rebate was approximately $672 and $650 for the three months ended March 31, 2001 and 2002, respectively.

Revisions in estimated contract profits are made in the period in which the circumstances requiring the revision become known. Provisions, if any, are made currently for anticipated losses on uncompleted contracts. Revenue in excess of billings is recorded as unbilled receivables and included in trade accounts receivable, and amounted to $45,910 at December 31, 2001 and $55,716 at March 31, 2002. Billings in excess of revenues recognized are recorded as deferred income. Billings are rendered based on agreed milestones included in the contracts with customers. At December 31, 2001 and March 31, 2002, the balance of trade accounts receivable of $20,813 and $26,350 respectively, represented amounts billed but not

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

yet collected. All billed and unbilled amounts are expected to be collected within 1 year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at December 31, 2001 and March 31, 2002 and the reported amounts of revenues and expenses during the three months ended March 31, 2001 and 2002. Actual results could differ from those estimates.

The financial records of the Company's PRC subsidiaries are maintained in Renminbi ("RMB"), their functional currency and the currency of the PRC. Their balance sheets are translated into United States dollars based on the rates of exchange ruling at the balance sheet date. Their statements of operations are translated using a weighted average rate for the period. Translation adjustments are reflected as accumulative translation adjustments in stockholders' equity.

The Renminbi is not fully convertible into United States dollars or other foreign currencies. The rate of exchange quoted by the People's Bank of China on March 31, 2002 was US$1.00=RMB8.2774. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollars at that rate or at any other rate.

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. Effective January 1, 2002, the Company discontinued amortization of its existing goodwill of $7,068, which arose from the acquisition of AI Zhejiang and the investment in Intrinsic, and was being amortized over 5 years. This resulted in the elimination of amortization expenses of $546 in the three months ended March 31, 2002. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles such as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairment of certain intangible assets, including goodwill. The effects of adopting the non-amortization provisions of SFAS No. 142, assuming these provisions were adopted as of January 1, 2001, are summarized at Note 4. SFAS No. 142 also requires the

Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is currently performing, but has not yet completed, the transitional goodwill impairment test which is expected to be completed by June 30, 2002.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 addresses the financial accounting and reporting requirements for the impairment or disposal of long-lived assets and discontinued operations. SFAS No. 144 applies to all recorded long-lived assets that are held for use or that will be disposed of, but excludes goodwill and other intangible assets that are not amortized. SFAS No. 144 was adopted by the Company on January 1, 2002. Adoption of SFAS No. 144 did not have a significant effect on the Company's financial position, results of operations or cash flows.

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three Months Ended March 31, 2001 and 2002
(In US Dollars thousands, except per share amounts)

1. GENERAL AND BASIS OF PREPARATION - CONTINUED

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for the recognition of obligations associated with the retirement of tangible long-lived assets. SFAS No. 143 is effective for financial statements issued for years beginning after June 15, 2002. Management does not believe that the adoption of SFAS No. 143 will have a significant impact on its financial position or results of operations.

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on hand, demand deposits and highly liquid investments, which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased.

3. SHORT-TERM INVESTMENTS

Short-term investments are classified as available for sale and consist principally of certificates of deposit issued by major financial institutions which have maturities of between 6 and 12 months. As there are no significant market price movements, such investments are held at cost and accrued interest. There were no realized or unrealized gains or losses as of March 31, 2002.

4. GOODWILL-ADOPTION OF SFAS No. 142

The following table summarizes the effect of adopting the non-amortization provisions of SFAS No. 142, assuming these provisions were adopted as of January 1, 2001.

	Three Months Ended March 31,	
	2001	2002
Reported net income	$ 1,379	$ 1,422
Add back: Goodwill amortization	264	-

(In US Dollars thousands, except per share amounts)

Adjusted net income	$ 1,643	$ 1,422
Basic earnings per share:		
Reported net income	$ 0.03	$ 0.03
Goodwill amortization	0.01	-
Adjusted net income	$ 0.04	$ 0.03
Diluted earnings per share:		
Reported net income	$ 0.03	$ 0.03
Goodwill amortization	0.01	-
Adjusted net income	$ 0.04	$ 0.03

5. COMPREHENSIVE INCOME

The components of comprehensive income for the periods presented are as follows:

	Three Months
	2001
Net income...	$1,379
Change in cumulative translation adjustment..............................	(2)
Comprehensive income...	$1,377

6. SHORT-TERM BANK LOANS

As of March 31, 2002, the Company had total short-term credit facilities for working capital purposes totaling $23,870 mainly expiring by June 2002. The facilities were secured by bank deposits of $15,551 as of March 31, 2002. At March 31, 2002, unused short-term credit facilities were $20,083 and used facilities totaled $3,787 of which $1,467 was used for issuing standby letters of credit provided to hardware suppliers. Additional borrowings of $410 were secured by bank deposits of $350 and Bonson's net assets which approximated $10,547 as of March 31, 2002. All the borrowings were in RMB, the currency of the PRC. The loans carry interest from 4.8% to 5.733% per annum and are repayable within one year. Additional bank deposits of $208 were used for issuing a standby letter of credit as of March 31, 2002. Bank deposits pledged as security for these credit facilities totaled $13,475 and $16,109 as of December 31, 2001 and March 31, 2002, respectively, and are presented as restricted cash in the condensed consolidated balance sheets.

7. INCOME TAXES

The Company is subject to US federal and state income taxes. The Company's subsidiaries incorporated in the PRC are subject to PRC income taxes.

A reconciliation between the provision for income taxes computed by applying the US federal tax rate to income before income taxes, minority interest and equity in loss of affiliate and the actual provision for income taxes is as follows:

	Three Months Ended March 31,	
	2001	2002
US federal rate	35%	35%
Differences between statutory rate and foreign effective tax rate	(20)	(24)
Expenses not deductible for tax purpose - deferred stock compensation expense and other	8	4
	23%	15%

8. CAPITAL STOCK

Option activity in the Company's stock option plans is summarized as follows:

	Number of shares	Outstandi weighte exercise pr
Outstanding, January 1, 2002:	8,309,168	$
Granted	24,600	1
Cancelled	(255,740)	1
Exercised	(172,563)	
Outstanding, March 31, 2002	7,905,465	$

The exercise price of all options granted during the three months ended March 31, 2002 was equal to the fair market value of the Company's common stock on the dates of grant.

9. NET INCOME PER SHARE

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations:

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2002
Net income (numerator):		
Net income		
Basic and diluted..........................	$ 1,379	$ 1,422
Shares (denominator):		
Weighted average		
Common Stock Outstanding..................	40,967,627	42,430,509
Basic......................................	40,967,627	42,430,509
Options (Treasury Method)..................	4,181,270	3,453,943
Diluted....................................	45,148,897	45,884,452
Net income per share:		
Basic......................................	$ 0.03	$ 0.03
Diluted....................................	$ 0.03	$ 0.03

During the first quarter of 2001 and 2002, the Company had 2,707,220 and 1,333,140 options outstanding, respectively, which could have potentially diluted earnings per share ("EPS") in the future, but which were excluded in the computation of diluted EPS in these periods, as their exercise prices were above the average market values in such periods.

10. ACQUISITION

On February 6, 2002, the Company completed the acquisition of Bonson. The acquisition was accounted for as a purchase in accordance with SFAS No. 141, "Business Combinations." Under the terms of the share purchase agreement, the Company acquired all outstanding capital stock of Bonson by paying $32,763 in cash and issuing approximately 1,031,686 shares of Company common stock. The total purchase price as of February 6, 2002 has been allocated to the assets acquired and liabilities assumed based on their respective fair values as follows, (in thousands):

Total purchase price:		
Cash consideration	$ 32,763	
Common stock	18,003	
Acquisition expenses	624	
	$ 51,390	
Purchase Price Allocation:		
Fair market value of net tangible assets acquired at February 6, 2002	$ 10,627	
Intangible assets acquired:		Economic Life
Core technology	1,280	3.5 years
Trade name	700	Indefinite
Contract backlog	2,700	2 years
Favorable lease	400	2.1 years
License	700	Indefinite
In-process technology	350	
Goodwill	35,067	Indefinite
Deferred tax liabilities	(434)	

	$ 51,390

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three Months Ended March 31, 2001 and 2002
(In US thousands, except per share amounts)

10. ACQUISITION - CONTINUED

The Company recorded a one-time charge of $350 in the first quarter of 2002 for purchased in-process technology related to a development project that had not reached technological feasibility, had no alternative future use, and for which successful development was uncertain. The conclusion that the in-process development effort, or any material sub-component, had no alternative future use was reached in consultation with the Company and Bonson's management.

The following selected unaudited pro forma combined results of operations for the three months ended March 31, 2001 and 2002 of the Company and Bonson have been prepared assuming that the acquisitions occurred at the beginning of the periods presented. The following pro forma financial information is not necessarily indicative of the results that would have occurred had the acquisition been completed at the beginning of the period indicated nor is it indicative of future operating results (in thousands, except per share data):

	Three Months Ended March 31,	
	2001	2002
Total revenue	$ 39,107	$ 29,068
Net income	984	1,100
Net income per share		
- Basic	$ 0.02	$ 0.03
- Diluted	$ 0.02	$ 0.02
Shares used in calculation of net income per share		
- Basic	41,999,313	43,268,662
- Diluted	46,180,583	46,722,605

The pro forma results of operations give effect to certain adjustments, including amortization of purchased intangibles with definite lives, associated with the acquisition. The charge for purchased in-process research and development of $350 has been excluded from the pro forma results, as it is a material non-recurring charge.

ASIAINFO HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
Three Months Ended March 31, 2001 and 2002
(In US thousands, except per share amounts)

11. SEGMENT AND GEOGRAPHIC OPERATING INFORMATION

Information on the Company's operating segments is as follows:

Three Months Ended March 31,

	2001	2002
	(unaudited)	
Revenues net of hardware cost:		
Network solutions net of hardware cost	$ 8,336	$ 10,268
Software solutions	5,870	6,806
Consolidated revenues net of hardware cost	14,206	17,074
Consolidated cost of sales net of hardware cost	2,927	5,786
Consolidated gross profit	$ 11,279	$ 11,288
Gross profit:		
Network solutions	$ 6,266	$ 6,478
Software solutions	5,013	4,810
Consolidated gross profit	$ 11,279	$ 11,288
Depreciation and amortization:		
Network solutions	$ 504	$ 593
Software solutions	316	393
	$ 820	$ 986
Amortization of deferred stock compensation:		
Network solutions	$ 217	$ 71
Software solutions	220	81
	$ 437	$ 152
Amortization of acquired intangible assets:		
Network solutions	$ -	$ 155
Software solutions	$ -	$ 163
	$ -	$ 318
(Loss) income from operations:		
Network solutions	$ (138)	$ 1,917
Software solutions	115	(827)
Consolidated (loss) income from operations	$ (23)	$ 1,090

For the three months ended March 31, 2001 and 2002, almost all of the Company's revenues have been derived from sales to customers in the People's Republic of China. Revenues are attributed to the country based on the country of installation of hardware, software and performance of system integration work and software related service. Also, as of December 31, 2001 and March 31, 2002, 99% of the Company's long-lived assets are located in the People's Republic of China.

12. COMMITMENTS AND CONTINGENCIES

On December 4, 2001, a securities class action suit was filed in the United States against the Company, certain of the Company's directors and the co-lead underwriters involved in the Company's Initial Public Offering ("IPO") on behalf of all persons and entities who purchased, converted, exchanged or otherwise acquired the common stock of the Company between March 2, 2000 and December 6, 2000, inclusive. The complaint alleges that the Company and certain of its officers and directors at the time of the IPO violated the federal securities laws by issuing and selling the Company's common stock pursuant to the IPO without disclosing to investors that several of the underwriters of the IPO had solicited and received excessive and undisclosed commissions from certain investors. The plaintiffs seek class action certification and claim for an unspecified amount of damages. While the outcome of this litigation is uncertain, management believes

12. COMMITMENTS AND CONTINGENCIES - CONTINUED

that the Company has meritorious defenses to the suit and intends to vigorously defend the action. In addition, management believes that the co-lead underwriters may have an obligation to indemnify the Company for the legal fees and other costs of defending this suit and that the Company's directors' and officers' liability insurance policies may also cover the defense and exposure or settlement of the suit.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information, the statements contained in this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 (the "Reform Act") contains certain safe harbors regarding forward-looking statements. Certain of the forward-looking statements include management's expectations, intentions and beliefs with respect to our growth, our operating results, the nature of the industry in which we are engaged, our business strategies and plans for future operations, our needs for capital expenditures, capital resources and liquidity; and similar expressions concerning matters that are not historical facts. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. These cautionary statements are being made pursuant to the provisions of the Reform Act with the intention of obtaining the benefits of the safe harbor provisions of the Reform Act. Among the factors that could cause actual results to differ materially are the factors discussed below under the heading "Factors Affecting our Operating Results and our Common Stock."

OVERVIEW

We are a leading provider of telecommunications network integration and management solutions in China. Our software products and network services enable our customers to build, maintain, operate, manage and continuously improve their Internet and telecommunications infrastructure.

We commenced our operations in Texas in 1993 and moved our operations from Texas to China in 1995. We began generating significant network solutions revenues in

1996 and significant software solutions revenues in 1998. While we source hardware for our customers through our U.S. parent company, AsiaInfo Holdings, Inc., and certain subsidiaries, we conduct the bulk of our business through our wholly-owned operating subsidiary, AsiaInfo Technologies (China) Inc., or AsiaInfo Technologies, which is a Chinese company.

Historically, our customer base was concentrated, with sales to China Telecommunications Corporation, or China Telecom, and its provincial subsidiaries accounting for approximately 80%, 35% and 45% of our revenues net of hardware costs in fiscal 1999, 2000 and 2001, respectively. However, our customer base has diversified significantly and, at March 31, 2002, approximately 15% of our backlog net of hardware costs was attributable to China Telecom, while 26% was attributable to China United Telecommunications Corporation, or China Unicom, 45% was attributable to China Mobile Communications Corporation, or China Mobile, and 4% was attributable to China Network Communications Corporation, or China Netcom.

We believe that there are opportunities for us to expand into new business areas and to grow our business both organically and through acquisitions. On February 6, 2002, we completed our acquisition of Bonson Information Technology Holdings Limited, or Bonson, a leading provider of operation support system solutions to wireless telecommunications carriers in China. The consideration paid to the former shareholders of Bonson consisted of $32.76 million in cash and 1,031,686 shares of our common stock which were valued at approximately $18 million at the time the acquisition was announced. The cash we

paid in connection with the acquisition was paid out of our existing cash reserves. On a stand-alone basis in 2002, we anticipate that Bonson will generate net revenue of $12 million to $13 million, operating profit of $4.5 million to $5.5 million, and net income of $3.8 million to $4.6 million. Bonson's operating results have been consolidated with our operating results from February 6, 2002, and the acquisition is expected to add approximately $0.04 to $0.05 to our 2002 earnings per share. Previously, we anticipated that Bonson would contribute $0.08 to $0.10 to our 2002 earnings per share but have revised this figure downwards on the basis of intangible assets we will be required to amortize in connection with the acquisition. We will amortize a total of $4.4 million in intangible assets, including Bonson's intellectual property and contract backlog, over a period of two to three years. (For more details, see Note 10 to our Financial Statements included in this Report.) However, we have not revised our full year 2002 pro forma earnings guidance of $0.41 to $0.43 per basic share. In view of the Bonson acquisition and potential future acquisitions we may engage in, our historical operating results may not be an adequate basis on which to evaluate our prospects.

As of December 31, 2001, we had invested a total of $2.7 million in our majority-owned network security business, Marsec System Inc., or Marsec, which focuses on high-end security services for our customers. Marsec's operating results are consolidated with our operating results for financial reporting purposes.

On April 27, 2001, we invested approximately $6.2 million to acquire a 14.25% equity interest in Intrinsic Technology (Holdings), Ltd., or Intrinsic, a company organized in the Cayman Islands and engaged in wireless Internet application and development through its two wholly-owned subsidiaries in China. We account for our interest in Intrinsic using the equity method.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to revenues and cost of revenues under customer contracts, warranty obligations, bad debts, income taxes, investment in affiliate, goodwill and other intangible assets, and litigation. We base our estimates and judgments on historical experience and on various other factors that we believe are reasonable. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

REVENUES AND COST OF REVENUES. We derive a significant portion of our revenue from fixed-price contracts using the percentage of completion method, which relies on estimates of total expected contract revenue and costs. We follow this method since reasonably dependable estimates of the revenue and costs applicable to various stages of a contract can be made. Recognized revenues and profit are subject to revisions as the contract progresses to completion. Revisions in profit estimates are charged to income in the period in which the facts that give rise to the revisions become known. Accordingly, changes in our estimates would impact our future operating results.

WARRANTY OBLIGATIONS. We record our estimate of warranty costs at the time revenue is recognized. While we obtain manufacturers' warranties for hardware we sell, we record our obligations based on historical experience. Future warranty costs, which vary from our past experience, could require us to adjust our accrual for warranty obligations, thereby impacting our future operating results.

BAD DEBTS. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to change, changes to these allowances may be required, which would impact our future operating results.

INCOME TAXES. We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. In the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of their recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

INVESTMENT IN AFFILIATE. We account for our 14.25% interest in Intrinsic using the equity method. Intrinsic has incurred operating losses since our investment in April 2001. Sustained operating losses of this affiliate or other adverse events could result in our inability to recover the carrying value of the investment, which may require us to record an impairment charge in the future. Through December 31, 2001, we have not recorded an impairment charge for this investment.

GOODWILL AND OTHER INTANGIBLE ASSETS. We make assumptions regarding estimated future cash flows and other factors to determine the fair value of goodwill and other intangible assets. If these estimates or their related assumptions change in the future, we may be required to record an impairment charge if the estimated fair value of goodwill and other intangible assets is less than its recorded amount. Through December 31, 2001, we have not recorded an impairment charge for goodwill and other intangible assets. Beginning January 1, 2002, we are required to adopt Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," and are required to analyze goodwill and certain other intangible assets for impairment issues during the first six months of fiscal 2002, and on a periodic basis thereafter.

LITIGATION. We record contingent liabilities relating to litigation or other loss contingencies when we believe that the likelihood of loss is probable and the amount of the loss can reasonably be estimated. Changes in judgments of outcome and estimated losses are recorded, as necessary, in the period such changes are determined or become known. Any changes in estimates would impact our future operating results. Significant contingent liabilities, which we believe are at least possible, are disclosed in the notes to our consolidated financial statements.

REVENUES

At the beginning of 2002, we reorganized our operations into three strategic business units: network infrastructure solutions, operation support system solutions, and service application solutions. These strategic business units comprise our three core solutions offerings. We also offer our customers network security solutions through our majority-owned subsidiary, Marsec. Notwithstanding this organizational structure, we continue to analyze our revenues

-18-

on the basis of our two principal types of revenues: network solutions revenues and software solutions revenues. For practical reasons, we cannot reclassify and present our financial information to correspond to our four product offerings prior to 2002. Although each of our strategic business units generates both network solutions revenues and software solutions revenues, in 2002 the network integration solutions unit is expected to generate approximately 70 to 80% of our total network solutions revenues (net of hardware pass-through) and the operation support system solutions and service application solutions units are expected to generate approximately 90% of our total software solutions revenues.

Although we account for our network solutions revenues on a gross basis, inclusive of hardware acquisition costs that are passed through to our customers, we manage our business internally based on revenues net of hardware costs, which is consistent with our strategy of providing our customers with high value IT professional services while gradually outsourcing lower-end services such as hardware acquisition and installation. This strategy may result in lower growth rates for total revenues as against prior periods, but will not adversely impact revenues net of hardware costs. The following table shows our revenue breakdown by business line on this basis:

	THREE MONTHS ENDED MARCH 31,		YE DEC	
BUSINESS LINE	2002	2001	2001	2000
Network solutions net of hardware costs	60%	59%	61%	61%
Software solutions	40%	41%	39%	39%

Total revenues net of hardware costs	100%	100%	100%	100%

As demonstrated by the foregoing table, software solutions revenues have accounted for an increasing portion of our total revenues net of hardware costs over the past several years, increasing from 7% in 1997 to 39% in 2001 and 40% for the first quarter of 2002. We anticipate that software solutions revenues will account for approximately 40 to 45% of our total net revenues for 2002. During 2001, we included as a component of software revenues the software service revenue that had previously been included as a component of network solutions revenue. Such change in classification is consistent with our internal reporting structure through December 31, 2001. We have reclassified prior year amounts to conform with this presentation.

BACKLOG. Most of our revenues are derived from customers' orders under separate binding contracts for hardware, network solutions and software solutions. These contracts constitute our backlog at any given time. Revenues for hardware, network solutions and software solutions are recognized during the course of the relevant project, as described in more detail below. At March 31, 2002, our revenue backlog net of hardware costs was $51.4 million, a 16% increase over backlog one year ago. Software solutions accounted for 50% of net revenue backlog, a 72% increase over the period a year ago and a 11% sequential increase. Bonson accounted for 27% of the total backlog net of hardware costs and 31% of software backlog.

NETWORK SOLUTIONS REVENUES. Network solutions revenues consist of hardware sales for equipment procured by us on behalf of our customers from hardware vendors, as well as services for planning, design, systems integration and training. We procure for and sell hardware to our customers as part of our total solutions strategy. We minimize our exposure to hardware risks by sourcing equipment from

hardware vendors against letters of credit from our customers. We believe that as the telecommunications-related market in China develops our customers will increasingly purchase hardware directly from hardware vendors and pay us separately for the full value of our professional services.

We generally charge a fixed price for network solutions projects and recognize revenue based on the percentage of completion of the project. We use labor costs and direct project expenses to determine the stage of completion, except for revenues associated with the procurement of hardware on behalf of the customer. We recognize such hardware-related revenues upon delivery. Since a large part of the cost of a network solutions project often relates to hardware, the timing of hardware delivery can cause our quarterly gross revenues to fluctuate significantly. However, these fluctuations do not significantly affect our gross profit because hardware-related revenues generally approximate the costs of the hardware.

Network solutions projects generally have a life of nine to twelve months, during which there are three key milestones. The first milestone occurs when the hardware is delivered, which is usually between three and four months after signing the contract. The second milestone in a network solutions project is at primary acceptance, which usually occurs around five months after hardware delivery. The third milestone is final acceptance, which occurs when the customer agrees that we have satisfactorily completed all of our work on the project.

SOFTWARE SOLUTIONS REVENUES. Software solutions revenues include two types of revenues: software license revenues and software service revenues. Software license revenues consist of fees received from customers for licenses to use our software products in perpetuity, up to a specified maximum number of users. Our customers must purchase additional user licenses from us when the number of users exceeds the specified maximum. Our software license revenues also include the benefit of value added tax rebates on software license sales, which are part of the Chinese government's policy of encouraging China's software industry. Software service revenues consist of revenues from software installation, customization, training and other services. To date, substantially all of our revenue from both software licenses and software services has been contract-related, meaning that it has been derived from customer orders requiring some modifications or customization of our software. We recognize all software revenue that is contract-related over the installation and customization periods, based on the percentage of completion of the project as measured by labor costs and direct project expenses.

The foregoing network solutions and software solutions revenue recognition policies result in our recognizing certain revenues even though we are not due to receive the corresponding cash payment under the relevant contract. In the case of hardware sales, the customer typically holds back around 10 to 20% of the hardware contract amount at the time of delivery. In the case of services, while there may be some down payment, most of the revenues becomes billable at the time of primary acceptance. The unpaid amounts for hardware and services become payable at the time of final project acceptance, when payment of all unpaid contract amounts is due. When we recognize revenues for which payments are not yet due, we book unbilled accounts receivable until the corresponding amounts become payable.

COST OF REVENUES

NETWORK SOLUTIONS COSTS. Network solutions costs consist primarily of third party hardware costs, compensation and travel expenses for the professionals involved in

-20-

designing and implementing projects, and hardware warranty costs. We recognize hardware costs in full upon delivery of the hardware to our customers. In order to minimize our working capital requirements, we generally obtain from our hardware vendors payment terms that are timed to permit us to receive payment from our customers for the hardware before our payments to hardware vendors are due. However, in large projects we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements. We accrue hardware warranty costs when hardware revenue is fully recognized upon final acceptance. We obtain manufacturers' warranties for hardware we sell, which cover a portion of the warranties that we give to our customers. We currently accrue 0.5% of hardware sales to cover potential warranty expenses. This estimate of warranty cost is based on our current experience with contracts for which the warranty period has expired.

SOFTWARE COSTS. Software license costs consist primarily of packaging and written manual expenses. The costs associated with creating and enhancing software are classified as research and development expenses as incurred. Software services costs consist primarily of compensation and travel expenses for the professionals involved in modifying, customizing or installing our software products and in providing consultation, training and support services.

OPERATING EXPENSES

Operating expenses are comprised of sales and marketing expenses, research and development expenses, general and administrative expenses, and amortization expenses for goodwill and deferred stock compensation.

Operating expenses consist primarily of compensation expenses, which have risen as our business has grown and we have hired new personnel. We review salaries on an annual basis in order to ensure that we remain competitive with the market and we do not foresee the need to make material increases in the near term. However, we may be required to do so from time to time in the future.

Research and development expenses relate almost entirely to the development of new software and the enhancement and upgrading of existing software. We expense these costs as they are incurred.

We provide most of our officers, employees and directors, with stock options. In the past, we granted a number of options with exercise prices below the fair market value of the related shares at the time of grant, resulting in our incurring deferred compensation expenses. Most of the options granted with exercise prices below fair market value on the date of grant were issued prior to 1997. We do not, however, intend to issue options below fair market value in the future. Therefore, our deferred compensation expenses have been significantly higher historically than we expect them to be in future years. The difference between the exercise price and the fair market value of the related shares is amortized over the vesting period of the options and reflected on our income statement as amortization of deferred stock compensation. See note 15 to our consolidated financial statements for the year ended December 31, 2001, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission on March 22, 2002.

We make bad debt provisions for accounts receivable balances based on management's assessment of the recoverability of revenues in accordance with the aging of the accounts receivable. Because our client base is continually expanding to include smaller telecommunications and Internet service providers, we revisit our

estimates on collectibility on a periodic basis. In any event, we make bad debt provisions for accounts receivable balances which are aged over 1 year.

TAXES

Except for hardware procurement and resale, we conduct substantially all of our business through our Chinese operating subsidiaries. Our Chinese subsidiaries are generally subject to a 30% state corporate income tax and a 3% local income tax. AsiaInfo Technologies, our principal operating subsidiary, is classified as a "high technology" company for purposes of Chinese tax law and, as such, is entitled to preferential tax treatment in China. AsiaInfo Technologies operated free of Chinese state corporate income tax for three years, beginning with its first year of operation, and was entitled to a 50% tax reduction for the subsequent three years. The tax holiday for AsiaInfo Technologies expired on December 31, 1997 and the 50% tax reduction expired on December 31, 2000. However, AsiaInfo Technologies received a continuation of its preferential tax treatment from the local tax authorities in China for an additional three years, expiring at the end of 2003, which reduces our effective income tax rate to not less than 10%. In 2002, we anticipate that the effective corporate income tax rate applicable to AsiaInfo Technologies will be 10%. Changes in Chinese tax laws may adversely affect our future operations.

Sales of hardware in China are subject to a 17% value added tax. Most of our hardware sales are made through our U.S. parent company and thus are not subject to the value added tax. We effectively pass these taxes through to our customers and do not include them in revenues reported in our financial statements. Sales of software in China are subject to a 17% value added tax. However, if the net amount of the value added tax payable exceeds 3% of software sales, the excess portion of the value added tax is refundable immediately. We therefore enjoy an effective net value added tax burden of 3% on software license revenues. This policy is effective until 2010.

We are also subject to U.S. income taxes on revenues generated in the U.S., including revenues from our hardware procurement activities in the U.S. and interest income earned in the U.S.

FOREIGN EXCHANGE

Substantially all of our revenues and expenses relating to hardware sales are denominated in U.S. dollars, and substantially all of our revenues and expenses relating to the service component of our network solutions business and software business are denominated in Renminbi. Although, in general, our exposure to foreign exchange risks should be limited, the value of our shares will be affected by the foreign exchange rate between U.S. dollars and Renminbi because the value of our business is effectively denominated in Renminbi, while our shares are traded in U.S. dollars. Furthermore, a decline in the value of Renminbi could reduce the U.S. dollar equivalent of the value of the earnings from, and our investment in, our subsidiaries in China.

CONSOLIDATED RESULTS OF OPERATIONS

REVENUES. Gross revenues were $28.5 million in the three-month period ended March 31, 2002, representing a decrease of 20% against the comparable period in 2001. This decrease was due to our recording a lower amount of hardware pass-through costs in this quarter as compared to the first quarter of 2001. This change reflects the increasing focus of our business on higher-margin software solutions

and does not significantly affect our gross profit because hardware-related revenues generally approximate the costs of the hardware.

Revenues net of hardware costs were $17.1 million in the three-month period ended March 31, 2002, representing an increase of 20% over the comparable period in 2001. Total software revenues were $6.8 million in the three-month period ended March 31, 2002, representing an increase of 16% over the comparable period in 2001. Bonson contributed 12% to this quarter's total revenue net of hardware costs and 13% of software solutions revenues. Although our net revenues grew as compared to the comparable period in 2001, we experienced a sequential decline in net revenues during the first quarter of 2002. Software solutions revenues were $6.8 million, up 4% as compared to the preceding quarter, and total net revenues were $17.1 million, down approximately 15% as compared to the preceding quarter. This sequential decline was attributable to the seasonality our business experiences in the first quarter of each year due to the long public holidays in China. It was also attributable to a slow-down in network infrastructure spending resulting from the announcement last year of the restructuring of certain state-controlled telecommunications companies in China, including China Telecom. Although the planned restructuring has caused some service providers to delay infrastructure expansion and improvement projects, we anticipate that spending will resume in the second half of 2002, and that the restructuring will be a long-term driver of telecommunications infrastructure projects in China.

COST OF REVENUES. Our cost of revenues decreased to $17.2 million in the first quarter of 2002, from $24.5 million in the first quarter of 2001. These costs of revenue include hardware pass-through costs.

GROSS PROFIT. Our gross profit remained relatively constant in the first quarter of 2002 at $11.3 million, as compared to the first quarter of 2001. Gross profit as a percentage of gross revenues, or gross margin, increased to 40% in the first quarter of 2002, as compared to 32% in the first quarter of 2001. The increased gross margin is attributable to the continued growth in our higher-margin software revenues and the increased contribution of high-end services (as opposed to hardware acquisition and installation) in our network solution projects.

OPERATING EXPENSES. Total operating expenses, including the contribution from Bonson, decreased 9% to $10.2 million in the first quarter of 2002, from $11.3 million (excluding Bonson) in the first quarter of 2001.

Sales and marketing expenses decreased 37% to $3.6 million in the first quarter of 2002, from $5.6 million in the first quarter of 2001, reflecting our continued efforts to lower costs and increase operating efficiency. We believe that sales and marketing expenses equalling 20-25% of net revenues are at a sustainable level for our business over the long term.

Research and development expenses increased 39% to $2.3 million in the first quarter of 2002 from $1.6 million in the first quarter of 2002 due to our increased focus on developing new products and solutions for China's telecom carriers, such as advanced operation support systems solutions.

General and administrative expenses decreased 2% to $3.5 million in the first quarter of 2002, from $3.6 million in the first quarter of 2001. We expect general and administrative expenses to remain relatively constant as our business continues to achieve economies of scale.

In the first quarter of 2002 we recognized a one-time charge of approximately $350,000 for in-process research and development related to our acquisition of

Bonson. We also recognized a charge of $318,000 for amortization of intangible assets resulting from our acquisition of Bonson. We will amortize a total of $4.4 million in intangible assets over a period of two to three years, $1.7 million of which will be amortized in 2002.

INCOME (LOSS) FROM OPERATIONS. Our operating income for the quarter increased to $1.1 million in the first quarter of 2002 from an operating loss or $23,000 in the comparable period in 2001. Our expanding profitability has been driven by increasing revenues net of hardware costs, increasing contributions from high-end solutions and software, and effective expense control. The Bonson acquisition contributed 6% of our operating profit for the quarter.

OTHER INCOME (EXPENSE). Other income and expenses, consisting primarily of net interest income and expense, decreased from income of approximately $2.1 million in the first quarter of 2001 to income of $691,000 in the first quarter of 2002, primarily due to a decrease in interest rates and our having less cash invested in interest bearing investments.

EQUITY IN LOSS OF AFFILIATE. Equity in loss of affiliate of approximately $127,000 represented our proportionate share of the loss incurred by Intrinsic.

NET INCOME. We recorded net income of $1.4 million, or $0.03 basic earnings per share, for the quarter ended March 31, 2002. The Bonson acquisition contributed 3% of the total net income this quarter. Although net income this quarter remained the same as compared to the comparable period last year, over 60% of this quarter's net income was generated by operations while 100% of net income was generated by interest income in the first quarter of 2001.

LIQUIDITY AND CAPITAL RESOURCES

Our capital requirements are primarily working capital requirements related to hardware sales and costs associated with the expansion of our business, such as research and development and sales and marketing expenses. We recognize hardware costs in full upon delivery of the hardware to our customers. In order to minimize our working capital requirements, we generally obtain from our hardware vendors payment terms that are timed to permit us to receive payment from our customers for the hardware before our payments to hardware vendors are due. However, we sometimes obtain less favorable payment terms from our customers, thereby increasing our working capital requirements. See "Factors Affecting our Operating Results and our Common Stock - Our working capital requirements may increase significantly." We have historically financed our working capital and other financing requirements through careful management of our billing cycle, private placements of equity securities, our initial public offering in March of 2000 and, to a limited extent, bank loans.

Our accounts receivable balance at March 31, 2002 was $82.1 million, consisting of $26.4 million in billed receivables and $55.7 million in unbilled receivables. Our billed receivables are based on revenue we have booked and billed. Our unbilled receivables are based on revenue we have booked through the percentage completion method, but for which we have not yet billed the customer. For example, we recognize revenues for hardware pass-through at the time the hardware is accepted by the customer, based on the cost of the underlying hardware. However, our contracts with our customers will often allow the customers to withhold 10-20% of the total contract payments until final project acceptance, which on average is eight to nine months after hardware delivery. As a result, revenues from hardware pass-through generally represent a significant portion of

our unbilled receivables and can cause the aging of these receivables to be relatively long.

At the end of the first quarter, our days sales outstanding were 259 days. Our billed receivables were 83 days sales outstanding and our unbilled receivables were 176 days sales outstanding. The longer-than-normal level of days sales outstanding is partially attributable to the large network construction project we are currently undertaking for China Unicom, which accounted for 46% of our total accounts receivable. We expect this project to be completed by the end of the next quarter. The longer days sales outstanding are also partly due to the inclusion of Bonson's accounts receivable which have longer days sales outstanding than ours. We have changed Bonson's contract terms to bring them more in line with our normal level of days sales outstanding. We expect days sales outstanding to be 125 days by the end of 2002. In connection with the inclusion of Bonson's accounts receivable on our balance sheet as of February 6, 2002, we have increased our bad debt provision by $0.35 million to $2.4 million as of March 31, 2002, consistent with our policies of provisioning for all receivables aged over 1 year. Historically, Bonson has never written off any bad debt.

Our inventory position at the end of the quarter was approximately $3.4 million. Inventories increased this quarter due to the addition of Bonson's inventory balance of $1.8 million.

Other total assets increased to $42.7 million, due to the addition of goodwill of $35 million and other intangible assets from the Bonson acquisition. Deferred revenue was $7.3 million due to an increase in software down payments and the addition of Bonson's deferred revenue balance. Other current liabilities increased from $13.1 million to $36.8 million due to cash payable to Bonson's shareholders of $21 million.

As of March 31, 2002, we had total short-term credit facilities totaling $23.9 million, expiring by June, 2002, for working capital purposes, of which unused short-term credit facilities were $20.1 million at that date. At March 31, 2002, borrowings under these facilities totaled $2.3 million, and $1.5 million had been used to issue a letter of credit. Additional borrowings of approximately $0.4 million were secured by bank deposits of $0.35 million and Bonson's net assets which are approximately $10.5 million. All the borrowings were in Renminbi. The loans carry interest from 4.8% to 5.73% per annum and are repayable within one year. Bank deposits pledged as security for these bank loans and short-term credit facilities totaled $16.1 million as of March 31, 2002, and are presented as restricted cash in our consolidated balance sheets.

We ended the quarter with a cash position of $142.4 million, of which $18.7 million was in short term investments, $16.1 million was in restricted cash for the purpose of securing local currency loans, and $107.6 million of which was in cash and cash equivalents. Our short-term investments feature fixed income, liquidity and low risk. The cash equivalents include investments in cash management accounts to enhance our interest income. The decrease in our cash position reflects a $4.6 million payment representing part of the cash consideration used in the Bonson acquisition net of cash acquired. The final portion of the cash consideration for Bonson, totalling approximately $20.4 million, was paid in the second quarter of 2002.

We anticipate that the net proceeds of our initial public offering in March 2000, together with available funds and cash flows generated from operations, will be sufficient to meet our anticipated needs for working capital, capital expenditures and business expansion through 2002. We may need to raise additional funds in the

future, however, in order to fund acquisitions, develop new or enhanced services or products, respond to competitive pressures to compete successfully for larger projects involving higher levels of hardware purchases, or if our business otherwise grows more rapidly than we currently predict. We plan to raise additional funds, if necessary, through new issuances of shares of our equity securities in one or more public offerings or private placements, or through credit facilities extended by lending institutions.

In the event that we decide to pay dividends to our shareholders, our ability to pay dividends will depend in part on our ability to receive dividends from our operating subsidiaries in China. Foreign exchange and other regulations in China may restrict our ability to distribute retained earnings from our operating subsidiaries in China or convert those payments from Renminbi into foreign currencies.

RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No.142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. Effective January 1, 2002, we discontinued amortization of existing goodwill of approximately $7.1 million, which arose from the acquisition of Zhejiang AsiaInfo Telecommunication Technology Co., Ltd. in April 1999 and the investment in Intrinsic in April 2001, and was being amortized over five years. This resulted in the elimination of amortization expenses of $546,000 in the three months ended March 31, 2002. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairment of certain intangible assets, including goodwill. See Note 4 to our Financial Statements included in this Report for a summary of the effects of adopting the non-amortization provisions of SFAS No. 142, assuming these provisions were adopted as of January 1, 2001. SFAS No. 142 also requires us to complete a transitional goodwill impairment test six months from the date of adoption. We are currently performing, but have not yet completed the transitional goodwill impairment test which is expected to be completed by June 30, 2002.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS No. 144 addresses the financial accounting and reporting requirements for the impairment or disposal of long-lived assets and discontinued operations. SFAS No. 144 applies to all recorded long-lived assets that are held for use or that will be disposed of, but excludes goodwill and other intangible assets that are not amortized. We adopted SFAS No. 144 on January 1, 2002. Adoption of SFAS No. 144 did not have a significant effect on our financial position, results of operations or cash flows.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which addresses the accounting for the recognition of obligations associated with the retirement of tangible long-lived assets. SFAS No. 143 is effective for financial statements issued for years beginning after June 15, 2002.   We do not believe that the adoption of SFAS Nos. 143 will have a significant impact on our financial position or results of operations.

FACTORS AFFECTING OUR OPERATING RESULTS AND OUR COMMON STOCK

In addition to the other information in this report, the following factors should be considered in evaluating our business and our future prospects:

THE GROWTH OF OUR BUSINESS IS DEPENDENT ON GOVERNMENT BUDGETARY POLICY, PARTICULARLY THE ALLOCATION OF FUNDS TO SUSTAIN THE GROWTH OF THE TELECOMMUNICATIONS INDUSTRY AND THE INTERNET IN CHINA.

Virtually all of our large customers are directly or indirectly owned or controlled by the government of China. Accordingly, their business strategies, capital expenditure budgets and spending plans are largely decided in accordance with government policies, which, in turn, are determined on a centralized basis at the highest level by the State Development and Planning Commission of China. As a result, the growth of our business is heavily dependent on government policies for telecommunications and Internet infrastructure. Despite the high priority currently accorded by the government to the development of China's telecommunications industry and Internet infrastructure, and a high level of funding allocated by the government to these sectors, insufficient government allocation of funds to sustain the growth of China's telecommunications and Internet industries in the future could reduce the demand for our products and services and have a material adverse effect on our ability to grow our business.

On December 11, 2001, in an effort to increase the efficiency of telecommunications service providers through competition, the State Council of China announced that it would split China Telecom geographically into a northern division (comprising ten provinces) and a southern division (comprising 21 provinces). Under the State Council's plan, the northern division of China Telecom will merge with China Netcom and Jitong Communication, and will use the China Netcom name, while the southern division will continue to operate under the China Telecom name. As a result of the planned restructuring, new orders for telecommunications infrastructure expansion and improvement projects decreased in the third and fourth quarters of 2001, adversely affecting our backlog and our rate of net revenue growth on a sequential basis. Although we expect that spending will resume in the second half of 2002 and that the restructuring will have a positive impact on growth in the telecommunications industry in China in the long-term, similar restructurings of this nature could cause our operating results to vary unexpectedly from quarter to quarter.

OUR CUSTOMER BASE IS CONCENTRATED AND THE LOSS OF ONE OR MORE OF OUR CUSTOMERS COULD CAUSE OUR BUSINESS TO SUFFER SIGNIFICANTLY.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of large customers, such as China Telecom, China Unicom, China Mobile and China Netcom. China Telecom accounted for almost all of our revenues in 1997 and 1998. In 1999, China Telecom, together with China Unicom, accounted for almost all of our revenues. The loss, cancellation or deferral of any large contract by any of our large customers would have a material adverse effect on our revenues, and consequently our profits.

LAWS AND REGULATIONS APPLICABLE TO THE INTERNET IN CHINA REMAIN UNSETTLED AND COULD HAVE A MATERIAL ADVERSE EFFECT ON THE INTERNET'S GROWTH AND THEREBY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS.

Growth of the Internet in China could be materially adversely affected by government regulation of the industry. Due to the increasing popularity and use of the Internet and other online services, new regulations have been and may continue to be adopted with respect to the Internet or other online services. In September 2000, China's Ministry of Information Industry promulgated the Administrative Measures on Internet Information Services and related implementing

-27-

regulations. Among other things, the Administrative Measures on Internet Information Services:

.. require Internet content providers to obtain approval from the Ministry of Information Industry before they can list securities overseas or obtain foreign investment;

.. require Internet content providers to obtain licenses from various ministries, depending on the nature of the content they provide; and

.. require Internet content providers to police their content in order to prevent restricted material from appearing on their websites.

Because we are engaged in telecommunications and Internet infrastructure development, we do not expect these regulations to have a direct impact on us. However, we cannot guarantee that the adoption of these regulations or other regulations will not slow the growth of the Internet or other online services in China. In particular, the prohibitions against a broad but vague range of information on the Internet (such as information that is damaging to national security, national interest, and social order), the relevant monitoring, record-keeping, reporting and other administrative burdens imposed on Internet access and content providers, and the severe penalties for violations of these regulations could have a chilling effect on Internet content providers and Internet users and could lead to increased compliance costs for Internet content providers. Any slowdown in the growth of the Internet in China could in turn lead to reduced Internet traffic, and a decrease in the demand for our network solutions and software products.

THE LONG AND VARIABLE SALES CYCLES FOR OUR PRODUCTS AND SERVICES CAN CAUSE OUR REVENUES AND OPERATING RESULTS TO VARY SIGNIFICANTLY FROM PERIOD TO PERIOD AND MAY ADVERSELY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our revenues and operating results will vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate. A customer's decision to purchase our services and products involves a significant commitment of its resources and an extended evaluation. As a result, our sales cycle tends to be lengthy. We spend considerable time and expense educating and providing information to prospective customers about features and applications of our services and products. Because our major customers operate large and complex networks, they usually expand their networks in large increments on a sporadic basis. The combination of these factors can cause our revenues and results of operations to vary significantly and unexpectedly from quarter to quarter. Other factors that may affect us include the following:

.. fluctuation in demand for our products and services as a result of the budgetary cycles of our large customers, particularly state-owned enterprises;

.. the reduction, delay, interruption or termination of one or more infrastructure projects; and

.. our ability to introduce, develop and deliver new software products that meet customer requirements in a timely manner.

-28-

A large part of the contract amount of a network solutions project usually relates to hardware procurement. Since we recognize most of the revenues relating to hardware plus a portion of contract services revenues at the time of hardware delivery, the timing of hardware delivery can cause our quarterly gross revenues to fluctuate significantly. Due to the foregoing factors, we believe that quarter to quarter comparisons of our operating results are not a good indication of our future performance and should not be relied upon. It is likely that our operating results in some periods may be below the expectations of public market analysts and investors. In this event, the price of our common stock will probably decline, perhaps significantly more in percentage terms than any corresponding decline in our operating results.

OUR WORKING CAPITAL REQUIREMENTS MAY INCREASE SIGNIFICANTLY.

We typically purchase hardware for our customers as part of our turn-key total solutions services. We generally require our customers to pay 80 to 90% of the invoice value of the hardware upon delivery. We typically place orders for hardware against back-to-back orders from customers and seek favorable payment terms from hardware vendors. This policy has historically minimized our working capital requirements. However, for certain large and strategically important projects, we have agreed to payment of less than 80 to 90% of the invoice value of the hardware upon delivery in order to maintain competitiveness. Wider adoption of less favorable payment terms or delays in hardware deliveries will require us to increase our working capital needs significantly.

Our working capital requirements may also increase significantly in order to fund more rapid expansion and acquisitions, to develop new or enhanced services or products, to respond to competitive pressure to compete successfully for larger projects involving higher levels of hardware purchases or otherwise if our business grows more rapidly than we currently predict. An increase in our working capital needs may require that we raise additional funds sooner than we presently expect.

WE HAVE SUSTAINED LOSSES IN PRIOR YEARS AND MAY INCUR SLOWER EARNINGS GROWTH, EARNINGS DECLINES OR NET LOSSES IN THE FUTURE.

Although we have recently achieved operating profitability and had net income in 1998 and 2001, we sustained net losses in 1997, 1999 and 2000. There are no assurances that we can sustain profitability or avoid net losses in the future. We continue to expect that certain of our operating expenses will increase as our business grows. The level of these expenses will be largely based on anticipated organizational growth and revenue trends and a high percentage will be fixed. As a result, any delays in expanding sales volume and generating revenue could result in substantial operating losses. Any such developments could cause the market price of our common stock to decline.

OUR ACQUISITION OF BONSON HAS BEEN, AND ANY ACQUISITIONS WE UNDERTAKE IN THE FUTURE MAY BE, COSTLY, AND WE MAY REALIZE LOSSES ON OUR INVESTMENTS

As a key component of our business and growth strategy, we have recently acquired Bonson Information Technology Holdings Limited, or Bonson. In the future, we may acquire other companies or assets that we feel will enhance our revenue growth, operations and profitability. Such acquisitions could result in the use of significant amounts of cash, dilutive issuances of our common stock and amortization expenses related to goodwill and other intangible assets, each of which could materially and adversely affect our business. Such acquisitions involve other significant risks, including:

-29-

.. the difficulties of integrating, assimilating and managing the operations, technologies, intellectual property, products and personnel of the acquired business;

.. the diversion of management attention from other business concerns;

.. the additional expense associated with acquired contingent liabilities;

.. the loss of key employees in acquired businesses; and

.. the risk of being sued by terminated employees and contractors.

We will need to integrate and manage Bonson and any other businesses we determine to acquire in the future. Our failure to do so successfully could have a material adverse effect on our business, results of operations and financial condition.

MANAGEMENT'S ABILITY TO IMPLEMENT ADEQUATE CONTROL SYSTEMS WILL BE CRITICAL TO THE SUCCESSFUL MANAGEMENT OF OUR FUTURE GROWTH.

In recent years, we have been expanding our operations rapidly, both in size and scope. Our growth places a significant strain on our management systems and resources. Our ability to market our products successfully and implement our business plan in a rapidly evolving market requires an effective planning and management process. We will need to continue to improve our financial, managerial and operational controls and reporting systems, and to expand, train and manage our work force. Our future growth will be compromised if we cannot implement adequate control systems in an efficient and timely manner.

WE ARE HIGHLY DEPENDENT ON OUR EXECUTIVE OFFICERS.

Each of our executive officers is responsible for an important segment of our operations. Although we believe that we have significant depth at all levels of management, the loss of any of our executive officers' services could be detrimental to our operations. To ensure continuity of management, we have entered into employment agreements with all of our executive officers. We do not have, and do not plan to obtain, "key man" life insurance on any of our employees.

WE FACE A COMPETITIVE LABOR MARKET IN CHINA FOR SKILLED PERSONNEL AND THEREFORE ARE HIGHLY DEPENDENT ON THE SKILLS AND SERVICES OF OUR EXISTING KEY SKILLED PERSONNEL AND OUR ABILITY TO HIRE ADDITIONAL SKILLED EMPLOYEES.

Competition for highly skilled software design, engineering and sales and marketing personnel is intense in China. Our failure to attract, assimilate or retain qualified personnel to fulfill our current or future needs could impair our growth. Competition for skilled personnel comes primarily from a wide range of foreign companies active in China, many of which have substantially greater resources than we have. Limitations on our ability to hire and train a sufficient number of personnel at all levels would limit our ability to undertake projects in the future and could cause us to lose market share.

SINCE OUR BUSINESS HAS BEEN EVOLVING, OUR HISTORICAL FINANCIAL INFORMATION MAY NOT BE AN APPROPRIATE BASIS ON WHICH TO EVALUATE US OR OUR PROSPECTS.

We founded our business in Texas in 1993, moved our operations from Texas to China in 1995, and began generating significant network solutions revenue in 1996 and significant software solutions revenues in 1998. We expect our business to

-30-

continue to evolve as the Internet and telecommunications markets in China change and expand. As a result, our historical financial data may not provide a meaningful basis upon which investors may evaluate us and our prospects. You should consider the risks and difficulties encountered by companies like ours in a new and rapidly evolving market. Our ability to sell products and our level of success depend, among other things, on the level of demand for telecommunications and Internet-related, professional IT services and software products in China.

WE EXTEND WARRANTIES TO OUR CUSTOMERS THAT EXPOSE US TO POTENTIAL LIABILITIES.

We customarily provide our customers with one to three year warranties, under which we agree to maintain installed systems at no additional cost to our customers. The maintenance services cover both hardware and our proprietary and third party software products. Although we seek to arrange back-to-back warranties with hardware and software vendors, we have the primary responsibility to maintain the installed hardware and software. Our contracts do not have disclaimers or limitations on liability for special, consequential and incidental damages, nor do we cap the amounts our customers can recover for damages. In addition, we do not currently maintain any insurance policy with respect to our exposure to warranty claims. The failure of our installed projects to operate properly could give rise to substantial liability for special, consequential or incidental damages, that in turn could materially and adversely affect us.

WE SELL OUR LARGE SYSTEMS INTEGRATION PROJECTS ON A FIXED-PRICE, FIXED-TIME

BASIS WHICH EXPOSES US TO RISKS ASSOCIATED WITH COST OVERRUNS AND DELAYS.

We sell substantially all of our systems integration projects on a fixed-price, fixed-time basis. In contracts with our customers, we typically agree to pay late completion fines of up to 5% of the total contract value. In large scale telecommunications infrastructure projects, there are many factors beyond our control which could cause delays or cost overruns. In this event, we would be exposed to cost overruns and liable for late completion fines. Our failure to complete a fixed-price, fixed-time project within budget and the required time frame would expose us to cost overruns and penalties that could have a material adverse effect on our business, operating results and financial condition. A part of our business is installing network hardware. If we are unable to obtain access to such equipment in a timely manner or on acceptable commercial terms, our business, particularly our relationships with our customers, may be materially and adversely affected.

WE MAY BECOME LESS COMPETITIVE IF WE ARE UNABLE TO DEVELOP OR ACQUIRE NEW PRODUCTS OR ENHANCEMENTS TO OUR SOFTWARE PRODUCTS THAT ARE MARKETABLE ON A TIMELY AND COST-EFFECTIVE BASIS.

We continually develop new services and proprietary software products. Unexpected technical, operational, distribution or other problems could delay or prevent the introduction of one or more of these products or services or any products or services that we may plan to introduce in the future. Moreover, we cannot be sure that any of these products and services will achieve widespread market acceptance or generate incremental revenues.

OUR PROPRIETARY RIGHTS MAY BE INADEQUATELY PROTECTED AND THERE IS A RISK OF POOR ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS IN CHINA.

Our success and ability to compete depend substantially upon our intellectual property rights, which we protect through a combination of copyright, trade secret law and trademark law. We have registered some marks and filed trademark

applications for other marks with the United States Patent and Trademark Office, the Trademark Bureau of the State Administration of Industry and Commerce in China and the Trade Marks Registry in Hong Kong. We have also registered copyrights with the State Copyright Bureau in China with respect to telecommunications-related software products, although we have not applied for copyright protection elsewhere (including the United States, which does not require registration for protection of copyrights). Despite these precautions, the legal regime protecting intellectual property rights in China is weak. Because the Chinese legal system in general, and the intellectual property regime in particular, are relatively weak, it is often difficult to enforce intellectual property rights in China. In addition, there are other countries where effective copyright, trademark and trade secret protection may be unavailable or limited, and the global nature of the Internet makes it virtually impossible to control the ultimate destination of our products.

We do not own any patents and have not filed any patent applications, as we do not believe that the benefits of patent protection outweigh the costs of filing and updating patents for our software products. We enter into confidentiality agreements with our employees and consultants, and control access to, and distribution of, our documentation and other licensed information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our licensed services or technology without authorization, or to develop similar technology independently. Policing unauthorized use of our licensed technology is difficult and there can be no assurance that the steps we take will prevent misappropriation or infringement of our proprietary technology. In addition, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others, which could result in substantial costs and diversion of our resources.

WE ARE EXPOSED TO CERTAIN BUSINESS AND LITIGATION RISKS WITH RESPECT TO TECHNOLOGY RIGHTS HELD BY THIRD PARTIES.

We currently license technology from third parties and intend to do so increasingly in the future as we introduce services that require new technology. There can be no assurance that these technology licenses will be available to us on commercially reasonable terms, if at all. Our inability to obtain any of these licenses could delay or compromise our ability to introduce new services. In addition, we may or may allegedly breach the technology rights of others and incur legal expenses and damages, which could be substantial.

INVESTORS MAY NOT BE ABLE TO ENFORCE JUDGMENTS BY UNITED STATES COURTS AGAINST US.

We are incorporated in the State of Delaware. However, a majority of our directors, executive officers and principal shareholders live outside the United States, principally in Beijing and Hong Kong. As a result, you may not be able to:

.. effect service of process upon us or these persons within the United States; or

.. enforce against us or these persons judgments obtained in United States courts, including judgments relating to the federal securities laws of the United States.

WE DO NOT INTEND TO PAY AND MAY BE RESTRICTED FROM PAYING DIVIDENDS ON OUR COMMON STOCK.

-32-

We have never declared or paid dividends on our capital stock and we do not intend to declare any dividends in the foreseeable future. We currently intend to retain future earnings to fund our growth. Furthermore, if we decide to pay dividends, foreign exchange and other regulations in China may restrict our ability to distribute retained earnings from China or convert these payments from Renminbi, the currency of China, into foreign currencies. In addition, loan agreements and contractual arrangements we enter into in the future may also restrict our ability to pay dividends.

THE FACT THAT OUR BUSINESS IS CONDUCTED IN BOTH U.S. DOLLARS AND RENMINBI MAY SUBJECT US TO CURRENCY EXCHANGE RATE RISK DUE TO FLUCTUATIONS IN THE EXCHANGE RATE BETWEEN THESE TWO CURRENCIES.

Substantially all of our revenues, expenses and liabilities are denominated in either U.S. dollars or Renminbi. As a result, we are subject to the effects of exchange rate fluctuations between these currencies. Because of the unitary exchange rate system introduced in China on January 1, 1994, the official bank exchange rate for conversion of Renminbi to U.S. dollars experienced a devaluation of approximately 50%. We report our financial results in U.S. dollars, therefore, any future devaluation of the Renminbi against the U.S. dollar may have an adverse effect on our reported net income.

Substantially all our revenues and expenses relating to hardware sales are denominated in U.S. dollars, and substantially all our revenues and expenses relating to the software and services component of our business are denominated in Renminbi. Although, in general, our exposure to foreign exchange risks should be limited, the value in our shares may be affected by the foreign exchange rate between the U.S. dollar and the Renminbi because the value of our business is effectively denominated in Renminbi, while our shares are traded in U.S. dollars. Furthermore, a decline in the value of the Renminbi could reduce the U.S. dollar value of earnings from, and our investments in, our subsidiaries in China.

THE MARKETS IN WHICH WE SELL OUR SERVICES AND PRODUCTS ARE COMPETITIVE AND WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY.

The market for telecommunications and Internet infrastructure solutions in China is new and rapidly changing. Our competitors in the network infrastructure solutions market mainly include domestic systems integrators such as Zoom Networks and Openet Information Technology (Shenzhen) Corporation. Although we are a leading player in this market, there are many large multinational companies with substantial, existing information technology operations in other markets in China, that have significantly greater financial, technological, marketing and human resources. Should they decide to enter the network infrastructure solutions market, this could hurt our profitability and erode our market share. In the operation support system solutions market, we compete with both international and local software and solutions providers.

In the online billing segment, we compete primarily with Portal Software, MIND C.T.I. Ltd. and Zoom Networks, and in the wireless billing segment, we compete with more than ten local competitors. Currently, due in part to a stringent approval system for providers of wireless billing software in China and competitive pricing offered by domestic companies, some multinational information technology companies have been deterred from entering this market. In view of the gradual deregulation of the Chinese telecommunications industry and China's entry into the WTO, we anticipate the entrance of new competitors into the operation support system solutions market.

The service application solutions sector is highly competitive. Our principal competitor in this sector is Openwave Systems Inc. (formerly Software.com).

In the network security solutions market, we mainly compete with Information Security One Limited, Nsfocus Information Technology Co., Ltd., and 21ViaNet China Inc. An increasing number of companies are devoting their resources to this sector in developing network security products. Through mergers and acquisitions, many information technology companies are entering the network security solutions market as part of their strategy of providing a full range of system integration services.

Our competitors, some of whom have greater financial, technical and human resources than us, may be able to respond more quickly to new and emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sale of new products or services. It is possible that competition in the form of new competitors or alliances, joint ventures or consolidation among existing competitors may decrease our market share. Increased competition could result in lower personnel utilization rates, billing rate reductions, fewer customer engagements, reduced gross margins and loss of market share, any one of which could materially and adversely affect our profits and overall financial condition.

POLITICAL AND ECONOMIC POLICIES OF THE CHINESE GOVERNMENT COULD AFFECT OUR INDUSTRY IN GENERAL AND OUR COMPETITIVE POSITION IN PARTICULAR.

Since the establishment of the People's Republic of China in 1949, the Communist

Party has been the governing political party in China. The highest bodies of leadership are the Politburo of the Communist Party, the Central Committee and the National People's Congress. The State Council, which is the highest institution of government administration, reports to the National People's Congress and has under its supervision various commissions, agencies and ministries, including The Ministry of Information Industry, the telecommunications regulatory body of the Chinese government. Since the late 1970s, the Chinese government has been reforming the Chinese economic system. Although we believe that economic reform and the macroeconomic measures adopted by the Chinese government have had and will continue to have a positive effect on economic development in China, there can be no assurance that the economic reform strategy will not from time to time be modified or revised. Such modifications or revisions, if any, could have a material adverse effect on the overall economic growth of China and investment in the Internet and the telecommunications industry in China. Such developments could reduce, perhaps significantly, the demand for our products and services. There is no guarantee that the Chinese government will not impose other economic or regulatory controls that would have a material adverse effect on our business. Furthermore, changes in political, economic and social conditions in China, adjustments in policies of the Chinese government or changes in laws and regulations could adversely affect our industry in general and our competitive position in particular.

UNCERTAINTIES WITH RESPECT TO THE CHINESE LEGAL SYSTEM COULD ADVERSELY AFFECT US.

Our principal operating subsidiary, AsiaInfo Technologies, is a wholly foreign owned enterprise for Chinese legal purposes, which means that it is incorporated in China and wholly-owned by foreign investors. AsiaInfo Technologies, along with certain of our other subsidiaries, are subject to laws and regulations applicable to foreign investment in China in general and laws applicable to wholly foreign owned enterprises in particular. Legislation and regulations over the past 20

years have significantly enhanced the protections afforded to various forms of foreign investment in China. However, since the Chinese legal system is still evolving, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit remedies available to us.

HIGH TECHNOLOGY AND EMERGING MARKET SHARES HAVE HISTORICALLY EXPERIENCED EXTREME VOLATILITY AND MAY SUBJECT YOU TO LOSSES.

The trading price of our shares may be subject to significant market volatility due to:

.. investor perceptions of us and investments relating to China and Asia;

.. developments in the Internet and telecommunications industries;

.. variations in our operating results from period to period due to project timing; and

.. announcements of new products or services by us or by our competitors.

In addition, the high technology sector of the stock market frequently experiences extreme price and volume fluctuations, which have particularly affected the market prices of many Internet and computer software companies and which have often been unrelated to the operating performance of these companies.

IF OUR STOCK PRICE IS VOLATILE, WE MAY BECOME SUBJECT TO SECURITIES LITIGATION WHICH IS EXPENSIVE AND COULD RESULT IN A DIVERSION OF RESOURCES.

In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. Many companies in our industry have been subject to this type of litigation in the past, and we have recently become the subject of this type of litigation. For more information on this litigation, see the discussion under the heading "Item 3. Legal Proceedings" in our annual report on Form 10-K for the year ended December 31, 2001 filed with the U.S. Securities and Exchange Commission on March 22, 2002. Litigation is often expensive and diverts management's attention and resources, which could materially and adversely affect our business.

FUTURE SALES OF SHARES BY OUR COMPANY OR EXISTING SHAREHOLDERS COULD CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO FALL.

If our stockholders sell substantial amounts of our common stock in the public market, including shares issued upon the exercise of outstanding options, the market price of our common stock could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

A SMALL NUMBER OF SHAREHOLDERS CONTROLS US.

A small number of shareholders, including Warburg-Pincus Ventures, ChinaVest Group, and their affiliates, as well as Edward Tian, one of our directors, James Ding, our President and Chief Executive Officer, and Louis Lau, our Chairman, control over 60% of our voting stock. As a result, these shareholders collectively are able to control all matters requiring shareholder approval, including election of directors and approval of significant corporate

transactions, such as a sale of our assets and the terms of future equity financings. The combined voting power of our large shareholders could have the effect of delaying or preventing a change in control.

WE ARE SUBJECT TO ANTI-TAKEOVER PROVISIONS THAT COULD PREVENT A CHANGE OF CONTROL AND PREVENT OUR SHAREHOLDERS FROM REALIZING A PREMIUM ON THEIR COMMON STOCK.

Our board of directors has the authority to issue up to 10,000,000 shares of our preferred stock. Without any further vote or action on the part of our stockholders, the board of directors has the authority to determine the price, rights, preferences, privileges and restrictions of the preferred stock. This preferred stock, if it is ever issued, may have preference over and harm the rights of the holders of our common stock. Although the issuance of this preferred stock will provide us with flexibility in connection with possible acquisitions and other corporate purposes, this issuance may make it more difficult for a third party to acquire a majority of our outstanding voting stock.

We currently have authorized the size of our board of directors to be not less than three nor more than nine directors. The terms of the office of the eight-member board of directors have been divided into three classes: Class I, whose term will expire at the annual meeting of the stockholders to be held in 2003; Class II, whose term will expire at the annual meeting of stockholders to be held in 2004; and Class III, whose term will expire at the annual meeting of stockholders to be held in 2005. This classification of the board of directors may have the effect of delaying or preventing changes in our control or management.

We are subject to the provisions of Section 203 of the Delaware General Corporation Law. In general, the statute prohibits a publicly-held Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date when the person became an interested stockholder unless, subject to exceptions, the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Generally, a "business combination" includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the stockholder.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to interest-rate risk primarily associated with our cash, short-term investments and short-term bank loans. To date, we have not entered into any types of derivatives to hedge against interest-rate changes, nor do we speculate in foreign currency. However, we do maintain a significant portion of our cash deposits in U.S. dollars to avoid currency risk related to Renminbi. A portion of these U.S. dollar deposits are used to collateralize Renminbi-denominated loans from Chinese banks.

Because substantially all of our revenues and expenses relating to hardware sales are denominated in U.S. dollars, and substantially all of our revenues and expenses relating to the service component of our network solutions business and software business are denominated in Renminbi, we do not have significant exposure to either the U.S. dollar or Renminbi. Thus, we do not believe that it is necessary to enter into derivatives contracts to hedge our exposures to either currency.

There have been no significant changes in our exposure to changes in either interest rates or foreign currency exchange rates for the quarter ended March 31,

2002. Our exposure to interest rates is limited as we do not have variable rate and long-term borrowings. We are subject to variable interest rates on our bank deposits that are cash and short-term investments. As there are no significant market price movements, such investments are held at cost. As of March 31, 2002, a hypothetical 10% immediate increase or decrease in interest rates would increase or decrease our annual interest expense and income by approximately $73,000 and $4,000, respectively.

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

On March 2, 2000, our Registration Statement on Form S-1 covering the offering of 5,000,000 shares of our common stock (No.333-93199) was declared effective. The underwriters in the offering exercised an over-allotment option to purchase an additional 750,000 shares of our common stock. The total price to the public for the shares offered and sold was $138,000,000. The net proceeds of the offering (after deducting expenses) was approximately $126,610,000. From the effective date of the Registration Statement through March 31, 2002, the net proceeds have been used for the following purposes:

Purchase and installation of machinery and equipment.............	$ 6,700,000
Temporary investments, including cash and cash equivalents........	68,290,000
Investments in subsidiaries.....................................	29,320,000

Research and development and sales and marketing expenses.........	22,300,000
	$126,610,000

The net proceeds will be used for general corporate purposes, including working capital, and expenses such as research and development and sales and marketing. A portion of the net proceeds may also be used to acquire or invest in complementary businesses or products. None of the net proceeds of the offering have been paid directly or indirectly to our directors, officers or their associates, to persons owning ten percent or more of our common stock, or to our affiliates.

ITEM 5. OTHER INFORMATION

We held our Annual Meeting of Shareholders on April 23, 2002. For more information on the following proposals, please refer to our definitive proxy statement dated March 22, 2002, the relevant portions of which are incorporated herein by reference.

(1) Our shareholders elected each of the three nominees to our Board of Directors for a three-year term:

DIRECTOR	FOR	WITHHELD
Edward Tian	31,879,656	83,867
Chang Sun	31,885,656	77,867
Michael Zhao	31,327,801	635,722

(2) Our shareholders ratified the appointment of Deloitte Touche Tohmatsu as our independent auditors:

For	31,767,922
Against	91,847
Abstain	103,754
Total	31,963,523

-37-

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The following exhibits are filed as a part of this Report.

Exhibit Number	Description Exhibits
2.1	Share Purchase Agreement for the acquisition of Bonson Information Technology Holdings Limited/****/
3.1	Certificate of Incorporation of AsiaInfo Holdings, Inc., dated June 8, 1998/*/
3.2	Certificate of Amendment to Certificate of Incorporation of AsiaInfo Holdings, Inc., dated August 27, 1999/*/
3.3	Certificate of Amendment to Certificate of Incorporation of AsiaInfo Holdings, Inc., dated November 15, 2000/***/
3.4	Certificate of Correction to Certificate of Amendment to Certificate of Incorporation of AsiaInfo Holdings, Inc., dated January 18, 2001/***/
3.5	By-Laws of AsiaInfo Holdings, Inc., dated December 19,

	2000/***/
4.1	Specimen Share Certificate representing AsiaInfo Holdings, Inc. shares of common stock/*/
10.1	2000 Stock Option Plan, approved and adopted as of October 18, 2000/**/
10.2	Shareholders' Agreement of Marsec Holdings, Inc., dated as of September 15, 2000, by and among AsiaInfo Holdings, Inc. and the Founders (as defined therein) of Marsec Holdings, Inc./**/
10.3	Lease of AsiaInfo's headquarters at 6 Zhongguancun South Street, Beijing, China, dated August 31, 1999/*/
10.4	Agreement for the Establishment of a Limited Liability Company (Guangdong Wangying Communications Technology Company Limited) and Capital Contribution/***/
11.1	Statement regarding computation of per share earnings (included in note 9 to condensed consolidated financial statements)

/*/ Incorporated by reference to our Registration Statement on Form S-1 (No.333-93199).

/**/ Incorporated by reference to our Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2000.

/***/ Incorporated by reference to our Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

/***/ Incorporated by reference to our Current Report on Form 8-K filed on February 21, 2002.

(b) Reports on form 8-K

We filed a Current Report on Form 8-K on February 21, 2002 relating to the completion of our acquisition of Bonson Information Technology Holdings Limited,

-38-

or Bonson, pursuant to a Share Purchase Agreement dated as of January 20, 2002 by and among the Company, Bonson and the shareholders of Bonson.

We filed a Current Report on Form 8-K/A on April 22, 2002 attaching certain audited financial statements of Bonson and certain of our pro forma financial statements.

-39-

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, AsiaInfo Holdings, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AsiaInfo Holdings, Inc.

Date: May 14, 2002 By: /s/ Ying Han

Name: Ying Han
Title: Chief Financial Officer
(duly authorized officer
and principal financial officer)