

Searchmedia Holdings Ltd
Form 20-F
June 30, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 20-F**

(Mark One)

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

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2010**

OR

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

OR

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

Date of event requiring this shell company report

Commission file number: 0001-33800

SEARCHMEDIA HOLDINGS LIMITED

(Exact name of Registrant as specified in its charter)

Cayman Islands

(Jurisdiction of incorporation or organization)

**Floor 13, Central Modern Building,
468 Xinhui Road, Shanghai, China, 200060**

(Address of principal executive offices)

Wilfred Chow

Chief Financial Officer

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

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

Title of each class

Name of each exchange on which registered

Ordinary Shares, \$0.0001 Par Value

NYSE Amex

Warrants

NYSE Amex

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

None

(Title of Class)

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

None

(Title of Class)

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

20,889,897 Ordinary Shares

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
 Yes No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
 Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
 Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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

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

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDING DURING THE PAST FIVE YEARS.)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.
 Yes No

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NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 20-F contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (PSLRA), Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended, (the Exchange Act), about our expectations, beliefs, or intentions regarding our business, financial condition, results of operations, strategies, or prospects. You can identify forward-looking statements by the fact that these statements do not relate strictly to historical or current matters. Rather, forward-looking statements relate to anticipated or expected events, activities, trends, or results as of the date they are made. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties that could cause our actual results to differ materially from any future results expressed or implied by the forward-looking statements. Many factors could cause our actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include those contained in Part I, Item 3 Key Information D. Risk Factors of this Annual Report on Form 20-F. We do not undertake any obligation to update forward-looking statements. We intend that all forward-looking statements be subject to the safe harbor provisions of PSLRA. These forward-looking statements are only predictions and reflect our views as of the date they are made with respect to future events and financial performance. The risks, uncertainties and other factors that our stockholders and prospective investors should consider include the following:

There is substantial doubt as to our ability to continue as a going concern, which could adversely affect our ability to meet our ongoing financing needs as well as to obtain third party financing.

We may not have sufficient liquidity to pay earn-out payments when they come due, which could materially and adversely affect our operations.

We have a history of significant operating losses and our future revenue and operating profitability are uncertain.

We have identified material weaknesses in our internal control over financial reporting and we have had to restate our historical financial statements.

We are subject to ongoing securities litigation and a government inquiry in the United States.

Deterioration of economic conditions and a resulting decrease in demand for advertising services would materially and adversely affect our financial condition and results of operations and limit our growth prospects.

A business strategy of making acquisitions subjects us to all of the risks inherent in identifying, acquiring and operating newly acquired businesses.

Failure to manage our growth could strain our management, operational and other resources, which could materially and adversely affect our business and growth potential.

Future charges due to possible impairments of acquired assets may have a material adverse effect on our financial condition and results of operations.

We face significant competition for advertising spending from operators of new and traditional advertising networks. If we cannot successfully compete, our results of operations would be materially and adversely affected.

We have a limited operating history which may make it difficult for you to evaluate our business and prospects.

If we fail to develop and maintain relationships with site owners, managers and sublessors that provide us access to desirable locations and network platforms, our growth potential and our business could be harmed.

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Failures to obtain site owners' consents or objections from site owners to the installations of our media products could lead to termination of our contracts or installations, which would harm our results of operations.

If we are unable to obtain or retain desirable placement locations for our advertising poster frames and outdoor billboards on commercially advantageous terms, our operating margins and earnings could decrease and our results of operations could be materially and adversely affected.

The shareholders of Jingli Shanghai may have potential conflicts of interest with us.

Our business depends substantially on the continuing efforts of our senior executives, and our business may be severely disrupted if we lose their services.

If we are unable to adapt to changing advertising trends of advertisers and consumers, we will not be able to compete effectively and we will be unable to increase or maintain our revenues, which may materially and adversely affect our business prospects and revenues.

Our growth could suffer if we fail to expand our media networks to include new media offerings, media platforms or enter into new markets.

If site managers or owners shut down our displays for site maintenance or other reasons, our business could be adversely affected.

Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

We rely on computer software and hardware systems in managing our operations; any failure in these systems could adversely affect our business, financial condition and results of operations.

We have no business liability, disruption or litigation insurance, and we could incur substantial costs if our business is disrupted due to natural disasters, litigation or other business interruptions.

Our operating results are difficult to predict and may fluctuate from period to period.

If the PRC government determines that the contractual arrangements that establish the structure for operating our China business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties.

We rely on contractual arrangements with Jingli Shanghai and its shareholders for our China operations, which may not be as effective in providing operational control as would be the case through ownership of a controlling equity interest in such operating entities.

Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

If advertising registration certificates are not obtained for advertisements on our outdoor billboard or rapid transit networks, we may be subject to fines.

Our outdoor billboards, light boxes and neon signs are subject to municipal zoning requirements, governmental approvals and administrative controls. If we are required to tear down our billboards, light boxes or neon signs as a result of these requirements, approvals or controls, our operations could be materially and adversely affected.

If we were deemed a resident enterprise by PRC tax authorities, we could be subject to tax on our global income and our non-PRC shareholders could be subject to certain PRC taxes.

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Uncertainties with respect to the PRC legal system could adversely affect us.

We may be subject to, and may expend significant resources in defending against, government actions and civil suits based on the content and services we provide through our network.

Governmental control of currency conversion may materially and adversely affect the value of your investment. Substantial limitations may be imposed on the removal of funds from the PRC to the Company, or the infusion of funds by us to our subsidiaries and affiliates located in the PRC.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may prevent us from making loans or capital contributions to our PRC operating subsidiaries and affiliated entities.

Fluctuation in the value of the Renminbi may have a material adverse effect on your investment.

Any health epidemics and other outbreaks, or war, acts of terrorism and other man-made or natural disasters could severely disrupt our business operations.

We are a Cayman Islands company and, because the rights of shareholders under Cayman Islands law differ from those under U.S. law, you may have fewer protections as a shareholder.

In the future, our Board of Directors may be subject to potential deadlock.

As a foreign private issuer, we will be exempt from certain SEC requirements that provide stockholders with protections and information that must be made available to stockholders of U.S. public companies.

Because we do not intend to pay dividends on our ordinary shares for the foreseeable future, stockholders will benefit from an investment in our ordinary shares only if those shares appreciate in value.

Voting control by executive officers, directors and other affiliates of the company may limit your ability to influence the outcome of director elections and other matters requiring shareholder approval.

The NYSE Amex may delist our securities from quotation on its exchange, which could limit investors' ability to make transactions in our securities and subject us to additional trading restrictions.

A significant number of shares are eligible for future sale by our stockholders and the sale of those shares could adversely affect the stock price.

There is a risk that we could be treated as a U.S. domestic corporation for U.S. federal income tax purposes after the Business Combination, which could result in significantly greater U.S. federal income tax liability to us.

There is a risk that we will be classified as a passive foreign investment company, or PFIC, which could result in adverse U.S. federal income tax consequences to U.S. holders of ordinary shares or warrants of SearchMedia.

If you acquire (directly, indirectly, or constructively) 10% or more of our shares, you may be subject to taxation under the controlled foreign corporation, or CFC rules.

We may choose to redeem our outstanding warrants at a time that is disadvantageous to the warrant holders, preventing such holders from realizing the potential economic value of their warrants.

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Our warrant holders may not be able to exercise their warrants, which may significantly reduce their economic value and create liability for us.

Unless otherwise indicated or required by the context, all references in this Annual Report on Form 20-F to we, us, our, SearchMedia Holdings, or the Company refer to SearchMedia Holdings Limited and its consolidated subsidiaries and all references to SearchMedia International refer to SearchMedia International Limited and its consolidated subsidiaries before completion of the Business Combination on October 30, 2009 (as defined below).

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PART I

Item 1 Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2 Offer Statistics and Expected Timetable

Not applicable.

Item 3 Key Information

A. Selected Financial Data

This annual report on Form 20-F contains the consolidated statements of operations data for our company for the years ended December 31, 2008, 2009 and 2010 and the selected consolidated balance sheet data for our company as of December 31, 2009 and 2010 have been derived from our audited financial statements included elsewhere in this annual report.

The consolidated statements of operations data for our company for the years ended December 31, 2006 and 2007 have been omitted from the Selected Financial Data per the instructions to Item 3 of Form 20-F. As previously disclosed in the Explanatory Note to our Annual Report on Form 10-K for the year ended December 31, 2009 filed on November 1, 2010, the historical financial statements of SearchMedia International for the years ended December 31, 2007 and December 31, 2008 were restated as a result of the analysis of our financial statements for the year ended December 31, 2009. After we completed the business combination pursuant to which we (1) redomiciled from Delaware to the Cayman Islands, as a Cayman Islands exempt company and (2) completed the acquisition of Search Media International, resulting in Search Media International becoming a wholly-owned subsidiary of SearchMedia Holdings (the Business Combination) and in connection with our preparation of the Annual Report on Form 10-K for the fiscal year ended December 31, 2009, we identified accounting irregularities and potential financial and operational improprieties, relating to transactions and financial reporting matters that occurred under the management of SearchMedia International before the Business Combination, which were not previously identified as a result of material weaknesses in our internal control over financial reporting. These material weaknesses related to, among other things: (i) recording of various erroneous transactions by certain employees; (ii) recording of certain assets and other accounting irregularities related to acquisitions; (iii) diligence and approval of questionable transactions; and (iv) confirmation of payments related to acquisitions.

We have restated the consolidated financial statements of SearchMedia International Limited as of and for the year ended December 31, 2008, but we omitted the consolidated Selected Financial Information for the years ended December 31, 2006 and 2007 to avoid undue reliance on SearchMedia International Limited financial information for these periods.

You should read the selected consolidated financial data in conjunction with those financial statements and the accompanying notes and Item 5. Operating and Financial Review and Prospects.

Total assets	99,765	86,871
Acquisition consideration payable	16,381	39,195
Total liabilities	51,365	86,408
Net assets	48,400	463
Total equity	48,400	463

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risk Related to Our Business and Operations

There is substantial doubt as to our ability to continue as a going concern, which could adversely affect our ability to meet our ongoing financing needs as well as to obtain third party financing.

As indicated in the report on our financial statements issued by our auditors, Marcum Bernstein & Pinchuk LLP, there is substantial doubt about our ability to continue as a going

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concern. As of December 31, 2010 our current liabilities exceeded our current assets by \$39.4 million and our net shareholders' equity was \$0.5 million. Our cash and cash equivalent as of December 31, 2010 was \$7.6 million. We cannot assure you that our business will generate sufficient cash flow from operations in the future to service our debts and make necessary capital expenditures, in which case we may (i) seek additional financing, (ii) dispose of certain assets or (iii) seek to refinance some or all of our debts. We are also taking a number of other actions to address the issue, including amendment of earn-out agreements which provides for extension of the payment time period, seeking funding from existing shareholders and adopting other cost-saving strategies. We cannot assure you that any of the alternatives above can be implemented on satisfactory terms, if at all. The inclusion of the substantial doubt language in the audit report about our ability to continue as a going concern could affect our ability to obtain financing from third parties or could result in increased costs of such financing.

We may not have sufficient liquidity to pay earn-out payments when they come due, which could materially and adversely affect our operations.

We are obligated to pay earn-out payments over the next two to three years in connection with our acquisitions of a number of advertising businesses. We estimate that \$29.0 million is payable within the next twelve months from the date of this Annual Report on Form 20-F and \$10.2 million is payable after the next twelve months. We also estimate that more than 50% of the earn-out payable is payable in stock.

Based on the current cash position and forecast for the rest of the payment period we believe that we currently do not have sufficient capital to pay the required cash earn-out payments over the next twelve months. In addition, due to a variety of factors which cannot presently be ascertained, including without limitation, the amount of working capital that we have available, and the financial performance of both the company and the acquired companies entitled to receive an earn-out payment, there can be no assurance that we will have sufficient liquidity to meet our long-term earn-out obligations. If such failure cannot be remedied through renegotiation of the terms of such earn-outs with the acquiring companies or the raising of the required proceeds on reasonable terms, our operations are likely to be adversely and materially impacted.

We have a history of significant operating losses and our future revenue and operating profitability are uncertain.

We recorded a net loss of \$46.6 million for the year ended December 31, 2010 and we ended the year with an accumulated deficit of \$122.2 million. In addition, we recorded a net loss of approximately \$22.6 million for the year ended December 31, 2009. Loss from operations reduced from \$7.5 million in 2009 to \$4.2 million in 2010. The greater net loss in 2010 was due to impairment charges which were non-cash. We may continue to incur operating losses for the foreseeable future, and such losses may be substantial. We will need to increase revenue in order to generate sustainable operating profit. Given our history of operating losses, we cannot be certain that we will be able to achieve operating profitability on an annual basis. Our failure to achieve profitability could adversely affect the trading price of our common stock and our ability to raise additional capital.

We have identified material weaknesses in our internal control over financial reporting and we have had to restate our historical financial statements.

In August 2010, we announced that we would restate the financial statements of SearchMedia International as of and for the year ended December 31, 2008, to, among other things, correct an overstatement of revenue \$47.0 million in 2008. We restated our financial statements for the year ended December 31, 2008, which was filed in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on November 1, 2010.

After the Business Combination and in connection with our preparation of the Annual Report on Form 10-K filed November 1, 2010, we identified accounting irregularities and potential financial and operational improprieties, relating to transactions and financial reporting matters that occurred under the management of SearchMedia International before the Business Combination, which were not previously identified as a result of material weaknesses in our internal control over financial reporting. These material weaknesses relate to, among other things: (i) recording of various erroneous transactions by certain employees; (ii) recording of certain assets and other accounting irregularities related to acquisitions; (iii) diligence and approval of questionable transactions; and (iv) confirmation of payments related to acquisitions.

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We have implemented and we plan to further implement steps to address these material weaknesses and improve our internal control over financial reporting. However, the implementation of these measures may not fully address these control weaknesses, and to date these control weaknesses have not been remediated in full. If we fail to implement and maintain the adequate internal control procedures in a timely manner, we may not be able to conclude that we have effective internal control over financial reporting. Furthermore, we cannot be certain we will effectively remediate our control weaknesses or that restatements will not occur in the future. The preparation and filing of restatements could create a significant strain on our internal resources and cause delays in our filing of quarterly or annual financial results, increase our financial accounting and related costs, and divert management's attention from the operation of our business.

We are subject to ongoing securities litigation and a government inquiry in the United States.

We and certain of our current and former directors and executive officers are defendants in a federal securities class action in the United States. The amended complaint alleges that the defendants violated Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934 and Rules 10b-5 and 14a-9 thereunder by making false and misleading statements regarding our acquisition of SearchMedia International and by overstating SearchMedia International's financial results during the period April 1, 2009 through August 20, 2010 (Proposed Class Period). The Company and certain of its co-defendants have moved to dismiss the claims asserted against them. We cannot predict the outcome of the motion to dismiss. Moreover, we cannot predict if the court will certify a class.

In addition, we have been notified that the U.S. Securities and Exchange Commission, Los Angeles Regional Office, is conducting a formal investigation regarding the issues that are the subject of our restatement of financial results announced on August 20, 2010. We are cooperating fully with the SEC during this investigation process. We cannot predict the cost or potential liabilities associated with responding to the SEC investigation or any related investigations or litigation that may arise from the matters under inquiry.

We have notified our insurance carriers of these matters. One carrier, which issued a directors' and officers' liability policy that applies to part of the Proposed Class Period, has informed the Company that it formed the view that its policy does not provide coverage for these matters. Accordingly, there can be no assurance that our insurance carriers will cover all or part of the defense costs, or any liabilities that may arise from these matters. Litigation and regulatory actions or proceedings can be time consuming and expensive, and could divert management time and attention from our business, which could have a material adverse effect on our revenues and results of operations. We also may be subject to claims for indemnification related to these matters, and we cannot predict the impact that indemnification claims may have on our business or financial results. Finally, we cannot provide any assurance that the final outcome of these matters will not have a material adverse effect on our business, results of operations, or financial condition.

Deterioration of economic conditions and a resulting decrease in demand for advertising services would materially and adversely affect our financial condition and results of operations and limit our growth prospects.

Demand for our advertising services, and the resulting advertising spending by our clients on our network, is affected significantly by prevailing economic conditions. The current economic downturns in global markets have impacted, and are expected to further impact, materially and adversely, the advertising spending of our existing and potential multinational clients and, as the crisis spreads to China, the advertising spending of our existing and potential domestic clients. With a severe decline in economic conditions, clients who would normally spend on a broad range of traditional and new media may curtail their overall spending or concentrate their advertising spending on one medium. As we derive most of our revenues from our billboard and in-elevator advertising networks, a decrease in demand for advertising media in general and for our advertising media or advertising networks in particular would materially and adversely affect our financial condition and results of operations and limit our growth prospects. In addition, our clients who are adversely affected by the worsened economic conditions may delay paying the advertising fees to us, which would adversely affect our liquidity and results of operations.

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A business strategy of making acquisitions subjects us to all of the risks inherent in identifying, acquiring and operating newly acquired businesses.

Our growth strategy includes acquiring new businesses to complement and expand our existing operations. In the future, we may continue to make acquisitions of, or investments in, businesses that we believe could complement or expand our current business or offer growth opportunities. To that end, we may spend significant management time and resources in analyzing and negotiating acquisitions or investments that are not consummated. The ongoing process of integrating these businesses is distracting, time consuming, expensive, and requires continuous optimization and allocation of resources. Additionally, if we use stock as consideration, this would have a dilutive effect on existing stockholders. If we use cash, this would reduce our liquidity and impact our financial flexibility. We may seek debt financing for particular acquisitions, which may not be available on commercially reasonable terms, or at all. We face all the risks associated with a business acquisition strategy, including, but not limited to:

the potential disruption of our existing businesses, including the diversion of management attention and the redeployment of resources;

entering new markets or industries in which we have limited prior experience;

failure to identify in due diligence key issues specific to the businesses we seek to acquire or the industries or other environments in which they operate, or, failure to protect against contingent liabilities arising from those issues;

unforeseen or hidden liabilities;

difficulties in integrating, aligning and coordinating organizations which will likely be geographically separated and may involve diverse business operations and corporate cultures;

difficulties in integrating and retaining key management, sales, research and development, production and other personnel;

potential loss of key employees, clients or distribution partners of the acquired businesses;

difficulties in incorporating the acquired business into our organization;

the potential loss of customers, distributors or suppliers;

adverse effects on our existing business relationships with our advertisers;

difficulties in integrating or expanding information technology systems and other business processes to accommodate the acquired businesses;

risks associated with integrating financial reporting and internal control systems;

the potential for future impairments of goodwill if the acquired business does not perform as expected;

the inability to obtain necessary government approvals for the acquisition, if any; and

successfully operating the acquired business.

If we cannot overcome these challenges, we may not realize actual benefits from past and future acquisitions, which will impair our overall business results. If we complete an investment or acquisition, we may not realize the anticipated benefits from the transaction.

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Failure to manage our growth could strain our management, operational and other resources, which could materially and adversely affect our business and growth potential.

We experienced rapid expansion in recent years, which resulted, and will continue to result, in substantial demand on our management resources. To manage our growth, we must develop and improve our existing administrative and operational systems and our financial and management controls, and further expand, train and manage our work force. We also need to incur substantial costs and spend substantial resources in connection with these efforts. We may not have the resources to revamp our systems and controls, recruit or train our personnel, or afford to incur the costs and expenses in order to successfully manage our growth. Failure to manage our growth may materially and adversely affect our business and growth potential.

Future charges due to possible impairments of acquired assets may have a material adverse effect on our financial condition and results of operations.

A portion of our assets is comprised of goodwill and other intangible assets, which may be subject to future impairment that would result in financial statement write-offs. Goodwill and other intangible assets represent approximately 57.5% of our total assets at December 31, 2010. If there is a material change in our business operations or prospects, the value of the intangible assets we have acquired or may acquire in the future could decrease significantly. On an ongoing basis and at least annually, we will evaluate, partially based on discounted expected future cash flows, whether the carrying value of such intangible assets may no longer be recoverable, in which case a charge to earnings may be necessary. Any future determination requiring the write-off of a significant portion of unamortized intangible assets, although not requiring any additional cash outlay, could have a material adverse effect on our financial condition, results of operations and stock price.

We face significant competition for advertising spending from operators of new and traditional advertising networks. If we cannot successfully compete, our results of operations would be materially and adversely affected.

We face competition for general advertising spending from operators of many other forms of advertising networks, such as television, print media, Internet and other types of out-of-home advertising.

Our success depends on the continuing and increased interest of advertising clients and agencies in in-elevator, outdoor billboard, transit advertising as components of their advertising strategies. Advertisers may elect not to use our services if they believe that the viewing public is not receptive to advertising platforms we offer or that these platforms do not provide sufficient value as effective advertising mediums. If we cannot successfully compete for advertising spending against traditional, Internet and other types of out-of-home advertising, we will be unable to generate sufficient revenues and cash flows to operate our business, and our results of operations could be materially and adversely affected.

For in-elevator and billboard advertising spending, we face competition from different players across different platforms and in different cities where we operate. For our in-elevator advertising platform, we compete primarily against large regional operators and other nationwide operators some of which have substantially more financial resources than we have. For our billboard advertising platform, we compete against mostly local or regional outdoor billboard owners and operators, as the outdoor billboard market in China is largely fragmented. For our transit advertising platform, we compete against other seasoned operators. We compete for advertising spending on these platforms generally on the basis of network coverage, service quality and brand name. If we cannot compete successfully for advertising spending on these platforms, our market share and our results of operations would suffer.

We have a limited operating history which may make it difficult for you to evaluate our business and prospects.

SearchMedia International entered the out-of-home advertising market in 2005. We have been a public company since 2009. Accordingly, we have a limited operating history for our current operations upon which you can evaluate the viability and sustainability of our business and our acceptance by advertisers.

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If we fail to develop and maintain relationships with site owners, managers and sublessors that provide us access to desirable locations and network platforms, our growth potential and our business could be harmed.

Our ability to generate revenues from advertising sales depends largely on our ability to provide a large network of our media products across media platforms at desirable locations. The effectiveness of our network also depends on the cooperation of site owners and managers to allow us to install the desired types of frames at the desired spots on their properties and, for in-elevator advertising, to keep the elevators in operation and accessible to the viewing public. To address these needs, we must develop and maintain business relationships with site managers and owners and, for a portion of our network, sublessors that consist primarily of advertising companies. Since the ownership of residential and office buildings are fragmented, maintaining these relationships requires considerable operational resources in terms of contract management and site development and maintenance personnel. If we fail to devote the necessary resources to maintaining these relationships or if we fail to perform our obligations under the existing leases, these lessors and sublessors may terminate their leases with us or not renew them upon expiration. In some cases, we have not maintained good relations and some of our leases have been terminated or may be terminated in the future. As there is a limited supply of billboards at desirable locations and a limited number of subway stations, the termination of a significant number of the leases for billboards and light boxes at subway stations could harm our multi-platform growth and operation strategies and our business and prospects could suffer as a result.

Failures to obtain site owners' consents or objections from site owners to the installations of our media products could lead to termination of our contracts or installations, which would harm our results of operations.

PRC real estate laws and regulations require that we obtain prior consent of site owners and managers for any commercial use of public areas or facilities of residential properties. We generally enter into display placement agreements with site managers. To comply with PRC real estate laws and regulations, we also need to obtain or urge site managers to obtain prior consent of site owners committees or site owners. In some circumstances, it is difficult to locate site owners. If we enter into an agreement for display placement with a site manager without the consent from the relevant site owners, we could be subject to fines of up to RMB0.2 million (approximately \$29,000) for each site and be required to remove our advertising posters from the affected building. In addition, site owners who object to the installation of poster frames in their buildings may cause site managers to terminate or fail to renew site contracts with us, which would harm our results of operations.

If we are unable to obtain or retain desirable placement locations for our advertising poster frames and outdoor billboards on commercially advantageous terms, our operating margins and earnings could decrease and our results of operations could be materially and adversely affected.

Our cost of revenues consists primarily of operating lease cost of advertising space for displaying advertisements, depreciation of advertisement display equipment, amortization of intangible assets relating to lease agreements and direct staff and material costs associated with production and installation of advertisement content. Our operating lease cost represents a significant portion of our cost of revenues. In 2009 and 2010, our operating lease cost accounted for 84.4% and 91.4%, respectively, of our cost of revenues and 62.0% and 64.3% respectively, of our total revenues. In the future, we may need to pay higher amounts in order to renew existing leases, obtain new and desirable locations, or secure exclusivity and other favorable terms. If we are unable to secure commercially advantageous terms or pass increased location costs onto our advertising clients through rate increases, our operating margins and earnings could decrease and our results of operations could be materially and adversely affected.

The shareholders of Jingli Shanghai may have potential conflicts of interest with us.

The shareholders of Jingli Shanghai are also the founders and shareholders of the Company. Conflicts of interests between their dual roles as shareholders of both Jingli Shanghai and the Company may arise. We cannot assure you that when conflicts of interest arise, any or all of these individuals will act in the best interests of the Company or that any conflict of interest will be resolved in our favor. In addition, these individuals may breach or cause Jingli Shanghai to breach or refuse to renew the existing contractual arrangements that allow us to effectively control Jingli Shanghai and receive economic benefits from it. If we cannot resolve any conflicts of interest or disputes between us and the shareholders of Jingli Shanghai, we would have to rely on legal proceedings, the outcome of which is uncertain and could be disruptive to our business.

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Our business depends substantially on the continuing efforts of our senior executives, and our business may be severely disrupted if we lose their services.

Our future success depends heavily on the continued services of our senior executives and other key employees, their industry expertise, their experience in business operations and sales and marketing, and their working relationships with our advertising clients as well as the site owners, property developers, property management companies, homeowner associations and relevant government authorities that affect the site contracts with us.

We do not have a long history of working with some of these senior executives and key employees. If one or more of our senior executives were unable or unwilling to continue in their present positions, we might not be able to replace them easily or at all. If any of our senior executives join a competitor or forms a competing company, we may lose clients, site contracts, key professionals and staff members. We have entered into an employment agreement with each of our executive officers, which agreement contains non-competition provisions. However, if a dispute arises between us and our executive officers, there is no assurance that any of these agreements could be enforced, or to what extent they could be enforced, in China, in light of the uncertainties with China's legal system.

If we are unable to adapt to changing advertising trends of advertisers and consumers, we will not be able to compete effectively and we will be unable to increase or maintain our revenues, which may materially and adversely affect our business prospects and revenues.

The competitive market for out-of-home advertising requires us to continuously identify new advertising trends of advertisers and consumers. In response to these new advertising trends, we may need to quickly develop and adopt new formats, features and enhancements for our advertising network and/or cost-effectively expand into additional advertising media and platforms beyond in-elevator, billboards, and transit platform advertising. We may be required to incur, but may not have the financial resources necessary to fund, development and acquisition costs in order to keep pace with new advertising trends. If we fail to identify or respond adequately to these changing advertising trends, demand for our advertising network and services may decrease and we may not be able to compete effectively or attract advertising clients, which would have a material and adverse effect on our business prospects and revenues.

Our growth could suffer if we fail to expand our media networks to include new media offerings, media platforms or enter into new markets.

Currently, our network primarily consists of in-elevator, outdoor billboard and transit advertising. Our growth strategy includes broadening our service offerings and possibly entering into new advertising markets. It is difficult to predict whether consumers and advertising clients will accept our entry into new media markets or accept the new media products or platforms we may offer. It is also difficult to predict whether we will be able to generate sufficient revenues to offset the costs of entering into these new markets or introducing these new products or new media platforms. We may also have limited or no prior experience working with these new products, platforms or markets. If we fail to expand our media network to include new media products, platforms or markets, our growth could suffer as a result.

If site managers or owners shut down our displays for site maintenance or other reasons, our business could be adversely affected.

Under certain site leasing contracts we entered into with site managers or owners, site managers or owners have the right to shut down our displays with prior written notice if they need to inspect or maintain the sites where we have installed advertising displays, or for other reasons such as facility reconstruction. However, under our contracts with our advertising clients, if these displays are shut down for an extended period of time, we are required to substitute these suspended displays with alternative displays. If we cannot reach an agreement with our clients on the alternative displays, we could be required to refund the advertising fees paid by these clients. If a substantial number of our displays are shut down by site managers within a short time period, we may not be able to locate alternative display locations and may incur substantial remedial costs. Our relationships with our advertising clients could also suffer and our financial results could be adversely affected.

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Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

We regard our copyrights, trademarks, trade secrets and other intellectual property as critical to our success.

Unauthorized use of the intellectual property used in our business may adversely affect our business and reputation. We have historically relied on a combination of trademark and copyright law, trade secret protection and restrictions on disclosure to protect our intellectual property rights. We have entered into confidentiality agreements with all our employees. We cannot assure you that these confidentiality agreements will not be breached, or that we will have adequate remedies for any breach.

We are still in the process of registering in China the SearchMedia trademark and logo used in our business. We cannot assure you that our trademark application will ultimately proceed to registration or will result in registration with scope adequate for our business. Some of our pending applications or registration may be successfully challenged or invalidated by others. If our trademark application is not successful, we may have to use different marks for affected services or technologies, or enter into arrangements with any third parties who may have prior registrations, applications or rights, which might not be available on commercially reasonable terms, if at all.

In addition, monitoring and preventing unauthorized use of our trademarks and other intellectual property is difficult and expensive, and litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations.

We rely on computer software and hardware systems in managing our operations; any failure in these systems could adversely affect our business, financial condition and results of operations.

We are dependent upon our computer software and hardware systems in supporting the sales, scheduling and maintenance of our network. In addition, we rely on our computer hardware for the storage and delivery of the data on our network. Any system failure which causes interruptions to the input and retrieval of data or increases our service time could disrupt our normal network operations. In addition, computer hackers infecting our network with viruses could cause our network to become unavailable. Although we believe that our disaster recovery plan is adequate to handle the failure of our computer software and hardware systems, we cannot assure you that we will be able to effectively carry out this disaster recovery plan or that we would be able to restore our network operations fast enough to avoid a significant disruption to our business. Any failure in our computer software and/or hardware systems could decrease our revenues and harm our relationships with advertisers and target audiences, which in turn could have a material adverse effect on our business, financial condition and results of operations.

We have no business liability, disruption or litigation insurance, and we could incur substantial costs if our business is disrupted due to natural disasters, litigation or other business interruptions.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products and do not, to our knowledge, offer business liability insurance. While business disruption insurance is available to a limited extent in China, we have determined that the risks of disruption, cost of such insurance and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. As a result, we do not have any business liability or disruption coverage for our operations in China. All industries are subject to legal claims. As a public company, we are particularly susceptible to securities and derivative lawsuits. These claims may be costly to defend and divert the attention of our management and our resources in general. Defense and settlement costs can be substantial, even with respect to claims that have no mer