CIRTRAN CORP
Form 424B3
August 22, 2006

CIRTRAN CORPORATION
A Nevada Corporation

100,000,000 Shares of Common Stock
$0.001 per share

This prospectus relates to the resale of up to 100,000,000 shares (the "Shares") of common stock of CirTran Corporation, a Nevada corporation. One of our shareholders, Highgate House Funds, Ltd., (the "Selling Shareholder") is offering all of the Shares covered by this prospectus. The Selling Shareholder may receive shares in connection with conversions of our 5% Secured Convertible Debenture (the "Debenture") sold to the Selling Shareholder pursuant to a Securities Purchase Agreement (the "Purchase Agreement"), discussed in more detail herein. The Selling Shareholder may elect to convert, at its option, all or part of the principal amount, together with accrued interest on the Debenture, into shares of our common stock at a conversion price discussed in more detail herein. This Prospectus, and the registration statement of which it is a part does not register the resale of any shares issued as interest accrued or accruable in connection with the Debenture. The Selling Shareholder will receive all of the proceeds from the sale of the Shares and we will receive none of those proceeds. Highgate House Funds, Ltd. may be deemed to be an underwriter of the Shares.

Investment in the Shares involves a high degree of risk. You should consider carefully the risk factors beginning on page 18 of this prospectus before purchasing any of the Shares offered by this prospectus.

CirTran Corporation common stock is quoted on the OTC Bulletin Board and trades under the symbol "CIRT". The last reported sale price of our common stock on the OTC Bulletin Board on July 20, 2006, was approximately $0.03 per share. Nevertheless, the Selling Shareholders do not have to sell the Shares in transactions reported on the OTC Bulletin Board, and may offer their Shares through any type of public or private transactions.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities, or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

August ___, 2006

CIRTRAN HAS NOT REGISTERED THE SHARES FOR SALE BY THE SELLING SHAREHOLDERS UNDER THE SECURITIES LAWS OF ANY STATE. BROKERS OR DEALERS EFFECTING TRANSACTIONS IN THE SHARES SHOULD CONFIRM THAT THE SHARES HAVE BEEN REGISTERED UNDER THE SECURITIES LAWS OF THE STATE OR STATES IN WHICH SALES OF THE SHARES OCCUR AS OF THE TIME OF SUCH SALES, OR THAT THERE IS AN AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES LAWS OF SUCH STATES.

THIS PROSPECTUS IS NOT AN OFFER TO SELL ANY SECURITIES OTHER THAN THE SHARES. THIS PROSPECTUS IS NOT AN OFFER TO SELL SECURITIES IN ANY CIRCUMSTANCES IN WHICH SUCH AN OFFER IS UNLAWFUL.

CIRTRAN HAS NOT AUTHORIZED ANYONE, INCLUDING ANY SALESPERSON OR BROKER, TO GIVE ORAL OR WRITTEN INFORMATION ABOUT THIS OFFERING, CIRTRAN, OR THE SHARES THAT IS DIFFERENT FROM THE INFORMATION INCLUDED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS. YOU SHOULD NOT ASSUME THAT THE INFORMATION IN THIS PROSPECTUS, OR ANY SUPPLEMENT TO THIS PROSPECTUS, IS ACCURATE AT ANY DATE OTHER THAN THE DATE INDICATED ON THE COVER PAGE OF THIS PROSPECTUS OR ANY SUPPLEMENT TO IT. IN THIS PROSPECTUS, REFERENCES TO "CIRTRAN," "THE COMPANY," "WE," "US," AND "OUR," REFER TO CIRTRAN CORPORATION AND ITS SUBSIDIARIES.

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Summary about CirTran Corporation and this offering

CirTran Corporation

CirTran Corporation is a Nevada corporation engaged in providing a mixture of high and medium size volume turnkey manufacturing services for electronics original equipment manufacturers ("OEMs") in the communications, networking, peripherals, gaming, consumer products, telecommunications, automotive, medical, and semiconductor industries. These services include providing design and new product introduction services, just-in-time delivery on low-volume to medium-volume turnkey and consignment projects, and other value-added manufacturing services. Our manufacturing processes include the following: surface mount technology, ball-grid array assembly and pin-through-hole technology, which are all methods of attaching electronic components to circuit boards; manufacturing and test engineering support and design for manufacturability; and in-circuit and functional test and full-system mechanical assembly. We also design and manufacture Ethernet cards that are used to connect computers through fiber optic networks and market these cards through an international network of distributors, value-added resellers and system integrators.

We incorporated in Nevada in 1987 under the name Vermillion Ventures, Inc., for the purpose of acquiring other operating corporate entities. We were largely inactive until the year 2000, when we effected a reverse split in our common stock, reducing our issued and outstanding shares to 116,004. In July 2000, we issued 10,000,000 shares of common stock to acquire, through our wholly owned subsidiary, CirTran Corporation (Utah), substantially all of the assets and certain liabilities of Circuit Technology, Inc., a Utah corporation. The shares we issued to Circuit Technology in connection with the acquisition represented approximately 98.6% of our issued and outstanding common stock immediately following the acquisition.

Effective August 6, 2001, we effected a 1:15 forward split and stock distribution which increased the number of our issued and outstanding shares of common stock from 10,420,067 to 156,301,005. We also increased our authorized capital from 500,000,000 to 750,000,000 shares of common stock.

Our address is 4125 South 6000 West, West Valley City, Utah 84128, and our phone number is (801) 963-5112.

This offering

On May 26, 2005, we entered into a securities purchase agreement (the "Purchase Agreement") with Highgate House Funds, Ltd., a Cayman Island exempted company ("Highgate" or the "Selling Shareholder"), relating to the issuance by us of a 5% Secured Convertible Debenture, due December 31, 2007, in the aggregate principal amount of $3,750,000 (the "Convertible Debenture").

In connection with the purchase of the Convertible Debenture, we used $2,265,000 to repay two promissory notes to Cornell Capital Partners, LP ("Cornell"), one in the amount of $1,700,000, and the other in the amount of $565,000. Highgate and Cornell have the same general partner, Yorkville Advisors, but have different portfolio managers.

We also paid a commitment fee of $240,765, a structuring fee of $10,000 to Highgate, and legal fees of $5,668. As such, of the total purchase amount of $3,750,000, the net proceeds to us were $1,228,567, which we received following the closing of the issuance of the Convertible Debenture. We used these proceeds for general corporate and working capital purposes.

The Convertible Debenture bears interest at a rate of 5%. Highgate is entitled to convert, at its option, all or part of the principal amount owing under the Convertible Debenture into shares of our common stock at a conversion price equal to the lesser of (a) $0.10 per share, or (b) an amount equal to the lowest closing bid price of the Common Stock as listed on the OTC Bulletin Board, as quoted by Bloomberg L.P. for the twenty (20) trading days immediately preceding the conversion date. Except as otherwise set forth in the Convertible Debenture,

Highgate's right to convert principal amounts owing under the Convertible Debenture into shares of our common stock is limited as follows:

1. Highgate may convert up to $250,000 worth of the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the market price of our stock is $0.10 per share or less at the time of conversion;

2. Highgate may convert up to $500,000 worth of the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the price of our stock is greater than $0.10 per share at the time of conversion, provided, however, that Highgate may convert in excess of the foregoing amounts if we and Highgate mutually agree; and

3. Upon the occurrence of an event of default (as defined in the Convertible Debenture), Highgate may, in its sole discretion, accelerate full repayment of all debentures outstanding and accrued interest thereon or may, notwithstanding any limitations contained in the Convertible Debenture and/or the Purchase Agreement, convert the Convertible Debenture and accrued interest thereon into shares of our common stock pursuant to the Convertible Debenture.

A chart showing the number of shares issuable upon hypothetical conversions at particular conversion prices is set forth in the "Risk Factors" section on page 18.

Pursuant to the Convertible Debenture, interest is to be paid at the time of maturity or conversion. We may, at our option, pay accrued interest in cash or in shares of common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either (i) the date the interest payment is due; or (ii) if the interest payment is not made when due, the date on which the interest payment is made.

We filed this registration statement to register the resale of shares issuable to Highgate upon conversions by Highgate of the Convertible Debenture. However, this registration statement does not register the resale of any shares issued to Highgate as payment of interest accrued on the Convertible Debenture, and neither this registration statement nor the prospectus may be used to sell shares issued to Highgate as payment of interest accrued on the Convertible Debenture.

On June 15, 2006, we entered into an agreement with Highgate to amend the registration rights agreement, pursuant to which we agreed to use our best efforts to have the registration statement declared effective by July 31, 2006. On August 10, 2006, we entered into a further agreement with Highgate to amend the registration rights agreement, pursuant to which we agreed to use our best efforts to have the registration statement declared effective by August 31, 2006. Under the second amendment agreement, if the registration statement has not been declared effective by August 31, 2006, Highgate may declare us in default under the Convertible Debenture.

The number of shares issuable in connection with this registration statement is also limited by our authorized capital, which as of July 20, 2006, was 750,000,000 shares. In other words, we are not authorized to issue more than 750,000,000 shares of our common stock, irrespective of how many shares are covered by this registration statement and prospectus, unless we increase our authorized capital, as discussed below in the "Risk Factors" section on page 22.

The terms of the Convertible Debenture include and set forth other information, including certain limitations on conversions by Highgate and redemption of the Convertible Debenture, all discussed more fully below in the Section "5% Convertible Debenture." Additionally, in connection with the issuance of the Convertible Debenture, we entered into additional agreements with Highgate, including a registration rights agreement, a security agreement, and an escrow agreement, all discussed more fully below in the Section "5% Convertible Debenture."

Recent Developments

Diverse Media Group

On March 21, 2006, the Company issued a press release "CirTran Forms New Division to Serve Direct Response and Entertainment Industries." The new division will concentrate its efforts on product marketing, production, media funding and merchandise manufacturing services working as a complete vertically-integrated platform that can augment our manufacturing services in the direct response industry. Our experience in this industry over the past two years has taught us that there is a need for a single source solution. In addition, we feel it will help us capture additional business that might otherwise had been lost at the manufacturing level allowing us to participate in all additional areas.

CirTran Products Division

On December 2, 2005, we announced that we had formed a new division, CirTran Products, which will offer products for sale at retail. The new division will be run from our new Los Angeles office, with Trevor Saliba, our executive vice president for worldwide business development, working to develop sales. We anticipate that consumer products built by our CirTran Asia subsidiary, as well as other products which we plan to acquire, will be available for retail sale in 2006

CirTran Products was established to pursue manufacturing relationships on both a contracted and proprietary basis in the consumer products industry. Proprietary products will be product lines where the intellectual property (logo, trade name etc.) are owned by CirTran Products as well as exclusively manufactured by CirTran Corporation. The marketing efforts may also be managed exclusively by CirTran, or CirTran may choose to engage third party consultants or partner with an independent marketing firm. CirTran Products also intends to pursue contract manufacturing relationships in the consumer products industry which can include product lines including: home/garden, kitchen, health/beauty, toys, licensed merchandise and apparel for film, television, sports and other entertainment properties. Licensed merchandise and apparel can be defined as any item that bears the image of, likeness, or logo of a product sold or advertised to the public. Licensed merchandise and apparel are sold and marketed in the entertainment (film and television) and sports (sports franchises) industries. As of July 20, 2006, we had concentrated our product development efforts into three areas, home/kitchen appliances, beauty products and licensed merchandise.

We anticipate that these products will be introduced into the market under one uniform brand name or under a separate trademarked names owned by CirTran Products.

Additional Convertible Debenture Transaction

On December 30, 2005, we entered into a securities purchase agreement (the "Purchase Agreement") with Cornell Capital Partners, a Delaware limited partnership ("Cornell Capital"), relating to the issuance by us of a 5% Secured Convertible Debenture, due July 30, 2008, in the aggregate principal amount of $1,500,000 (the "Cornell Debenture").

We also paid a commitment fee of $120,000, and a structuring fee of $10,000 to Cornell Capital. As such, of the total purchase amount of $1,500,000, the net proceeds to us were $1,370,000. We will use these proceeds for general corporate and working capital purposes, in our discretion.

The Cornell Debenture bears interest at a rate of 5%. Cornell Capital is entitled to convert, at its option, all or part of the principal amount owing under the Debenture into shares of the Company's common stock at a conversion price equal one hundred percent (100%) of the lowest closing bid price of the Common Stock as listed on the OTC Bulletin Board, as quoted by Bloomberg L.P. for the twenty (20) trading days immediately preceding the Conversion Date, subject to certain restrictions and limitations set forth in the Cornell Debenture.

Under the terms of the Cornell Debenture, except upon an event of default as defined in the Cornell Debenture, Cornell Capital may not convert the Cornell Debenture for a number of shares of common stock in excess of that

number of shares of common stock which, upon giving effect to such conversion, would cause the aggregate number of shares of Common Stock beneficially owned by Cornell Capital and its affiliates to exceed 4.99% of the outstanding shares of the common stock following such conversion.

Pursuant to the Cornell Debenture, interest is to be paid at the time of maturity or conversion. We may, at our option, pay accrued interest in cash or in shares of our common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either (i) the date the interest payment is due; or (ii) if the interest payment is not made when due, the date on which the interest payment is made.

Also pursuant to the Cornell Debenture, we have the right to redeem, by giving 3 days' written notice to Cornell Capital, a portion or all of the Cornell Debenture then outstanding by paying an amount equal to one hundred five percent (105%) of the amount redeemed plus interest accrued thereon. In the event that we redeem only a portion of the outstanding principal amount of the Cornell Debenture, Cornell Capital may convert all or any portion of the unpaid principal or interest of the Cornell Debenture not being redeemed by us. Additionally, if after the earlier to occur of (x) fifteen (15) months following the date of the purchase of the Cornell Debenture or (y) twelve (12) months following the date on which the initial registration statement is declared effective, all or any portion of the Cornell Debenture remains outstanding, then we, at the request of Cornell Capital, are required to redeem such amount outstanding at the rate of five hundred thousand dollars ($500,000) per each 30-day period. Finally, upon the occurrence of an event of default as defined in the Cornell Debenture, Cornell Capital can convert all outstanding principal and accrued interest under the Cornell Debenture irrespective of any of the limitations set forth in the Cornell Debenture and/or the Purchase Agreement, and in such event, all such principal and interest shall become immediately due and payable.

In connection with the Purchase Agreement, we also agreed to grant to Cornell Capital warrants (the "Cornell Warrants") to purchase up to an additional 10,000,000 shares of our common stock. The Cornell Warrants have an exercise price of $0.09 per share, and expire three years from the date of issuance. The Cornell Warrants also provide for cashless exercise if at the time of exercise there is not an effective registration statement or if an event of default has occurred.

Additionally, we entered into an investor registration rights agreement (the "Registration Rights Agreement") with Cornell Capital, pursuant to which we agreed to file, within 120 days of the closing of the purchase of the Cornell Debenture, a registration statement to register the resale of shares of our common stock issuable to Cornell Capital upon conversion of the Cornell Debenture. We agreed to register the resale of up to 42,608,696 shares, consisting of 32,608,696 shares underlying the Cornell Debenture, and 10,000,000 shares underlying the Cornell Warrants. We agreed to keep such registration statement effective until all of the shares issuable upon conversion of the Cornell Debenture have been sold. In the event that we issue more than 32,608,696 shares of its common stock upon conversion of the Cornell Debenture, we will file additional registration statements as necessary.

On June 15, 2006, we entered into an agreement with Cornell to amend the registration rights agreement, pursuant to which we agreed to file the registration statement not later than August 15, 2006, instead of 120 days following the closing of the issuance of the Cornell Debenture. On August 10, 2006, we entered into a further agreement with Cornell to extend the filing date to October 15, 2006. Under the second agreement, if the registration statement has not been filed by October 15, 2006, Cornell may declare us in default under the Cornell Debenture.

We also entered into a security agreement (the "Security Agreement") with Cornell Capital, pursuant to which we granted a second position security interest in all of our property, including goods; inventory; contract rights and general intangibles; documents, receipts, and chattel paper; accounts and other receivables; products and proceeds; and any interest in any subsidiary, joint venture, or other investment interest to secure our obligation under the Cornell Debenture and the related agreements.

We also entered into an escrow agreement (the "Escrow Agreement") with Cornell Capital relating to the holding and disbursement of payment of the purchase price of the Cornell Debenture and cash payments made by us in payment of the obligations owing under the Cornell Debenture. We agreed with Cornell

Capital to appoint David Gonzalez as the Escrow Agent under the Escrow Agreement.

By way of background, we have previously entered into financing transactions with Cornell Capital. In April 2003, we had entered into an equity line of credit agreement with Cornell Capital, pursuant to which we drew a total of $2,150,000 on the equity line, and issued a total of 57,464,386 shares of common stock to Cornell Capital. In May 2004, we entered into a standby equity distribution agreement with Cornell Capital, but the agreement was terminated before any funds were drawn or any shares were issued. Between June 2003 and January 2005, Cornell Capital loaned to us an aggregate of $5,595,000 pursuant to promissory notes issued to Cornell Capital. These notes were paid in full by May 2005.

Highgate House Funds, Ltd., a Cayman Island exempted company ("Highgate"), who is the Selling Shareholder under this registration statement, and Cornell Capital have the same general partner, Yorkville Advisors, but have different portfolio managers. Additionally, the escrow agent appointed in connection with the purchase and sale of both the Cornell Capital debenture transaction and the Highgate debenture transaction is David Gonzalez, who is an officer of Cornell Capital.

The Company does not anticipate that it will use any of the proceeds of the sale of the Cornell Debenture to Cornell Capital to repay the debenture sold to Highgate.

Exclusive Manufacturing Agreement

On December 28, 2005, we signed an Exclusive Manufacturing Agreement (the "Agreement") with Arrowhead Industries, Inc. ("Arrowhead"), pursuant to which we will become the exclusive manufacturer of a tool for assisting with the removal of door hinges called the "Hinge Helper" (the "Product"). Under the Agreement, Arrowhead agreed to buy the Product exclusively from us for the period of the Agreement, which is three years. The Product will be manufactured by us or by sub-manufacturers selected by us.

The Agreement provides that Arrowhead will own all right, title, and interest in the Product, and will sell and market the Product under its trademarks, service marks, or trade names.

On January 9, 2006, we issued a press release which referred, in the title, to the Agreement as a "$22 Million Exclusive Manufacturing Agreement." The dollar amount referenced relates to the potential amount of income or revenue which we may receive over the anticipated life of the Agreement.

CirTran announced on January 9, 2006, that Arrowhead Industries, Inc., of Windermere, Florida, had awarded us an exclusive contract to manufacture its patented Hinge Helper (TM) do-it-yourself utility tool for the home. The Hinge Helper will be manufactured by CirTran-Asia, the Company's China-based subsidiary. The exclusive manufacturing contract for the product is for three years. Arrowhead has filmed a Hinge Helper infomercial for TV with an airing date scheduled for late April.

The Hinge Helper is a unique hand tool designed and developed for use by household customers as well as tradesmen. Recognized by the U.S. Patent Office (#6,308,390 B1), its trademark and patent are owned by and registered to Arrowhead. The specific advantage of the Hinge Helper is its ease-of-use and simplistic design. It can be applied to any residential hinge on wood, metal or composite doors, and is being manufactured with highly-durable materials, enabling it to carry a lifetime guarantee.

The contract is for three years, and Arrowhead agreed to purchase a minimum of ten million (10,000,000) units of the Product (the "Minimum Quantity"), subject to the terms and conditions of the Agreement. Arrowhead and CirTran have agreed on the Minimum Quantity in good faith, although the parties acknowledged that in certain circumstances described in the agreement, the agreement may be terminated prior to the sale of the entire Minimum Quantity. Arrowhead agreed to submit purchase orders for the Product from time to time in accordance with the terms of the agreement. Arrowhead agreed to pay CirTran for the Product purchased at the prices ranging from $2.95 to $1.90 per unit, depending on the cumulative number of units of Product which have been purchased by Arrowhead.

Arrowhead will also be entitled to a rebate equal to 10% of the purchase Price paid for Product in the previous Tier. Rebates will be payable only in the form of a credit memo against future purchases. Rebate credit memos will not be paid in cash and may not be applied against outstanding balances. We will calculate eligibility for the Rebate as soon as practicable following the end of the month in which a new Tier is entered.

We have produced hand made samples, which have been sent to Arrowhead. These were approved and we are awaiting final approval for the production samples that were supplied at the end of March 2006.. Once the production samples are approved, we will start production according to the release schedule that should be provided by Arrowhead shortly thereafter.

Aegis Assessments

On March 14th, 2006, we announced that we had received a $250,000 order to build and deliver the first production run of the next generation SafetyNet(TM) RadioBridge(TM) which we redesigned at the request and on behalf of Aegis Assessments, Inc., a Scottsdale, Arizona-based homeland security contractor. Since the announcement, we have been procuring materials to manufacture the units and ship to Aegis so they can start fulfilling their orders to their customers. We delivered the new, redesigned units and received payment in full from Aegis in April 2006.

Settlement of Legal Proceedings

On April 12th, 2006, we announced that we had settled all major litigation in which we were a defendant. These litigation matters had been described in our previous SEC filings and were settled for less than the original claims against us. We were able to settle these cases with a total cash outlay of only $200,000 after originally having exposure of up to $4.25 million. We settled with Howard Salamon, a financial consultant who originally sued us for $1.75 million through the issuance of 4 million restricted shares and a warrant to purchase an additional 7 million shares exercisable at $.05 per share. We also settled our dispute with Sunborne XII, LLC, a Colorado limited liability company and the owner of a building in Colorado Springs, Colorado, to which we expanded our operations in the late 1990s, for $200,000 in cash. Sunborne's claim originally ranged up to $2.5 million. Both settlements were reached in February 2006. Our subsidiary, CirTran Asia, will continue to proceed with its action against International Edge, Inc., Michael Casey Enterprises, Inc., Michael Casey, David Hayek, and HIPMG, Inc., as discussed below under "Legal Proceedings."

Real Deal Grill

On April 18th, 2006, we announced that we had joined forces with former heavyweight champion Evander Holyfield to market and promote "The Real Deal Grill(TM)," a new electric indoor/outdoor cooking product to be sold via TV infomercials. We arranged with the former champion's company, Holyfield Management, Inc., of Georgia, for his services to promote the product and to film a series of TV infomercials featuring Mr. Holyfield and The Real Deal Grill, which are scheduled to be filmed in Florida in May 2006. Mr. Holyfield will receive a talent fee for all units sold.

HBD/Reliant Agreement

On April 19, 2006, we announced that we had signed an agreement relating to "The

Real Deal Grill(TM) (the "Grill"), which will initially be sold on TV worldwide and endorsed by Evander Holyfield, the four-time heavyweight boxing champion of the world. The agreement was signed with Harrington Business Development ("HBD") of St. Petersburg, Florida, giving HBD the rights to market the Grill in the Americas and Japan (the "Territory"). Under the contract, HBD will initially market the Grill on TV through infomercials in the U.S., Canada, South America and Japan, which will be filmed in Florida featuring Mr. Holyfield. Under the terms of the contract, we have paid one-half of the costs of producing the initial infomercial, in the amount of $37,500. Under the contract, HBD granted to us the right to use the raw footage, including audio and video, for the initial infomercial to produce infomercials or other advertisements for the Grill for use solely outside of the Territory. The agreement has an initial term

of 3 years and may be renewed. HBD is part of Reliant International Media Corporation ("Reliant"), a full-service direct response company founded by industry pioneers and leaders Tim and Kevin Harrington. The Harringtons, who have been in the direct response industry since the early 1980's, have produced long and short form infomercials for products in numerous categories, which have been seen on TV around the world.

In further consideration for use of the Infomercial footage, we agreed to pay to HBD a royalty of $2.00 per unit of product on all products sold outside of the territory covered by the agreement (consisting of North America, South America, and Japan) by the Company or sublicensees of the Infomercial footage, net of returns and warranty replacements. For purposes of this royalty obligation, a unit of product consists of the Real Deal Grill itself including any accessories included in the price of the grill. The royalty to HBD for any accessories or options which are advertised in the Infomercial and which may be sold separately shall be 10% of the wholesale price for such items received by the Company. Sales will be calculated on a cash basis, and royalties are due within 14 days of the receipt of payment by the Company for the product.

As of July 20, 2006, we had not received any purchase orders for the Grill, the infomercial had not been filmed, and we had not begun manufacturing the Grill. Once we receive the initial purchase order, we anticipate that we will begin manufacturing, although there can be no guarantee that HBD or Reliant will place any orders or that we will receive the maximum amount possible under the agreement, announced as $30 million, which assumed that HBD would purchase $30 million worth of the Grill.

Diverse Talent Group Agreement

On May 26, 2006, Diverse Media Group Corp. ("DMG") a Utah corporation and a wholly-owned subsidiary of CirTran Corporation, entered into an assignment and exclusive services agreement (the "Services Agreement") with Diverse Talent Group, Inc., a California corporation, ("DT Group") and Christopher Nassif ("Nassif" and together with DT Group, "DT"). The Services Agreement was made effective as of April 1, 2006 (the "Effective Date"). The term of the Services Agreement is for five years, and expires on March 31, 2011.

Prior to entering into the Services Agreement, Nassif and DT Group operated a talent agency in Los Angeles, California, with extensive industry contacts. DMG, a subsidiary of the Company, was seeking to commence a diversified media business of product marketing, infomercial production, media financing and product merchandising services to the Direct Response and Entertainment Industries.

Pursuant to the Services Agreement, DMG and DT entered into an exclusive operations relationship whereby DMG agreed to outsource its talent agency operations to DT and to provide financing to DT to assist in DT's growth. Under the Services Agreement, DMG and DT created a relationship whereby DT would operate exclusively under the DMG business structure.

Pursuant to the Services Agreement, DT agreed to provide all creative and operational needs of DMG's talent division. DT agreed to supply these services exclusively to DMG. Additionally, all gross revenues generated from DT's operations after the Effective Date are to be paid to DMG.

At the time of signing the Services Agreement, DMG paid to DT an initial payment of $50,000 in consideration of the following:

- the right to use the name "Diverse" and be associated with the existing reputation of DT;
- the right to obtain DT's services on an exclusive basis;
- all accounts receivable and contracts receivable of DTGroup as of the Effective Date; and
- the assignment by DT of certain talent contracts.

As future compensation for services provided, DMG agreed to pay to DT a percentage of the gross profits for the talent contracts entered into between DT and its clients. The percentage ranges from 62.5% to 85%, depending on the type

of talent contract and the amount of gross compensation paid under the talent contract.

In connection with the Services Agreement, Nassif entered into an employment agreement (the "Employment Agreement") with DMG. Nassif's continued employment with DMG is an express condition of the Services Agreement. Under the Employment Agreement, DMG agreed to cause to be issued to DT options (the "Options") to purchase a total of 2,500,000 shares of the Company's common stock, with an exercise price of $0.045 per share. The Options will expire five years from the date of grant if not exercised prior to that date. The Options vest as follows: 500,000 on the date of grant, and an additional 500,000 on each of the next four anniversaries of the Effective Date, subject to Nassif's continued employment with DMG.

Additionally, Nassif will receive 5% of the gross margin received by DMG on any new business opportunities generated for DMG through Nassif's personal efforts and contacts (the "New Business Payments"). The New Business Payments may be made in cash or in shares of the Company's restricted common stock, subject to compliance with all applicable securities laws.

DMG also agreed in the Services Agreement to provide financing to DT, in the form of a non-interest-bearing capital line of credit (the "Capital Line"), not to exceed $200,000, pursuant to a loan agreement (the "Loan Agreement"). DT may make weekly draws not to exceed $20,000, on terms as set forth in the Loan Agreement.

In connection with the Loan Agreement, DT and DMG entered into a security agreement (the "Security Agreement"), pursuant to which DT granted to DMG a security interest (the "Security Interest") in all of the personal property of DT, including inventory, accounts, equipment, general intangibles, deposit accounts, and other items listed in the Security Agreement. The Security Interest secures DT's obligations to DMG under the Capital Line.

Also in connection with the Loan Agreement, Nassif provided a fraudulent transaction guarantee (the "Guarantee"), pursuant to which Nassif agreed to indemnify DMG and its officers, affiliates, and others against any damages arising out of any fraudulent actions by DT.

May 2006 Private Offering

On May 24, 2006, we closed a private placement of shares of our common stock and warrants (the "Private Offering"). Pursuant to a securities purchase agreement (the "Agreement"), we sold Fourteen Million, Two Hundred Eighty-five Thousand, Seven Hundred Fifteen (14,285,715) shares of our Common Stock (the "Shares") to ANAHOP, Inc., a California corporation (the "Purchaser"). The consideration paid for the Shares was One Million Dollars ($1,000,000). There were no underwriting discounts. In addition to the Shares, we issued warrants (the "Warrants") to designees of the Purchaser as follows:

- A warrant to purchase up to 10,000,000 shares, with an exercise price of $0.15 per share, exercisable upon the date of issuance, to Albert Hagar.
- A warrant to purchase up to 5,000,000 shares, with an exercise price of $0.15 per share, exercisable upon the date of issuance, to Fadi Nora.
- A warrant to purchase up to 5,000,000 shares, with an exercise price of $0.25 per share, exercisable upon the date of issuance, to Fadi Nora.
- A warrant to purchase up to 10,000,000 shares, with an exercise price of $0.50 per share, to Albert Hagar.

The Warrants have exercise prices ranging from $0.15 to $0.50 as noted above, and are exercisable as of the date of issuance and through and including the date which is five years following the date on which our Common Stock is listed for trading on either the Nasdaq Small Cap Market, the Nasdaq Capital Market, the American Stock Exchange, or the New York Stock Exchange (the "Expiration Date").

With respect to the shares underlying the Warrants, we granted piggyback registration rights as follows: (A) once all of the warrants with an exercise

price of $0.15 (the "Fifteen Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifteen Cent Warrants; (B) once all of the warrants with an exercise price of $0.25 (the "Twenty-five Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Twenty-five Cent Warrants; and (C) once all of the warrants with an exercise price of $0.50 (the "Fifty Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifty Cent Warrants. We did not grant any registration rights with respect to the Shares.

The Shares and the Warrants were issued without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act and the rules and regulations promulgated thereunder. We intend to use the proceeds from the Private Offering for working capital and general business purposes.

Closing and Approval of Asset Purchase Agreement

On June 6, 2006, CirTran Corporation (the "Company") and Advanced Beauty Solutions, LLC ("ABS") closed a transaction (the "Asset Purchase") whereby the Company purchased certain assets of ABS, subject to the approval of the U.S. Bankruptcy Court adjudicating the bankruptcy proceedings of ABS (the "ABS Bankruptcy Court"). On June 7, 2006, the ABS Bankruptcy Court entered an order approving the Asset Purchase.

Background

On January 19, 2005, the Company signed an Exclusive Manufacturing Agreement with ABS, a California limited liability company, relating to the manufacture of a flat iron hair product in California. On July 7, 2005, the Company signed another Exclusive Manufacturing Agreement with ABS, relating to the manufacture of a hair dryer product in California.

In early October 2005, the Company was notified that ABS had defaulted on its obligation to its financing company. Following the notice of ABS's default, the Company terminated the agreements for both products based on the default. In January 2006, following efforts to resolve the disputes with ABS, the Company filed a lawsuit against ABS, claiming breach of contract, interference with contractual relationships, unjust enrichment, and fraud, and seeking damages from ABS.

With respect to the flat iron products, through October 2005, CirTran had shipped directly to ABS approximately $4,746,000 worth of the product, and CirTran had received from ABS or its finance company total payments of approximately $788,000. In November 2005, the Company repossessed from ABS approximately $2,341,000 worth of the products in the United States, as the Company was permitted to do pursuant to the agreement.

Since November 2005, the Company has been pursuing its rights under the agreements and has been offering the flat iron product for sale directly to ABS's customers. In doing so, the Company sold to ABS's international customers directly approximately $426,000 worth of the flat iron product. The shipments have all been paid in full. These products shipped were not part of the repossessed inventory.

On January 24, 2006, ABS filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Central District of California, San Fernando Valley Division (the "ABS Bankruptcy Court"), Case No. SV 06-10076 GM. On January 30, 2006, a hearing ("Hearing") was held to consider the Emergency Motion for Order Approving the Settlement and Compromise of the Disputed Secured Claims of Inventory Capital Group, Inc. ("ICG"), and Media Funding Corporation ("MFC") (the "Settlement Motion") filed by ABS. The continued Hearing on the Settlement Motion was held on February 16, 2006, at which time the settlement was modified. Prior to a separate hearing held on March 24, 2006, on ABS's Motion for Order: (1) Approving Sale and Assignment of Substantially All Assets of the Estate Free and Clear of Liens; (2) Approving Assumption and Assignment of Leases and Executory Contracts Included in the Sale and Rejection of Leases and Executory Contracts Not Included in the Sale; and (3) Granting Related Relief (the "Sale Motion"),

the settlement was further modified.

Pursuant to the Sale Motion, the Company and ABS entered into negotiations for the purchase by the Company of certain of the assets and assumption of certain of the obligations (described more fully below) of ABS. Because ABS was subject to the jurisdiction of the ABS Bankruptcy Court, any agreement between the Company and ABS relating to the sale of ABS's assets had to be approved by the ABS Bankruptcy Court.

On June 6, 2006, the Company and ABS signed an agreement (the "Asset Purchase Agreement"), subject to the ABS Bankruptcy Court's approval. On June 7, 2006, the ABS Bankruptcy Court entered orders approving the Asset Purchase Agreement and granting the Sale Motion, and approving the settlement and compromise of certain disputed claims against ABS.

Pursuant to the settlement of ABS's bankruptcy proceedings and the Asset Purchase Agreement, the Company has an allowed claim against the ABS's estate in the amount of $2,350,000, of which $750,000 is to be credited to the purchase of substantially all of ABS's assets. Under the settlement, the Company shall be allowed to participate as a general unsecured creditor of ABS's estate in the amount of $1,600,000 on a pari passu basis with the $2,100,000 general unsecured claim of certain insiders of ABS and subject to the prior payment of certain secured, priority, and non-insider claims in the amount of approximately $1,507,011.

Under the Asset Purchase Agreement, the Company agreed to purchase substantially all of ABS's assets in exchange for:

(i) a cash payment in the amount of $1,125,000;
(ii) a reduction of CirTran's allowed claim in the Bankruptcy Case by $750,000;
(iii) the assumption of any assumed liabilities; and
(iv) the obligation to pay ABS a royalty equal to $3.00 per True Ceramic Pro flat iron unit sold by ABS (the "Royalty Obligation").

The Assets include personal property; intellectual property; certain executory contracts and unexpired leases; inventory; ABS's rights under certain insurance policies; deposits and prepaid expenses; books and records; goodwill; certain causes of action; permits; customer and supplier lists; and telephone numbers and listings (collectively, the "Assets").

Under the Asset Purchase Agreement, the Royalty Obligation is capped at $4,135,000. To the extent the amounts paid to ABS on account of the Royalty Obligation equal less than $435,000 on the 2 year anniversary of the Closing, then, within 30 days of such anniversary, the Company agreed to pay ABS an amount equal to $435,000 less the royalty payments made to date. As part of the settlement, the Company agreed to exchange general releases with, among others, ABS, Jason Dodo (the manager of ABS), Inventory Capital Group ("ICG"), and Media Funding Corporation ("MFC"). The settlement also resolved a related dispute with ICG in which ICG assigned $65,000 of its secured claim against ABS to the Company.

Pursuant to the court-approved settlement, payments under the Royalty Obligation will be made in the following order:

(a) The Royalty Obligation payments will be made exclusively to ICG and MFC (collectively, the "Secured Parties") until (i) the Secured Parties have been paid in full on account of their $1,243,208.44 secured claim, or (ii) the Secured Parties have been paid $100,000 in payments under the Royalty Obligation, whichever comes first.

(b) The next $70,000 Royalty Obligation payments will be made to a service provider to ABS (in the amount of $50,000) and to an individual with an allowed claim (in the amount of $20,000).

(c) Following the payments to the Secured Parties and others as set forth immediately above, the remaining Royalty Obligation payments

will be used for distribution to allowed general unsecured claims not including those of the Company and certain insiders with unpaid notes (the "Insider Noteholders").

(d) Following payments as set forth in (a), (b), and (c) above, the Royalty Obligation payments will be shared pro rata among the Insider Noteholders (with a total allowed aggregate claim of $2,100,000), and the Company (with a general unsecured claim in the amount of $1,600,000), until paid in full.

The total claims against ABS's estate that must be paid before the Company begins to share in the Royalty Obligation payments is $435,000.

Marketing and Distribution Agreement

On July 3, 2006, we finalized a Marketing and Distribution Agreement (the "MD Agreement") with Media Syndication Global, LLC, a Delaware limited liability company ("MSG"). The MD Agreement relates to the marketing and distribution by MSG of a product designed by Advanced Beauty Solutions, LLC ("ABS"), which we purchased (as discussed above).

Background

In a Current Report filed with the SEC on June 13, 2006, we announced that we had closed a transaction (the "Asset Purchase") whereby we purchased certain assets of ABS, subject to the approval of the U.S. Bankruptcy Court adjudicating the bankruptcy proceedings of ABS (the "Bankruptcy Court"). On June 7, 2006, the Bankruptcy Court entered an order approving the Asset Purchase.

Pursuant to the order entered by the Bankruptcy Court, we were required to give to Tristar Products, Inc. ("Tristar") a first-right opportunity to enter into a world-wide marketing and distribution agreement with the Company. The term of the first-right period ended on July 3, 2006.

Prior to the approval of the Asset Purchase by the Bankruptcy Court, and in anticipation of such approval, we had entered into the MD Agreement with MSG, subject to (A) the approval of the Asset Purchase by the Bankruptcy Court; (B) our completion of the purchase of ABS's assets; and (C) our failure to enter into a distribution agreement with Tristar. We entered into the MD Agreement with MSG on April 24, 2006, although the effective date of the MD Agreement was the date on which all three conditions listed above were satisfied. Additionally, the MD Agreement provided to MSG the opportunity to perform test marketing of the product, which was successfully completed.

Pursuant to the MD Agreement, we granted to MSG the exclusive, world-wide rights to advertise, promote, market, sell, and otherwise distribute the True Ceramic Pro Bionic hair styler (the "Product"), designed by ABS. Additionally, MSG agreed that during the term of the MD Agreement, MSG would purchase 100% of its requirements of the Product, together with any products that are substantially similar to the Product (a "Similar Product"), from us. MSG also agreed that it would not purchase, manufacture, or cause any third party to manufacture any Similar Product during the term of the MD Agreement and for one year following the termination of the MD Agreement, except from us.

Under the MD Agreement, MSG is required to purchase an initial minimum quantity of 10,000 units, and yearly quantities of at least 400,000 units. The initial term of the MD Agreement is for three years from the effective date. If MSG has purchased the required minimum quantities during the initial term, the MD Agreement will renew for additional one-year terms.

The MD Agreement may be terminated by either party upon 45 days' notice to the other party upon the breach by the other party of any material terms, covenants, conditions, or obligations under the MD Agreement. However, if the breach upon which such notice of termination is based shall have been fully cured to the reasonable satisfaction of the non-breaching party within such notice period, then such notice of termination shall be deemed rescinded. We

agreed with MSG that such right of termination was in addition to such other rights and remedies as the terminating party would have under applicable law.

We agreed with MSG that all customer lists, price lists, written and unwritten marketing plans, techniques, methods and data, sales and transaction data, and other information designated or deemed either by MSG or us as being confidential or a trade secret, would constitute confidential information of MSG or CirTran, respectively ("Confidential Information"). We agreed with MSG to hold all Confidential Information in the strictest confidence and shall protect all Confidential Information with the same degree of care that MSG or we would exercise with respect to its own proprietary information.

June 2006 Private Offering

On June 30, 2006, we closed a second private placement of shares of our common stock and warrants (the "June Private Offering"). Pursuant to a securities purchase agreement (the "June Agreement"), the Company agreed to sell Twenty-Eight Million, Five Hundred Seventy-One Thousand, Four Hundred Twenty-Eight (28,571,428) shares of its Common Stock (the "June Shares") to ANAHOP. The total consideration to be paid for the Shares will be Two Million Dollars ($2,000,000) if all tranches of the sale close.

Pursuant to the Agreement, ANAHOP agreed to pay Three Hundred Thousand Dollars ($300,000) at the time of closing, and an additional Two Hundred Thousand Dollars ($200,000) within 30 days of the closing. (The payments of $300,000 and $200,000 are referred to collectively as the "First Tranche Payment.") Upon the receipt of the First Tranche Payment, we agreed to issue a certificate or certificates to the Purchaser representing 7,142,857 of the Shares.

The remaining $1,500,000 is to be paid by ANAHOP as follows:

(i) No later than thirty calendar days following the date on which any class of our capital stock is first listed for trading on either the Nasdaq Small Cap Market, the Nasdaq Capital Market, the American Stock Exchange, or the New York Stock Exchange, ANAHOP agreed to pay an additional $500,000 to us; and

(ii) No later than sixty calendar days following the date on which any class of our capital stock is first listed for trading on either the Nasdaq Small Cap

Market, the Nasdaq Capital Market, the American Stock Exchange, or the New York Stock Exchange, ANAHOP agreed to pay an additional $1,000,000 to us. (The payments of $500,000 and $1,000,000 are referred to collectively as the "Second Tranche Payment.")

Upon receipt by us of the Second Tranche Payment, we agreed to issue a certificate or certificates to ANAHOP representing the remaining 21,428,571 Shares. Additionally, once we have received the Second Tranche Payment, we agreed to issue warrants to designees of the Purchaser as follows:

- A warrant to purchase up to 20,000,000 shares, with an exercise price of $0.15 per share, exercisable upon the date of issuance, to Albert Hagar.
- A warrant to purchase up to 10,000,000 shares, with an exercise price of $0.15 per share, to Fadi Nora.
- A warrant to purchase up to 10,000,000 shares, with an exercise price of $0.25 per share, exercisable upon the date of issuance, to Fadi Nora.
- A warrant to purchase up to 23,000,000 shares, with an exercise price of $0.50 per share, exercisable upon the date of issuance, to Albert Hagar.

The Warrants have exercise prices ranging from $0.15 to $0.50 as noted above, and are exercisable as of the date of issuance and through and including the later of (1) the fifth anniversary of the date of the Warrant or (2) the fifth anniversary of the date on which our Common Stock is first listed for trading on either the Nasdaq Small Cap Market, the Nasdaq Capital Market, the

American Stock Exchange, or the New York Stock Exchange (the "Expiration Date").

With respect to the shares underlying the Warrants, we granted piggyback registration rights as follows: (A) Once all of the warrants with an exercise price of $0.15 (the "Fifteen Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifteen Cent Warrants; (B) Once all of the warrants with an exercise price of $0.25 (the "Twenty-five Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Twenty-five Cent Warrants; and (C) Once all of the warrants with an exercise price of $0.50 (the "Fifty Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifty Cent Warrants. We did not grant any registration rights with respect to the Shares.

The Shares and the Warrants were issued without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act and the rules and regulations promulgated thereunder. We intend to use the proceeds from the June Private Offering for working capital and general business purposes.

Lockdown Agreements

On July 20, 2006, we entered into two lockdown agreements with existing security holders.

The first agreement (the "Cornell Agreement") was with Cornell and related to the Cornell Debenture. Pursuant to the Cornell Agreement, Cornell agreed that it would not convert any of the principal or interest on the Cornell Debenture or exercise any of the Warrants granted to Cornell until we had taken the steps necessary to increase our authorized capital. As such, we were able to lock down 50,000,000 shares underlying the Cornell Debenture and 10,000,000 shares underlying the Cornell Warrants.

The second agreement (the "ANAHOP Agreement") was with ANAHOP, Albert Hagar, and Fadi Nora, and related to the May and June private placement transactions discussed above. Pursuant to the ANAHOP Agreement, Hagar and Nora agreed that they would not exercise any of the warrants they received in connection with the May or June private offerings until we had taken the steps necessary to increase our authorized capital. Additionally, ANAHOP agreed that it would not make the Second Tranche Payment to purchase the Second Tranche Shares until we had taken the steps necessary to increase our authorized capital. As such, under the ANAHOP Agreement, we were able to lock down 21,428,571 shares (the Second Tranche Shares), and 93,000,000 shares underlying the warrants issued to Hagar and Nora in the May and June private placements.

Press Release Regarding Sales Increase

On July 19, 2006, the Company issued a press release stating it was projecting an increase in sales of 30% for the second quarter of 2006, consisting of sales of approximately $2.2 million, compared with sales of approximately $1.7 million for the first quarter of 2006. The projection was based on a preliminary summary of second quarter sales for the Company and its subsidiaries as follows:

	Sales for the Second Quarter 2006	Sales for the Second Quarter 2005
Electronics Assembly	$ 687,470	$ 946,162
CirTran Asia, Inc.	944,958	3,332,275
CirTran Products Corporation	243,652	-0-
Racore Technology Corporation	6,830	40,747
Diverse Media Group Corporation	374,896	-0-
Total Sales	$ 2,257,806	$ 4,309,184

Although as of August 10, 2006, the Company had not finalized its financial statements for the quarter ended June 30, 2006, it appears that sales decreased to $3,995,630 for the six month period ended June 30, 2006, as compared to $7,229,649 during the same period in 2005, for a decrease of $3,234,019 or 44.7%. A significant portion of this sales decrease can be attributed to the bankruptcy of a major customer, Advanced Beauty Solutions, Inc. (ABS). During the second quarter of 2005, the Company recorded sales of $2,002,363 to ABS whereas there were no sales to ABS in the second quarter of 2006 due to ABS's filing of bankruptcy in January 2006.

As of August 10, 2006, other financial information about the Company's operations for the second quarter of 2006 was being prepared and will be released when the Company issues its quarterly report on Form 10-QSB for the quarter ended June 30, 2006.

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Risk Factors

The short- and long-term success of CirTran is subject to certain risks, many of which are substantial in nature and outside the control of CirTran. You should consider carefully the following risk factors, in addition to other information contained herein. When used in this prospectus, words such as "believes," "expects," "intends," "plans," "anticipates," "estimates," and similar expressions are intended to identify forward-looking statements, although there may be certain forward-looking statements not accompanied by such expressions. You should understand that several factors govern whether any forward-looking statement contained herein will or can be achieved. Any one of those factors could cause actual results to differ materially from those projected herein. These forward-looking statements include plans and objectives of management for future operations, including the strategies, plans and objectives relating to the products and the future economic performance of CirTran and its subsidiaries discussed above. We disclaim any intention or obligation to update or revise and forward-looking statement, whether as a result of new information, future events, or otherwise. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of any such statement should not be regarded as a representation by CirTran or any other person that the objectives or plans of CirTran will be achieved.

In addition to the other information in this report, the following risk factors should be considered carefully in evaluating our business before making any investment decisions with respect to any of our shares of common stock. A purchase of our common stock is speculative and involves significant and substantial risks. Any person who is not in a position to lose the entire amount of his investment should forego purchasing our common stock.

Risks Related to Our Operations

We have a history of operating losses which could have a material adverse impact on our ability to continue operations.

Our current assets exceeded our current liabilities by $300,528 as of March 31, 2006. Our accumulated deficit increased to $19,605,311 at March 31, 2006, compared to $19,327,310 at December 31, 2005. Our net loss for the quarter ending March 31, 2006, was $277,998, compared to $201,728 for the quarter ended March 31, 2005. The change was mostly attributable to settlements of notes payable. Our current liabilities exceeded our current assets by $1,142,874 as of December 31, 2005, and by $3,558,826 as of December 31, 2004. Our net loss for the year ending December 31, 2005, was $527,708, which included a gain on forgiveness of debt of $337,761, compared to $658,322 for the year ended December 31, 2004, which included a gain on forgiveness of debt of $1,713,648. Our ability to operate profitably depends on our ability to increase our sales further and achieve sufficient gross profit margins for sustained growth. We can give no assurance that we will be able to increase our sales sufficiently to enable us to operate profitably, which could have a material adverse impact on our business. Our ability to obtain funding has had a material effect on our operations. Additionally, there is no guarantee that the fluctuations in the volume of our sales will stabilize or that we will be able to continue to increase our revenues to exceed our expenses. There are doubts that we will be able to continue as a going concern.

Our current liabilities exceeded our current assets, which raises doubts that we may continue as a going concern.

Our current assets exceeded our current liabilities by $300,528 as of March 31, 2006. For the three months ended March 31, 2006 and 2005, we had negative cash flows from operations of $719,898 and $385,701, respectively. As of December 31, 2005, our current liabilities exceeded our current assets by $1,142,874, compared to $3,558,826 as of December 31, 2004. For the year ended December 31, 2005 and 2004, we had negative cash flows from operations of $1,751,744 and $1,680,054, respectively. There can be no guarantee that our current assets will exceed our current liabilities. As such, and in light of our recent history, there remains a doubt we will be able to meet our obligations as they come due and will be able to execute our long-term business plans. If we are unable to meet our obligations as they come due or are unable to execute our long-term business plans, we may be forced to curtail our operations, sell part or all of our assets, or seek protection under bankruptcy laws.

The "going concern" paragraph in the reports of our independent registered public accounting firm for the years ended December 31, 2005 and 2004, raises doubts about our ability to continue as a going concern.

The independent registered public accounting firm's reports for our financial statements for the years ended December 31, 2005 and 2004, include an explanatory paragraph regarding substantial doubt about our ability to continue as a going concern. This may have an adverse effect on our ability to obtain financing for our operations and to further develop and market our products.

Our volume of sales has fluctuated significantly over the last four years, and there is no guarantee that we will be able to increase sales. These fluctuations in sales volume could have a material adverse impact on our ability to operate our business profitably.

Our sales volume increased in the year of 2005 as compared to 2004. Our sales volumes for the previous four years have changed as indicated by the following levels of net sales for the periods indicated: $2,299,668 for the year ended December 31, 2002; $1,215,245 for the year ended December 31, 2003 and $8,862,715 for the year ended December 31, 2004. For the year ended December 31, 2005 our sales increased to $12,992,512 which is a 46.6% increase from year ended December 31, 2004. This increase indicates an increasing trend in sales volume. There is no guarantee that the fluctuations in the volume of our sales will stabilize or that we will be able to continue to increase our sales volume.

One of our customers was responsible for approximately 71% of our accounts receivable at December 31, 2005. That customer filed bankruptcy in January 2006. If the bankruptcy estate is unable to make full payments on this account receivable, or if such payments are delayed, the resulting impact on our collections could have a material adverse impact on our business.

As of December 31, 2005, one customer, Advanced Beauty Solutions ("ABS"), accounted for approximately 71% of our accounts receivable, in the amount of $2,350,000. On January 24, 2006, ABS filed a voluntary petition for relief (the "ABS Bankruptcy Case") under Chapter 11 of the U.S. Bankruptcy Code. We have an allowed claim of $2,350,000 against ABS's estate (the "Estate"). In connection with a settlement of the ABS Bankruptcy Case, we recently closed the purchase of the assets of ABS, which included a reduction of our claim by approximately $750,000, leaving us with a remaining claim of approximately $1,600,000. On June 7, 2006, the transaction was approved by the ABS Bankruptcy Court.

We intend to continue to produce and sell the ceramic flat iron products under our contracts with ABS. However, we are required to pay to the Estate royalties on each unit sold. The Estate will then use those royalties to pay the claims against the Estate, including our claim of approximately $1,600,000. There can be no guarantee that we will be able to sell sufficient quantities of the flat iron products and pay royalties to the Estate to allow us to recover the full amount of our remaining claim. If we are unable to recover the claimed amount, the resulting impact on our collections could have a material adverse impact on our business operations.

We are involved in numerous legal proceedings that may give rise to significant liabilities, which could impair our ability to continue as a going concern.

We are involved in legal proceedings, several of which involve lawsuits filed against us. As of July 20, 2006, one company had a judgment against us in the amount of $37,966, and there were additional claims, in connection with pending litigation, in the aggregate amount of approximately $10,000,000. This pending litigation involves CirTran Asia and the other plaintiffs whom have filed their reply to the counterclaim, disputing all of the allegations and claims. International Edge filed a motion to dismiss for lack of jurisdiction, which was pending as of the date of this report. This claim involves licensing issues relating to a product which generated approximately $3,510,000 in revenue in 2004 and $960,000 in 2005. As discussed in the "Legal Proceedings" section, we are currently attempting to negotiate with each of these claimants to settle the claims against CirTran, although in many cases, we have not yet reached final settlements. There can be no assurance that we will be successful in those

negotiations or that, if successful, we will be able to service any payment obligations which may result from such settlements.

There is substantial risk, therefore, that the existence and extent of these liabilities could adversely affect our business, operations and financial condition. The liabilities and claims could also result in a reduction in our revenues to the extent that claims relate to specific products or licenses. As a result, we may be forced to curtail our operations, sell part or all of our assets, or seek protection under bankruptcy laws. Additionally, there is substantial risk that our vendors could expand their collection efforts to collect the unpaid amounts. If they undertake significant collection efforts, and if we are unable to negotiate settlements or satisfy our obligations, we could be forced into bankruptcy.

In connection with the sale of the Convertible Debentures, we granted a security interest in all of our assets to secure our payment obligations under the Convertible Debentures. If we are unable to satisfy our payment obligations, Highgate or Cornell Capital could execute on the security interest and take control of our assets.

In connection with the sale of the Convertible Debenture to Highgate, we entered into a security agreement with Highgate, pursuant to which we pledged all of our property, including goods; inventory; contract rights and general intangibles; documents, receipts, and chattel paper; accounts and other receivables; products and proceeds; and any interest in any subsidiary, joint venture, or other investment interest to secure our obligation under the Convertible Debenture and the related agreements. Similarly, in connection with the sale of the Convertible Debenture to Cornell Capital, we entered into a security agreement with Cornell Capital, pursuant to which we gave a second position security interest and pledged all of our property, including goods; inventory; contract rights and general intangibles; documents, receipts, and chattel paper; accounts and other receivables; products and proceeds; and any interest in any subsidiary, joint venture, or other investment interest to secure our obligation under the Cornell Capital Convertible Debenture and the related agreements. In the event that we are unable to make our payment obligations under the Convertible Debentures or to work out alternate arrangements with Highgate and/or Cornell Capital, or to arrange for financing to enable us to make our payment obligations to Highgate and/or Cornell Capital, Highgate and/or Cornell Capital could execute on the security interest and take control of all of our property and assets.

We are dependent on the continued services of our President and other officers, and the untimely death or disability of Iehab Hawatmeh could have a serious adverse effect upon our Company.

We view the continued services of our president, Iehab Hawatmeh, and our other officers as critical to the success of our Company. Though we have employment agreements with Mr. Iehab Hawatmeh, Mr. Trevor Saliba, and Mr. Shaher Hawatmeh (see "Executive Compensation"), and a key-man life insurance policy for Mr. Iehab Hawatmeh, the untimely death or disability of Mr. Hawatmeh could have a serious adverse affect on our operations.

Our international business activities subject us to risks that could adversely affect our business.

For the year ended December 31, 2005, sales of products manufactured in the United States accounted for 24.1 percent of our total net revenues, and sales of products manufactured in China accounted for 75.9 percent of our total net revenues. Our sales of our products manufactured internationally have increased, and now represents a larger percentage of our sales. Additionally, the portion of our products that are produced at facilities in close proximity to our CirTran-Asia production facilities in ShenZhen, China, has increased. As a result, we are subject to the risks inherent in international operations. Our international business activities could be affected, limited, or disrupted by a variety of factors, including:

* the imposition of or changes in governmental controls, taxes, tariffs, trade restrictions and regulatory requirements;

* the costs and risks of localizing products for foreign countries;

* longer accounts receivable payment cycles;

* changes in the value of local currencies relative to our functional currency;

* import and export restrictions;

* loss of tax benefits due to international production;

* general economic and social conditions within foreign countries;

* taxation in multiple jurisdictions; and/or

* political instability, war or terrorism.

All of these factors could harm future sales of our products to international customers or future production outside of the United States of our products, and have a material adverse effect on our business, results of operations and financial condition.

We may continue to expand our operations in international markets. Our failure to effectively manage our international operations could harm our business.

Entering new international markets, including our entry into China with

CirTran-Asia, may require significant management attention and expenditures and could adversely affect our operating margins and earnings. To date, we have only recently begun to penetrate international markets. To the extent that we are unable to do so, our growth in international markets would be limited, and our business could be harmed.

We expect that our international business operations will be subject to a number of material risks, including, but not limited to:

* difficulties in managing foreign sales channels;
* difficulties in enforcing agreements and collecting receivables through foreign legal systems and addressing other legal issues;
* longer payment cycles;
* taxation issues;
* differences in international telecommunications standards and regulatory agencies;
* product requirements different from those of our current customers;
* fluctuations in the value of foreign currencies; and
* unexpected domestic and international regulatory, economic or political changes.

A combination of any or all of these risks could have a material adverse impact both on our international business, and on our core business operations in the United States.

We are dependent on the continued services of Charles Ho, the President of our CirTran-Asia subsidiary, and the untimely death or disability of Mr. Ho could have a serious adverse effect upon our subsidiary and Company.

We view the continued services of Charles Ho, the president of our CirTran-Asia subsidiary, as critical to the success of that subsidiary. Though we have an employment agreement with Mr. Ho (see "Executive Compensation"), we have no key-man life insurance policy for Mr. Ho. The untimely death or disability of Mr. Ho could have a serious adverse affect on our international operations and our operations overall.

We have not held an annual shareholder meeting in several years, which could result in a legal action being brought against the Company to compel an annual meeting.

We have not held an annual meeting of shareholders since 2001. Under Nevada law, if a Nevada corporation does not hold a meeting to elect directors of the corporation within eighteen months after the last election of directors, a shareholder or shareholders owning at least fifteen percent of the Company's outstanding voting stock can apply to a court for an order compelling the Company to hold a shareholder meeting to elect directors. Because it has been more than eighteen months since our last meeting where directors were elected, an action could be brought, pursuant to Nevada law, against the Company to compel us to hold an annual meeting and elect directors of the Company.

Our authorized capital presently would be insufficient to allow us to issue shares upon conversion of our outstanding derivative securities, which could result in our being in default or subject to claims of breach of contract, and could have a material adverse impact on our business.

Our authorized capital stock consists of 750,000,000 shares of common stock. As of July 20, 2006, we had 636,874,906 shares issued and outstanding. A hypothetical conversion of the remaining principal amount of the Highgate Convertible Debenture, namely $3,000,000, would result in the issuance of 100,000,000 shares, assuming a hypothetical conversion price of $0.03 per share. Conversion of the full principal amount of the Cornell Convertible Debenture, namely $1,500,000, would result in the issuance of 50,000,000 shares of common stock, assuming a hypothetical conversion price of $0.03 per share. Additionally, in May 2006, we issued warrants to purchase up to an additional 30,000,000 shares of our common stock and in June 2006, we entered into an agreement to issue additional warrants to purchase up to 63,000,000 shares of our common stock, although we have entered into a lockdown agreement with the holders of the 93,000,000 warrants. Presently, we do not have sufficient shares to permit a full conversion of all of the convertible debentures and exercise of outstanding warrants. We have also entered into a lockdown agreement with Cornell relating to the Cornell Debenture, whereby Cornell agreed not to convert any of the Cornell Debenture until we can increase our authorized capital. Nevertheless, under the Highgate Convertible Debenture and the Cornell Convertible Debenture, failure to deliver shares upon conversion can constitute an event of default, giving Highgate or Cornell, as applicable, the right to accelerate the payment of all remaining amounts due and owing under the debentures. Additionally, failure to deliver shares upon exercise of the warrants could result in claims being brought against us for breach of contract, among others.

We intend to hold an annual meeting of shareholders to seek approval of our shareholders to amend our articles of incorporation to increase our authorized capital, although there can be no guarantee that we will be able to obtain shareholder approval to do so. If we do not receive shareholder approval to increase our authorized capital, we would not have sufficient shares to permit a full conversion of the convertible debentures and exercise of the outstanding warrants. A failure to deliver shares upon conversion or exercise of our outstanding derivative securities or to increase our authorized capital could have a material adverse impact on our business and operations

Risks Related to Our Industry

The variability of customer requirements in the electronics industry could adversely affect our results of operations.

Electronic manufacturing service providers must provide increasingly rapid turnaround time for their OEM customers. We do not obtain firm, long-term purchase commitments from our customers and have experienced a demand for reduced lead-times in customer orders. Our customers may cancel their orders,

change production quantities or delay design and production for several factors. Cancellations, reductions or delays by a customer or group of customers could adversely affect our results of operations. Additional factors that affect the electronics industry and that could have a material adverse effect on our business include the inability of our customers to adapt to rapidly changing technology and evolving industry standards and the inability of our customers to develop and market their products. If our customers' products become obsolete or fail to gain commercial acceptance, our results of operations may be materially and adversely affected, which could make it difficult for us to continue as a going concern.

Our customer mix and base fluctuates significantly, and responding to these fluctuations could cause us to lose business or have delayed revenues, which could have a material adverse impact on our business.

A percentage of our revenue is generated from our electronics assembly and manufacturing services. Of this amount our three largest customers generate approximately 12% of the total revenue. Our customers include electronics, telecommunications, networking, automotive, gaming, exercise equipment, and medical device OEMs that contract with us for the manufacture of specified quantities of products at a particular price and during a relatively short period of time. As a result, the mix and number of our clients varies significantly from time to time. Responding to the fluctuations and variations in the mix and number of our clients can cause significant time delays in the operation of our business and the realization of revenues from our clients. These delays could have a material adverse impact on our business, resulting from, among other things, the costs associated from shifting operations to respond to different orders.

Our industry is subject to rapid technological change. If we are not able to adequately respond to changes, our services may become obsolete or less competitive and our operating results may suffer.

We may not be able to effectively respond to the technological requirements of a changing market, including the need for substantial additional capital expenditures that may be required as a result of these changes. The electronics manufacturing services industry is characterized by rapidly changing technology and continuing process development. The future success of our business will depend in large part upon our ability to maintain and enhance our technological capabilities and successfully anticipate or respond to technological changes on a cost-effective and timely basis. In addition, our industry could in the future encounter competition from new or revised technologies that render existing technology less competitive or obsolete. If we are unable to respond adequately to such changes, our business operations could be adversely impacted, which could make it difficult for us to continue as a going concern.

There may be shortages of required components which could cause us to curtail our manufacturing or incur higher than expected costs.

Component shortages or price fluctuations in such components could have an adverse effect on our results of operations by delaying or making it more difficult or expensive for us to fill customer orders. We purchase the components we use in producing circuit board assemblies and other electronic manufacturing services and we may be required to bear the risk of component price fluctuations. In addition, shortages of electronic components have occurred in the past and may occur in the future. These shortages and price fluctuations could potentially have an adverse effect on our results of operations, again by delaying or making it more difficult or expensive for us to fill orders or to seek new orders.

Holders of CirTran common stock are subject to the risk of additional and substantial dilution to their interests as a result of the issuances of common stock in connection with the Convertible Debentures.

The following table describes the number of shares of common stock that would be issuable, assuming that the full principal amount of the Convertible Debentures (excluding any interest accrued) was converted into shares of our common stock, irrespective of the availability of registered shares and any conversion limitations contained in the Convertible Debentures, and further assuming that the applicable conversion or exercise prices at the time of such conversion or exercise were the following amounts:

Hypothetical Conversion Price	Shares Issuable Upon Conversion of $3,000,000 Principal Amount of Convertible Debenture by Highgate House Funds, Ltd.	Shares Issuable Upon Conversion of $1,500,000 Principal Amount of Convertible Debenture by Cornell Capital Partners	Total Shares Issuable in Connection with Conversion of Aggregate Principal Amount of Convertible Debentures
$0.01	300,000,000	150,000,000	450,000,000
$0.02	150,000,000	75,000,000	225,000,000
$0.03	100,000,000	50,000,000	150,000,000
$0.04	75,000,000	37,500,000	112,500,000
$0.05	60,000,000	30,000,000	90,000,000
$0.10	30,000,000	15,000,000	45,500,000

Given the formula for calculating the shares to be issued in connection with conversions of the Convertible Debentures, there effectively is no limitation on the number of shares of common stock which may be issued in connection with conversions of the Convertible Debentures, except for the number of shares registered under prospectuses and related registration statements. As such, holders of our common stock may experience substantial dilution of their interests to the extent that Highgate and/or Cornell Capital converts amounts under the Convertible Debentures.

Although we have entered into an agreement with Cornell wherein Cornell agreed that it would not convert any of the principal or interest on the Cornell Debenture or exercise any of the Warrants granted to Cornell until we had taken the steps necessary to increase our authorized capital, if we are successful in increasing our authorized capital, Cornell will be able to convert the Cornell Debenture pursuant to its terms, which could result in the dilution described above.

Our issuances of shares in connection with conversions of the Convertible Debentures likely will result in overall dilution to market value and relative voting power of previously issued common stock, which could result in substantial dilution to the value of shares held by shareholders prior to sales under this prospectus.

The issuance of common stock in connection with conversions of the Convertible Debenture by Highgate and Cornell Capital may result in substantial dilution to the equity interests of holders of CirTran common stock other than Highgate and Cornell Capital. Specifically, the issuance of a significant amount of additional common stock will result in a decrease of the relative voting control of our common stock issued and outstanding prior to the issuance of common stock in connection with conversions of the Convertible Debentures. Furthermore, public resales of our common stock by Highgate and/or Cornell Capital following the issuance of common stock in connection with conversions of the Convertible Debentures likely will depress the prevailing market price of our common stock. Even prior to the time of actual conversions and public resales, the market "overhang" resulting from the mere existence of our obligation to honor such conversions or exercises could depress the market price of our common stock, which could make it more difficult for existing investors to sell their shares of our common stock, and could reduce the amount they would receive on such sales.

Existing shareholders likely will experience increased dilution with decreases in market value of common stock in relation to our issuances of shares in connection with the Convertible Debentures, which could have a material adverse impact on the value of their shares.

The formulas for determining the number of shares of common stock to be issued in connection with conversions of the Convertible Debentures are based, in part, on the market price of the common stock. With respect to the Highgate Convertible Debenture, the conversion price is are equal to the lower of $0.10 per share or the lowest closing bid price of our common stock over the twenty trading days after the conversion notice is tendered by us to Highgate. With respect to the Cornell Capital Convertible Debenture, the conversion price is are equal to the lowest closing bid price of our common stock over the twenty trading days after the conversion notice is tendered by us to Cornell Capital. As a result, the lower the market price of our common stock at and around the

time we issue shares to Highgate or Cornell Capital in connection with the Convertible Debentures, the more shares of our common stock Highgate or Cornell Capital, respectively, will receive. Any increase in the number of shares of our common stock issued upon conversion of principal or interest on the Convertible Debentures as a result of decreases in the prevailing market price would compound the risks of dilution described in the preceding paragraphs.

There is an increased potential for short sales of our common stock due to the sales of shares issued to Highgate and Cornell Capital in connection with the Convertible Debentures, which could materially effect the market price of our stock.

Downward pressure on the market price of our common stock that likely will result from sales of our common stock by Highgate and/or Cornell Capital issued in connection with conversions of the Convertible Debentures, could encourage short sales of common stock by Highgate or Cornell Capital. A "short sale" is defined as the sale of stock by an investor that the investor does not own. Typically, investors who sell short believe that the price of the stock will fall, and anticipate selling at a price higher than the price at which they will buy the stock. Significant amounts of such short selling could place further downward pressure on the market price of our common stock, which could make it more difficult for existing shareholders to sell their shares.

The restrictions on the number of shares issued upon conversion of the Convertible Debentures may have little if any effect on the adverse impact of our issuance of shares in connection with the Convertible Debentures, and as such, Highgate and Cornell Capital may sell a large number of shares, resulting in substantial dilution to the value of shares held by our existing shareholders.

Both Highgate and Cornell Capital are prohibited, except in certain circumstances, from converting amounts of the Convertible Debentures to the extent that the issuance of shares would cause Highgate or Cornell Capital, respectively, to beneficially own more than 4.99% of our then outstanding common stock. These restrictions, however, do not prevent Highgate or Cornell Capital from selling shares of common stock received in connection with a conversion, and then receiving additional shares of common stock in connection with a subsequent conversion. In this way, either Highgate or Cornell Capital could sell more than 4.99% of the outstanding common stock in a relatively short time frame while never holding more than 4.99% at one time. As a result, existing shareholders and new investors could experience substantial dilution in the value of their shares of our common stock.

The trading market for our common stock is limited, and investors who purchase shares from Highgate or Cornell Capital may have difficulty selling their shares.

The public trading market for our common stock is limited. On July 15, 2002, our common stock was listed on the OTC Bulletin Board. Nevertheless, an established public trading market for our common stock may never develop or, if developed, it may not be able to be sustained. The OTCBB is an unorganized, inter-dealer, over-the-counter market that provides significantly less liquidity than other markets. Purchasers of our common stock therefore may have difficulty selling their shares should they desire to do so.

It may be more difficult for us to raise funds in subsequent stock offerings as a result of the sales of our common stock by Highgate and Cornell Capital in connection with the Convertible Debentures.

As noted above, sales by Highgate and/or Cornell Capital likely will result in substantial dilution to the holdings and interest of current and new shareholders. Additionally, as noted above, the volume of shares sold by Highgate and Cornell Capital could depress the market price of our stock. These factors could make it more difficult for us to raise additional capital through subsequent offerings of our common stock, which could have a material adverse effect on our operations.

We may be required to pay liquidated damages to Highgate for failure to meet certain obligations under the registration rights agreement.

In connection with the sale of the Debenture to Highgate, we entered into a registration rights agreement with Highgate, pursuant to which we agreed to file

a registration statement within 120 days of closing the sale of the Debenture, and to have the registration statement declared effective within 90 days of its filing. More than 90 days have passed since the filing of the registration statement, and it has not yet been declared effective. Under the terms of the registration rights agreement, we were required to pay one percent of the liquidated value of the Debenture outstanding as liquidated damages for the period commencing one day after the date on which the registration statement should have been declared effective and ending sixty days thereafter, plus two percent of the liquidated value of the Convertible Debentures outstanding as liquidated damages for each thirty-day period commencing sixty-one days after the date on which the registration statement was to be declared effective during which the registration statement has not been declared effective by the SEC. Although we recently entered into an amendment to the registration rights agreement pursuant to which Highgate agreed to a later date by which we need to have the registration statement effective, there can be no guarantee that we will be successful in meeting this extended deadline. As such, we may be required to make substantial liquidated damages payments to Highgate.

Our common stock is considered a penny stock. Penny stocks are subject to special regulations, which may make them more difficult to trade on the open market.

Securities in the OTC market are generally more difficult to trade than those on the Nasdaq National Market, the Nasdaq SmallCap Market or the major stock exchanges. In addition, accurate price quotations are also more difficult to obtain. The trading market for our common stock is subject to special regulations governing the sale of penny stock.

A "penny stock," is defined by regulations of the Securities and Exchange Commission as an equity security with a market price of less than $5.00 per share. However, an equity security with a market price under $5.00 will not be considered a penny stock if it fits within any of the following exceptions:

* the equity security is listed on Nasdaq or a national securities exchange;

* the issuer of the equity security has been in continuous operation for less than three years, and either has (a) net tangible assets of at least $5,000,000, or (b) average annual revenue of at least $6,000,000; or

* the issuer of the equity security has been in continuous operation for more than three years, and has net tangible assets of at least $2,000,000.

If you buy or sell a penny stock, these regulations require that you receive, prior to the transaction, a disclosure explaining the penny stock market and associated risks. Furthermore, trading in our common stock would be subject to Rule 15g-9 of the Exchange Act, which relates to non-Nasdaq and non-exchange listed securities. Under this rule, broker-dealers who recommend our securities to persons other than established customers and accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. Securities are exempt from this rule if their market price is at least $5.00 per share.

Penny stock regulations will tend to reduce market liquidity of our common stock, because they limit the broker-dealers' ability to trade, and a purchaser's ability to sell the stock in the secondary market. The low price of our common stock will have a negative effect on the amount and percentage of transaction costs paid by individual shareholders. The low price of our common stock may also limit our ability to raise additional capital by issuing additional shares. There are several reasons for these effects. First, the internal policies of many institutional investors prohibit the purchase of low-priced stocks. Second, many brokerage houses do not permit low-priced stocks to be used as collateral for margin accounts or to be purchased on margin. Third, some brokerage house policies and practices tend to discourage individual brokers from dealing in low-priced stocks. Finally, broker's commissions on low-priced stocks usually represent a higher percentage of the stock price than commissions on higher priced stocks. As a result, our shareholders will pay transaction costs that are a higher percentage of their total share value than if our share price were substantially higher.

The price of our common stock is volatile, and an investor may not be able to resell our shares at or above the purchase price.

In recent years, the stock market in general, and the OTC Bulletin Board and the securities of technology companies in particular, has experienced extreme price and trading volume fluctuations. These fluctuations have often been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations may materially adversely affect our stock price, regardless of operating results. Investors in our common stock should be aware that they may not be able to resell our shares at or above the price paid for them due to the fluctuations in the market.

There may be additional unknown risks which could have a negative effect on us and our business.

The risks and uncertainties described in this section are not the only ones facing CirTran. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the foregoing risks actually occur, our business, financial condition, or results of operations could be materially adversely affected. In such case, the trading price of our common stock could decline.

Use of Proceeds

All of the shares of common stock issued in connection with conversions of the Convertible Debenture, if and when sold, are being offered and sold by the Highgate as the Selling Shareholder or its pledgees, donnees, transferees, or other successors in interest. We will not receive any proceeds from those sales.

Under the Convertible Debenture and related purchase agreement, we used $2,265,000 to repay two promissory notes to Cornell Capital Partners, LP ("Cornell"), one in the amount of $1,700,000, and the other in the amount of $565,000.

We also paid a commitment fee of $240,765, a structuring fee of $10,000 to Highgate, and legal fees of $5,668. As such, of the total purchase amount of $3,750,000, the net proceeds to us were $1,228,567. We used these proceeds for general corporate and working capital purposes.

As discussed below in the section "MET Advisors Agreement," we presently have no acquisitions pending or anticipated. Nevertheless, we will continue to review potential acquisition candidates as they arise, and we may choose to use the proceeds of the sale of the Convertible Debenture in connection with future acquisitions.

Determination of Offering Price

The Selling Shareholders may sell our common stock at prices then prevailing or related to the then current market price, or at negotiated prices. The offering price may have no relationship to any established criteria or value, such as book value or earnings per share. Additionally, because we have not generated any profits for several years, the price of our common stock is not based on past earnings, nor is the price of the shares of our common stock indicative of current market value for the assets we own. No valuation or appraisal has been prepared for our business or possible business expansion.

DESCRIPTION OF BUSINESS

This discussion should be read in conjunction with Managements' Discussion and Analysis of Financial Condition and Results of Operations included in our Annual

Report on Form 10-KSB for the year ended December 31, 2005.

Overview

We provide a mixture of high and medium size volume turnkey manufacturing services using surface mount technology, ball-grid array assembly, pin-through-hole and custom injection molded cabling for leading electronics OEMs in the communications, networking, peripherals, gaming, law enforcement, consumer products, telecommunications, automotive, medical, and semiconductor industries. Our services include pre-manufacturing, manufacturing and post-manufacturing services. Through our subsidiary, Racore Technology Corporation, we design and manufacture Ethernet technology products. Our goal is to offer customers the significant competitive advantages that can be obtained from manufacture outsourcing, such as access to advanced manufacturing technologies, shortened product time-to-market, reduced cost of production, more effective asset utilization, improved inventory management, and increased purchasing power.

During 2004, we established a new division, CirTran-Asia, Inc, which has contributed to a large portion of the increase in revenue for the year ended December 31, 2004 and the year ended December 31, 2005. This division is an Asian-based, wholly owned subsidiary of CirTran Corporation and provides a myriad of manufacturing services to the direct response and retail consumer markets. Our experience and expertise in manufacturing enables CirTran-Asia to enter a project at any phase: engineering and design, product development and prototyping, tooling, and high-volume manufacturing. We anticipate that CirTran-Asia will pursue manufacturing relationships beyond printed circuit board assemblies, cables, harnesses and injection molding systems by establishing complete "box-build" or "turn-key" relationships in the electronics, retail, and direct consumer markets. This strategic move into the Asian market has helped to elevate CirTran to an international contract manufacturer status for multiple products in a wide variety of industries, and has, in short order, allow us to target large-scale contracts.

CirTran has established a dedicated satellite office for CirTran-Asia, and has retained Mr. Charles Ho to lead the new division. Having proven the value and reliability of its core products, CirTran Corporation has chosen to expand into previously untapped product lines.

On December 2, 2005, we announced that we had formed a new division, CirTran Products, which will offer products for sale at retail. The new division will be run from our new Los Angeles office, with Trevor Saliba, our executive vice president for worldwide business development, working to develop sales. We anticipate that consumer products built by our CirTran Asia subsidiary, as well as other products which we plan to acquire, will be available for retail sale in 2006.

On March 21, 2006, we announced that we had formed a new subsidiary to provide end-to-end services to the direct response and entertainment industries. The new division will provide product marketing, production, media funding and merchandise manufacturing services. Forming this new division was a necessary step to maximize product manufacturing opportunities for CirTran's proprietary products and to provide marketing services for individual entrepreneurs and inventors. The new division will be headquartered in CirTran's Los Angeles (Century City) offices and be headed by Mr. Saliba. We are presently in development of proprietary programs to be launched in the product marketing division, production services and media funding divisions. We are also in final discussions on two projects for our merchandising division. We continue to pursue opportunities in the direct response and entertainment division to maximize manufacturing and business opportunities.

On June 1, 2006, the Company, through its newly formed subsidiary Diverse Media Group ("Diverse Media"), signed an exclusive services agreement with the Diverse Talent Group, Inc. ("DTG") a nationally known talent and literary agency, and its founder and CEO Christopher Nassif. The agreement covers a five-year period that commenced on April 1, 2006, when the companies began co-marketing and working together, and includes the assignment of all of DTG's talent contacts and the first right of refusal on all new and existing business to Diverse Media.

By joining forces with DTG, the Company intends to add business and a record of business success to this new joint venture. The Company believes that Diverse Media can meet its needs of marketing-driven companies in the U.S. and overseas by pairing talent and products to establish a recognizable and long-standing brand. Management believes that talent and product together can create a powerful brand and it is the intention of Diverse Media, in its partnership with DTG, to develop this concept. The agreement also provides the Company with

access to the Diverse Talent Group's talent pool which will be a valuable resource in developing in-house marketing programs for future products. By doing so, CirTran anticipates that it will be able to generate a potential profit margin from the marketing of its programs. Plans for Diverse Media also include the establishment of a full-service music division as well as product merchandise and direct response divisions, although there can be no guarantee that the Company will be able to establish these additional divisions.

Included in the terms of the agreement, Diverse Media agreed to provide DTG with a $200,000 line of credit. The line will be available to DTG in increments of $20,000 per week, which DTG will use to cover operating expenses during its seasonally slow periods from about June to August, which coincides with the lull in industry production prior to its new fall programming releases. As of July 20, 2006, DTG had drawn $40,000 on the line of credit.

Fitness Products

In early June 2004, the Company entered into an exclusive manufacturing agreement with certain Developers, including Charles Ho, the President of CirTran-Asia. Under the terms of the agreement, CirTran, through its wholly-owned subsidiary CirTran-Asia, has the exclusive right to manufacture certain products developed by the Developers or any of their affiliates. Pursuant to the agreement, we could enter into addendum agreements with the developers with respect to particular products to be produced and manufactured. The agreement was to be for an initial term of 36 months, and may be continued after that on a month-to-month basis unless terminated by either party by providing written notice.

On June 7, 2004, we announced that CirTran-Asia had received an initial purchase order on May 26, 2004, from International Edge relating to the manufacture of 80,000 abdominal fitness machines. This order was the first order placed with CirTran-Asia under the exclusive manufacturing agreement. Subsequently, on June 14, 2004, we received another order for 80,000 units of the abdominal fitness machines, which was announced on June 16, 2004, through a separate press release. The Company received many orders subsequent to these first orders. Since these announcements, CirTran-Asia has manufactured, shipped, and received payments of approximately $5,546,000. On August 13, 2004, we also announced that on August 11, 2004 we had received new orders for Wal-Mart. The Company shipped to Wal-Mart the complete order of abdominal fitness machines and received payments of approximately $400,000 through the date of this Report. The units were distributed to Wal-Mart stores throughout Canada.

On September 9, 2004, we announced that on September 6, 2004, CirTran-Asia had been awarded the rights to manufacture the Ab Trainer Club Pro, a new abdominal fitness machine, for Tristar Products, under an exclusive manufacturing agreement. This new product is another type of abdominal fitness machine. Since this announcement, and through the date of this Report, CirTran-Asia had manufactured and shipped units, and received payments of approximately $42,000.

On September 10, 2004, we announced that on September 7, 2004, CirTran-Asia had been awarded the rights to manufacture the AbRoller, another type of an abdominal fitness machine, for Tristar Products, under an exclusive manufacturing agreement. Since this announcement, and through the date of this Report, CirTran-Asia had manufactured and shipped units, and received payments of approximately $1,700,000.

On September 14, 2004, we announced that on September 7, 2004, we had begun manufacturing the Instant Abs product, another type of abdominal fitness machine, for Tristar Products, under an exclusive manufacturing agreement. Since this announcement, and through the date of this Report, CirTran-Asia had manufactured, and shipped units, and received payments of approximately $640,000.

On September 30, 2004, we announced that on September 23, 2004, CirTran-Asia had been awarded the rights to manufacture the Denise Austin Pilates product, a pilates fitness machine, for Tristar Products, under an exclusive manufacturing agreement. Since this announcement, and through the date of this Report, CirTran-Asia had manufactured and shipped units, and received payments of approximately $85,000.

On April 28, 2005, CirTran-Asia announced that it has been awarded a contract (the "April 2005 Agreement") from Guthy - Renker Corporation ("GRC") to be the exclusive manufacturer of a new fitness machine (the "Fitness Product") for the sold-on-TV direct response industry. Pursuant to the April 2005 Agreement, GRC agreed to purchase all of its requirements of the Fitness Product during the term of the April 2005 Agreement, which is defined as running from the signing of the agreement through the time when the Fitness Product is not being sold in quantity. Since signing the April 2005 Agreement, we have received orders totaling approximately $1,370,000. Since these announcements, CirTran-Asia has manufactured and shipped orders and has received $1,033,000 as payment for such shipments.

New Products

On August 11, 2004, we announced that CirTran-Asia received a purchase order from Emson in New York, on August 10, 2004 relating to the manufacture of a household cooking appliance for hot dogs and sausages. Since these announcements, and through the date of this Report, CirTran-Asia had manufactured and shipped units, and received payments of approximately $1,630,000.

On October 1, 2004, we entered into an agreement with Transactional Marketing Partners, Inc. ("TMP"), for consulting services. Pursuant to the agreement, we engaged TMP to provide strategic planning and for introduction of new business to us. Under the agreement, we agreed to pay to TMP a fee of ten percent of the net proceeds received by us from business brought to us by TMP. The fee is to be paid within 15 calendar days following the end of the month in which we receive the net proceeds. Additionally, we agreed to pay $7,500 during each of the first six months of the term of the agreement, with such payments being viewed as an advance against the fee to be earned. The advance payments are not refundable, but will be deducted from fees earned by TMP. The agreement had an initial term of six months, beginning October 1, 2004, and could automatically extended for successive six-month periods unless either party gives written notice at least 30 days prior to the expiration of the term of the agreement of its intent not to renew. Additionally, we may terminate the agreement at any time by giving 30 days' written notice. In March 2006, the parties have agreed to six-month extensions through September 2006. The parties will evaluate the relationship at that time and decide if there needs to be another extension. To date the relationship has proven successful, resulting in multiple new manufacturing relationships.

On January 19, 2005, CirTran Corporation signed an Exclusive Manufacturing Agreement with Advanced Beauty Solutions L.L.C. ("ABS"), a company relating to the manufacture of a hair product in California. In early October 2005, we were notified that ABS had defaulted on its obligation to its financing company. We have stopped shipping under credit and are in the process of exercising our rights permitted by the agreements.

On July 7, 2005, CirTran Corporation signed another Exclusive Manufacturing Agreement with ABS, relating to the manufacture of a hair dryer product in California. We had already begun shipment on previous contracts and were projecting to begin early in 2006.

In October 2005, following the notice of ABS's default, we terminated the agreement for both products based on the default. In January 2006, following efforts to resolve the disputes with ABS, the Company filed a lawsuit against ABS, claiming breach of contract, interference with contractual relationships, unjust enrichment, and fraud, and seeking damages from ABS.

With respect to the flat iron products, through October 2005, CirTran had shipped directly to ABS approximately $4,746,000 worth of the product, and CirTran had received from ABS or its finance company a total amount of approximately $788,000. In November 2005, we repossessed from ABS approximately $2,341,000 worth of the products in the United States, as we were permitted to do pursuant to the agreement.

Since November 2005, we have been pursuing our rights under the agreement and have been offering the flat iron product for sale directly to ABS's customers. In doing so, we sold to ABS's international customers directly approximately $426,000 worth of the flat iron product. The shipments have all been paid in

full. These products shipped were not part of the repossessed inventory.

On January 24, 2006, ABS filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Central District of California, San Fernando Valley Division (the "ABS Bankruptcy Court"), Case No. SV 06-10076 GM. On January 30, 2006, a hearing ("Hearing") was held to consider the Emergency Motion for Order Approving the Settlement and Compromise of the Disputed Secured Claims of Inventory Capital Group, Inc. ("ICG"), and Media Funding Corporation ("MFC") (the "Settlement

Motion") filed by ABS. The continued Hearing on the Settlement Motion was held on February 16, 2006, at which time the settlement was modified. Prior to a separate hearing held on March 24, 2006, on ABS's Motion for Order: (1) Approving Sale and Assignment of Substantially All Assets of the Estate Free and Clear of Liens; (2) Approving Assumption and Assignment of Leases and Executory Contracts Included in the Sale and Rejection of Leases and Executory Contracts Not Included in the Sale; and (3) Granting Related Relief (the "Sale Motion"), the settlement was further modified. The modifications to the proposed settlement were read into the ABS Bankruptcy Court's record at the Hearing on the Settlement Motion and the March 24, 2006 hearing on the Sale Motion ("Proposed Modifications"). Written notice of the Proposed Modifications was provided to creditors and parties in interests on March 27, 2006, and the Declaration of James C. Bastian, Jr., attesting that no objections to the Proposed Modifications have been received by ABS, was filed with the ABS Bankruptcy Court.

On June 6, 2006, the Company and ABS signed an agreement (the "Asset Purchase Agreement"), subject to the ABS Bankruptcy Court's approval. On June 7, 2006, the ABS Bankruptcy Court entered orders approving the Asset Purchase Agreement and granting the Sale Motion, and approving the settlement and compromise of certain disputed claims against ABS.

Pursuant to the settlement of ABS's bankruptcy proceedings and the Asset Purchase Agreement, the Company has an allowed claim against the ABS's estate in the amount of $2,350,000, of which $750,000 is to be credited to the purchase of substantially all of ABS's assets. Under the settlement, the Company shall be allowed to participate as a general unsecured creditor of ABS's estate in the amount of $1,600,000 on a pari passu basis with the $2,100,000 general unsecured claim of certain insiders of ABS and subject to the prior payment of certain secured, priority, and non-insider claims in the amount of approximately $1,507,011.

Under the Asset Purchase Agreement, the Company agreed to purchase substantially all of ABS's assets in exchange for:

i) a cash payment in the amount of $1,125,000;
ii) a reduction of CirTran's allowed claim in the Bankruptcy Case by $750,000;
iii) the assumption of any assumed liabilities; and
iv) the obligation to pay ABS a royalty equal to $3.00 per True Ceramic Pro flat iron unit sold by ABS (the "Royalty Obligation").

The Assets include personal property; intellectual property; certain executory contracts and unexpired leases; inventory; ABS's rights under certain insurance policies; deposits and prepaid expenses; books and records; goodwill; certain causes of action; permits; customer and supplier lists; and telephone numbers and listings (collectively, the "Assets").

Under the Asset Purchase Agreement, the Royalty Obligation is capped at $4,135,000. To the extent the amounts paid to ABS on account of the Royalty Obligation equal less than $435,000 on the 2 year anniversary of the Closing, then, within 30 days of such anniversary, the Company agreed to pay ABS an amount equal to $435,000 less the royalty payments made to date. As part of the settlement, the Company agreed to exchange general releases with, among others, ABS, Jason Dodo (the manager of ABS), Inventory Capital Group ("ICG"), and Media Funding Corporation ("MFC"). The settlement also resolved a related dispute with ICG in which ICG assigned $65,000 of its secured claim against ABS to the Company.

Pursuant to the court-approved settlement, payments under the Royalty Obligation will be made in the following order:

(a) The Royalty Obligation payments will be made exclusively to ICG and MFC (collectively, the "Secured Parties") until (i) the Secured Parties have been paid in full on account of their $1,243,208.44 secured claim, or (ii) the Secured Parties have been paid $100,000 in payments under the Royalty Obligation, whichever comes first.

(b) The next $70,000 Royalty Obligation payments will be made to a service provider to ABS (in the amount of $50,000) and to an individual with an allowed claim (in the amount of $20,000).

(c) Following the payments to the Secured Parties and others as set forth immediately above, the remaining Royalty Obligation payments will be used for distribution to allowed general unsecured claims not including those of the Company and certain insiders with unpaid notes (the "Insider Noteholders").

(d) Following payments as set forth in (a), (b), and (c) above, the Royalty Obligation payments will be shared pro rata among the Insider Noteholders (with a total allowed aggregate claim of $2,100,000), and the Company (with a general unsecured claim in the amount of $1,600,000), until paid in full.

The total claims against ABS's estate that must be paid before the Company begins to share in the Royalty Obligation payments is $435,000.

On December 28, 2005, we signed an Exclusive Manufacturing Agreement (the "Agreement") with Arrowhead Industries, Inc. ("Arrowhead"), pursuant to which we will become the exclusive manufacturer of a tool for assisting with the removal of door hinges called the "Hinge Helper" (the "Product"). Under the Agreement, Arrowhead agreed to buy the Product exclusively from us for the period of the Agreement, which is three years. The Product will be manufactured by us or by sub-manufacturers selected by us.

The Agreement provides that Arrowhead will own all right, title, and interest in the Product, and will sell and market the Product under its trademarks, service marks, or trade names.

On January 9, 2006, we issued a press release which referred, in the title, to the Agreement as a "$22 Million Exclusive Manufacturing Agreement." The dollar amount referenced relates to the potential amount of income or revenue which we may receive over the anticipated life of the Agreement.

CirTran announced on January 9, 2006, that Arrowhead Industries, Inc., of Windermere, Florida, had awarded us an exclusive contract to manufacture its patented Hinge Helper (TM) do-it-yourself utility tool for the home. The Hinge Helper will be manufactured by CirTran-Asia, the Company's China-based subsidiary. The exclusive manufacturing contract for the product is for three years. Arrowhead has filmed a Hinge Helper infomercial for TV with an airing date scheduled for late April.

The Hinge Helper is a unique hand tool designed and developed for use by household customers as well as tradesmen. Recognized by the U.S. Patent Office (#6,308,390 B1), its trademark and patent are owned by and registered to Arrowhead. The specific advantage of the Hinge Helper is its ease-of-use and simplistic design. It can be applied to any residential hinge on wood, metal or composite doors, and is being manufactured with highly-durable materials, enabling it to carry a lifetime guarantee.

The contract is for three years, and Arrowhead agreed to purchase a minimum of ten million units of the Product (the "Minimum Quantity"), subject to the terms and conditions of the Agreement. Arrowhead and CirTran have agreed on the Minimum Quantity in good faith, although the parties acknowledged that in certain circumstances described in the agreement, the agreement may be terminated prior to the sale of the entire Minimum Quantity. Arrowhead agreed to submit purchase orders for the Product from time to time in accordance with the terms of the agreement. Arrowhead agreed to pay CirTran for the Product purchased at the prices ranging from $2.95 to $1.90 per unit, depending on the cumulative number of units of Product which have been purchased by Arrowhead.

Arrowhead will also be entitled to a rebate equal to 10% of the purchase Price paid for Product in the previous Tier. Rebates will be payable only in the form of a credit memo against future purchases. Rebate credit memos will not be paid in cash and may not be applied against outstanding balances. We will calculate eligibility for the Rebate as soon as practicable following the end of the month in which a new Tier is entered.

We have produced hand made samples, which have been sent to Arrowhead. These were approved and we are awaiting final approval for the production samples that were supplied at the end of March 2006. Once the production samples are approved, we will start production according to the release schedule that should be provided by Arrowhead shortly thereafter. As of July 20, 2006, the product samples had been approved. Arrowhead had released and the Company shipped 1,500 units to test media. We are awaiting final production releases.

Electronics Business and Lines of Products

On June 10, 2005, we announced that Racore Technology Inc., ("Racore"), a subsidiary of CirTran Corporation, received a purchase order from the New York Fire Department, an established city public department on the east coast for fiber optic Ethernet network adapters. Since this announcement, the product has been manufactured and shipped, and a payment of $9,000 has been received. We continue to market and solicit orders on the Racore product line from various commercial and public agency clients.

On June 23, 2005, we announced that CirTran Corporation entered the "sold-on-TV" market by having its CirTran-Asia subsidiary build consumers' electronics products in China, and is now bringing business to the United States, refurbishing popular skill-stop slot machines from Japan for home amusement use in the United States. We continue to receive the imported machines from Rock Bottom Slots, perform the conversion and refurbishment services and ship directly to the customer.

On June 24, 2005, we announced that Racore received a purchase order from Lockheed-Martin, a well-known aerospace manufacturing company for fiber optic token-ring network adapters. Direct sales of new and repeat business from this company have totaled more than $30,000. Since this announcement the product has been manufactured and shipped, and payment has been received. As of July 20, 2006, we had shipped an additional $45,000 worth of product to this company.

On July 22, 2005, we announced that Racore received a purchase order from the United States Air Force for OptiCORE network interface cards. Since this announcement, the product has been manufactured and shipped, and payments of $15,000 have been received.

On August 1, 2005, we announced that Racore received a purchase order for fiber optics products from Cherokee City Appraisal District, another city public department located in the southern United States for fiber optic PCI Ethernet network interface cards with VF-45 connectors. Since this announcement, the product has been manufactured and shipped, and a payment of $1,030 has been received.

On August 4, 2005, we announced that Racore received a purchase order from Walt Disney World, a well-known amusement park in the southeastern United States, for more than $21,000 worth of network interface cards. Since this announcement, the product has been manufactured and shipped, and payment has been received.

On August 9, 2005, we announced that CirTran Corporation completed the first phase of the redevelopment of the next-generation SafetyNet(TM) RadioBridge(TM). Since this announcement, the Company has completed working on the second phase of the contract. On March 14, 2006, we announced that we had received a $250,000 order to build and deliver the first production run of the next generation SafetyNet(TM) RadioBridge(TM) which we redesigned at the request and on behalf of Aegis Assessments, Inc., a Scottsdale, Arizona-based homeland security contractor. We delivered the new, redesigned units and received payment in full from Aegis in April 2006.

On September 13, 2005, we announced that Racore had been named an "approved vendor" by the City of New York. Racore began its current business relationship

with the City of New York in April when it received a request for an evaluation unit of the Racore M8190A Fiber Optic Fast Ethernet Network Adapters with Volition Patch Cords. Racore subsequently received an order placed through one of its value-added resellers. Since this announcement, the product has been manufactured and shipped, and a payment of $4,500 has been received.

On October 11, 2005, we announced that CirTran Corporation was opening a satellite office in Los Angeles in accordance with the Company's internal expansion program. The new 2,500-square foot office will be located on the 17th floor at 1875 Century Park East in the Century City Entertainment and Business District of Los Angeles. Scheduled to open in late November, the office will serve as headquarters for CirTran's business development and strategic planning activities for the Company's multiple business divisions including electronics, consumer products, direct response/retail and "as sold-on-TV" products. Current plans call for CirTran to open additional satellite offices in New York and London in 2006. Since this announcement, we have leased office space in Los Angeles, California.

On December 2, 2005, we announced that we had formed a new division, CirTran Products, which will offer products for sale at retail. The new division will be run from our new Los Angeles office, with Trevor Saliba, our executive vice president for worldwide business development, working to develop sales. We anticipate that consumer products built by our CirTran Asia subsidiary, as well as other products which we plan to acquire, will be available for retail sale in 2006

CirTran Products was established to pursue manufacturing relationships on both a contracted and proprietary basis in the consumer products industry. Proprietary products will be product lines where the intellectual property (logo, trade name etc.) are owned by CirTran Products as well as exclusively manufactured by CirTran Corporation. The marketing efforts may also be managed exclusively by

CirTran, or CirTran may choose to engage third party consultants or partner with an independent marketing firm. CirTran Products also intends to pursue contract manufacturing relationships in the consumer products industry which can include product lines including: home/garden, kitchen, health/beauty, toys, licensed merchandise and apparel for film, television, sports and other entertainment properties. Licensed merchandise and apparel can be defined as any item that bears the image of, likeness, or logo of a product sold or advertised to the public. Licensed merchandise and apparel are sold and marketed in the entertainment (film and television) and sports (sports franchises) industries. As of July 20, 2006, we have concentrated our product development efforts into three areas, home/kitchen appliances, beauty products and licensed merchandise. We anticipate that these products will be introduced into the market under one uniform brand name or under separate trademarked names owned by CirTran Products.

Industry Background

The contract manufacturing industry specializes in providing the program management, technical and administrative support and manufacturing expertise required to take products from the early design and prototype stages through volume production and distribution. The goal is to provide a quality product, delivered on time and at the lowest cost, to the client. This full range of services gives the client an opportunity to avoid large capital investments in plant, inventory, equipment and staffing and to concentrate instead on innovation, design and marketing. By using our contract manufacturing services, our customers have the ability to improve the return on their investment with greater flexibility in responding to market demands and exploiting new market opportunities.

We believe two important trends have developed in the contract manufacturing industry. First, we believe customers increasingly require contract manufacturers to provide complete turnkey manufacturing and material handling services, rather than working on a consignment basis where the customer supplies all materials and the contract manufacturer supplies only labor. Turnkey contracts involve design, manufacturing and engineering support, the procurement of all materials, and sophisticated in-circuit and functional testing and distribution. The manufacturing partnership between customers and contract manufacturers involves an increased use of "just-in-time" inventory management techniques that minimize the customer's investment in component inventories, personnel and related facilities, thereby reducing costs.

We believe a second trend in the industry, that relates to our electronics division, has been the increasing shift from pin-through-hole, or PTH, to surface mount technology, or SMT, interconnection technologies. Surface mount and pin-through-hole printed circuit board assemblies are printed circuit boards on which various electronic components, such as integrated circuits, capacitors, microprocessors and resistors are mounted. These assemblies are key functional elements of many types of electronic products. PTH technology involves the attachment of electronic components to printed circuit boards with leads or pins that are inserted into pre-drilled holes in the boards. The pins are then soldered to the electronic circuits. The drive for increasingly greater functional density has resulted in the emergence of SMT, which eliminates the need for holes and allows components to be placed on both sides of a printed circuit. SMT requires expensive, highly automated assembly equipment and significantly more operational expertise than PTH technology. We believe the shift to SMT from PTH technology has increased the use of contract manufacturers by OEMs seeking to avoid the significant capital investment required for development and maintenance of SMT expertise.

Electronics Assembly and Manufacture

As of December 31, 2005, approximately 23% of our revenues were generated by our low-volume electronics assembly activities, which consist primarily of the placement and attachment of electronic and mechanical components on printed circuit boards and flexible (i.e., bendable) cables. We also assemble higher-level sub-systems and systems incorporating printed circuit boards and complex electromechanical components that convert electrical energy to mechanical energy, in some cases manufacturing and packaging products for shipment directly to our customers' distributors. In addition, we provide other manufacturing services, including refurbishment and remanufacturing. We manufacture on a turnkey basis, directly procuring any of the components necessary for production where the OEM customer does not supply all of the components that are required for assembly. We also provide design and new product introduction services, just-in-time delivery on low to medium volume turnkey and consignment projects and projects that require more value-added services, and price-sensitive, high-volume production. Our goal is to offer customers significant competitive advantages that can be obtained from manufacturing outsourcing, such as access to advanced manufacturing technologies, shortened product time-to-market, reduced cost of production, more effective asset utilization, improved inventory management and increased purchasing power.

As part of our electronics assembly and manufacture focus, in April 2004, we entered into a Preferred Manufacturing Agreement (the "Broadata Agreement") with Broadata Communications, Inc. ("Broadata"). Under this agreement, we will perform exclusive "turn-key" manufacturing services handling most of Broadata's manufacturing operations from material procurement to complete finished box-build. Specifically, Broadata agreed that during the three-year term of the Broadata Agreement, we would be the exclusive manufacturer of the Broadata products covered by the Broadata Agreement. Under the Broadata Agreement, Broadata issues us purchase orders specifying the work to be completed and the delivery time. The price paid for work performed under the Broadata Agreement is our costs plus 10%, plus an assembly fee of $0.07 per component and an hourly charge of $18 per hour for manual assembly, mechanical assembly, and testing, subject to periodic review and adjustment. We agreed to ship the products manufactured FOB West Valley City, Utah. Beginning in May 2005, we began handling a portion of Broadata's manufacturing operations from material procurement to complete finished box-build. The initial term of the agreement is three years, continuing month to month thereafter unless terminated by either party.

Ethernet Technology

Through our subsidiary, Racore Technology Corporation ("Racore"), we design, manufacture, and distribute Ethernet cards. These components are used to connect computers through fiber optic networks. In addition, we produce private label, custom designed networking products and technologies on an OEM basis. Our products serve major industrial, financial, and telecommunications companies worldwide. We market our products through an international network of distributors, value added resellers, and systems integrators who sell, install, and support our entire product catalogue.

Additionally, we have established, and continue to seek to establish, key business alliances with major multinational companies in the computing and data communications industries for which we produce private label, custom designed networking products and technologies on an OEM basis. These alliances generally require that Racore either develop custom products or adapt existing Racore products to become part of the OEM customer's product line. Under a typical contract, Racore provides a product with the customer's logo, packaging, documentation, and custom software and drivers to allow the product to appear unique and proprietary to the OEM customer. Contract terms generally provide for a non-recurring engineering charge for the development and customization charges, together with a contractual commitment for a specific quantity of product over a given term.

Contract Manufacturing

Through our subsidiary, CirTran-Asia, we design, engineer, manufacture and supply products in the electronics, consumer products and general merchandise industries for various marketers, distributors and national retailers. This new division is our Asian-based, wholly owned subsidiary, and provides manufacturing services to the direct response and retail consumer markets. Our experience and expertise in manufacturing enables CirTran-Asia to enter a project at any phase: engineering and design; product development and prototyping; tooling; and high-volume manufacturing. This strategic move into the Asian market has helped to elevate CirTran to an international contract manufacturer status for multiple products in a wide variety of industries, and has, in short order, allowed us to target large-scale contracts.

CirTran has established a dedicated satellite office for CirTran-Asia, and has retained Mr. Charles Ho to lead the new division. Having proven the value and reliability of its core products, CirTran Corporation has chosen to expand into previously untapped product lines. CirTran-Asia intends to pursue manufacturing relationships beyond printed circuit board assemblies, cables, harnesses and injection molding systems by establishing complete "box-build" or "turn-key" relationships in the electronics, retail, and direct consumer markets.

Market and Business Strategy

Our goal is to benefit from the increased market acceptance of, and reliance upon, the use of manufacturing specialists by many OEMs, marketing firms, distributors and national retailers. We believe the trend towards outsourcing manufacturing will continue. OEMs utilize manufacturing specialists for many reasons, including the following:

* To Reduce Time to Market. Due to intense competitive pressures in the electronics and general manufacturing industry, OEMs are faced with increasingly shorter product life-cycles and, therefore, have a growing need to reduce the time required to bring a product to market. We believe OEMs can reduce their time to market by using a manufacturing specialist's manufacturing expertise and infrastructure.

* To Reduce Investment. The investment required for internal manufacturing has increased significantly as products have become more technologically advanced and are shipped in greater unit volumes. We believe use of manufacturing specialists allows OEMs to gain access to advanced manufacturing capabilities while substantially reducing their overall resource requirements.

* To Focus Resources. Because the electronics industry is experiencing greater levels of competition and more rapid technological change, many OEMs are focusing their resources on activities and technologies which add the greatest value to their operations. By offering comprehensive electronics assembly and related manufacturing services, we believe manufacturing specialists allow OEMs to focus on their own core competencies such as product

development and marketing.

* To Access Leading Manufacturing Technology. Electronic

products and electronics manufacturing technology have become increasingly sophisticated and complex, making it difficult for OEMs to maintain the necessary technological expertise to manufacture products internally. We believe OEMs are motivated to work with a manufacturing specialist to gain access to the specialist's expertise in interconnect, test and process technologies.

* To Improve Inventory Management and Purchasing Power. Electronics industry OEMs are faced with increasing difficulties in planning, procuring and managing their inventories efficiently due to frequent design changes, short product life-cycles, large required investments in electronic components, component price fluctuations and the need to achieve economies of scale in materials procurement. OEMs can reduce production costs by using a manufacturing specialist's volume procurement capabilities. In addition, a manufacturing specialist's expertise in inventory management can provide better control over inventory levels and increase the OEM's return on assets.

An important element of our strategy is to establish partnerships with major and emerging OEM leaders in diverse segments across the electronics industry. Due to the costs inherent in supporting customer relationships, we focus our efforts on customers with which the opportunity exists to develop long-term business partnerships. Our goal is to provide our customers with total manufacturing solutions for both new and more mature products, as well as across product generations.

Another element of our strategy is to provide a complete range of manufacturing management and value-added services, including materials management, board design, concurrent engineering, assembly of complex printed circuit boards and other electronic assemblies, test engineering, software manufacturing, accessory packaging and post-manufacturing services. We believe that as manufacturing technologies become more complex and as product life cycles shorten, OEMs will increasingly contract for manufacturing on a turnkey basis as they seek to reduce their time to market and capital asset and inventory costs. We believe that the ability to manage and support large turnkey projects is a critical success factor and a significant barrier to entry for the market it serves. In addition, we believe that due to the difficulty and long lead-time required to change manufacturers, turnkey projects generally increase an OEM's dependence on its manufacturing specialist, which can result in a more stable customer base.

In our high volume electronics, consumer products, and general merchandise manufacturing divisions, we believe we add value by providing turn-key solutions in design, engineering, manufacturing and supply of products to our clients.

Suppliers; Raw Materials

Our sources of components for our electronics assembly business are either manufacturers or distributors of electronic components. These components include passive components, such as resisters, capacitors and diodes, and active components, such as integrated circuits and semi-conductors. Our suppliers include Siemens, Muriata-Erie, Texas Instruments, Fairchild, Harris and Motorola. Distributors from whom we obtain materials include Avnet, Future Electronics, Digi-key and Force Electronics. Although we have experienced shortages of various components used in our assembly and manufacturing processes, we typically hedge against such shortages by using a variety of sources and, to the extent possible, by projecting our customer's needs.

Research and Development

During 2005 and 2004, CirTran Corporation spent approximately $200,000 and $75,000, respectively, on research and development of new products and services. The costs of that research and development were paid for by our customers. In addition, during the same periods, our subsidiary, Racore, spent approximately $45,000 and $42,536, respectively. None of Racore's expenses were paid for by its customers. We remain committed, particularly in the case of Racore, to continuing to develop and enhance our product line as part of our overall business strategy.

Beginning in 2004, Racore started working more aggressively on marketing existing products by simplifying ordering and sales processing to existing customers. We are also working towards some cost reduced versions of existing product line and adding new sales channels. We are also in the process of expanding the current product line, adding new product categories to existing sales channels, along with products with reduced development costs, quicker time to market, higher profit margins, greatly reduced support costs, less pressure from competitors and shorter sales cycles.

In the coming months, we anticipate that Racore will redesign some of its products to reduced versions of existing products, but also similar yet unique products that will satisfy market needs which currently have no deliverable or affordable solutions. These products will realize reduced development costs, quicker time to market, higher profit margins, greatly reduced support costs, less pressure from competitors, and shorter sales and delivery cycles. These products will leverage our expertise in the areas of fiber optics, security, and portability.

We possess advanced design and engineering capabilities with experienced professional staffs at both our Salt Lake City and ShenZhen offices for electrical, software, mechanical and industrial design. This provides the end client a total solution for original design, re-design and final design of products.

Sales and Marketing

As of July 20, 2006, we had three individuals on our internal sales staff, and we have continued to pursue sales representative relationships with firms that work as independent contractors in generating new business. We signed an agreement with TMP and have other outside independent contractors that we continue to work with. This is advantageous to the Company, as it provides the Company with a broad sales network with no direct cost. It is our intention to continue pursuing sales representative relationships as well as internal salaried sales executives. Early in 2006 the Company opened a dedicated satellite sales/engineering office in Los Angeles to headquarter all business development activities companywide. The Company has since begun staffing this office with administrative and project management staff. The Company is still pursuing product development and business development professionals with concentrated efforts on the direct response, product and retail distribution divisions as well as sales executives for the electronics manufacturing division.

We are working aggressively to market existing products through current sales channels. We will also add major new conduits to deliver products and services directly to end users, as well as motivate our distributors, partners, and other third party sales mechanisms. We continue to simplify and improve the sales, order, and delivery process. We are also pursuing strategic relationships with retail distribution firms to engage with us in a reciprocal relationship where they would act as CirTran's retail distribution arm and we would act as their manufacturing arm with both parties giving the other priority and first opportunity to work on the other's products.

Historically, we have had substantial recurring sales from existing customers, though we continue to seek out new customers to generate increased sales. We treat sales and marketing as an integrated process involving direct salespersons and project managers, as well as senior executives. We also use independent sales representatives in certain geographic areas. We have also engaged strategic consulting groups to make strategic introductions to generate new business. This strategy has proven successful, and has already generated multiple manufacturing contracts. These relationships were responsible for a portion of sales generated in 2005 and we anticipate will be a major factor in our sales growth for 2006 and 2007.

During the typical sales process, a customer provides us with specifications for the product it wants, and we develop a bid price for manufacturing a minimum quantity that includes manufacture engineering, parts, labor, testing, and shipping. If the bid is accepted, the customer is required to purchase the minimum quantity and additional product is sold through purchase orders issued under the original contract. Special engineering services are provided at either an hourly rate or at a fixed contract price for a specified task.

In 2005, 38% of our net sales were derived from pre-existing customers, whereas during the year ended December 31, 2004, only 20% of our net sales were derived from customers that were also customers during 2003. In 2005, 62% of our sales

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were derived from new business, with the majority of those sales being secured by exclusive manufacturing contracts. In 2005, our major new customer was Advanced Beauty Solutions, LLC which accounted for about 35% of our net sales. Our second and third largest customers for 2005 were also new customers, Tristar Products with about 14%, and Emson with 9% of our net sales. Our largest pre-existing customer was Dynojet Research Inc. with over 8% of our net sales. We anticipate that our exclusive manufacturing contracts with Guthy-Renker, Reliant and Arrowhead Industries will contribute significantly to our sales for 2006 and 2007 as those projects are scheduled to roll out in the second and third quarter of 2006. Historically, a small number of customers accounted for a significant portion of our electronics assembly and manufacture division net sales.

Our expansion into China manufacturing has allowed us to increase our sales, manufacturing capacity and output with minimal capital investment required. By using various subcontractors among which are Zhejiang Hengtai Machinery Manufacturing Co., Ltd., which manufactures the Supreme Pilates and Zhejiang Cuiori Electrical Appliances Co., Ltd,, which manufactures the Perfect Grill, we leverage our upfront payments for inventories and tooling to control costs and receive benefits from economics of scale in Asian manufacturing facilities. These expenses can be upwards of $100,000 per product. The Company will, depending on the contract, prepay anywhere from 10% to 50% of the purchase orders for materials to some of the factories we have contracts with. In exchange for theses financial commitments, the Company receives dedicated manufacturing responsiveness hence eliminating the costly expense associated with capitalizing complete proprietary facilities.

Backlog consists of contracts or purchase orders with delivery dates scheduled within the next twelve months. As of July 20, 2006, our backlog was approximately $1,152,000 with confirmed deliveries dates. The Company also has a total of approximately $90,000,000 of signed contracts for blanket quantities (i.e. the full amount of the contract), in which the customer agrees to purchase a set amount and will issue purchases against the contract when product is needed. The majority of these blanket quantities orders are two contracts from Arrowhead for $22,000,000 and Reliant for $30,000,000. We have a $30,000,000 contract from Guthy - Renker Corporation, a contract from Emson for about $7,000,000 along with a few other smaller contracts. Each contract contains a buy out clause that varies, depending on the product and amounts of product agreed upon.

In December of 2004, we issued a press release relating to our hiring of Mr. Patrick L. Gerrard Sr. as a director of our corporate Quality Control Systems. We also announced that we had received an order for the United States Air Force. The products were built and shipped to them.

Management has continued its internal plan for increasing sales, reducing costs and restructuring the overall financial condition. As part of this strategy, sales for the Company in 2005 were greater than sales in 2004, and the Company reached an offer in compromise with the Internal Revenue Service in 2004 and the State of Utah in 2006 settling all outstanding tax liabilities.

The year 2004 was a critical year for CirTran Corporation. The most significant event for CirTran in 2004 was the acceptance of the offer in compromise by the Internal Revenue Service settlement of the Company's prior tax obligation. This has been a top priority for management and the board of directors as the Company's viability was in question. With this new milestone, management feels the Company is financially stable and in position to continue its plan to grow. In addition, our effort to enter high-volume manufacturing in the electronics, consumer products and general merchandise industries has had a dramatic impact to the Company's sales and backlog. Also, management's constant pursuit of establishing the Company as a world-class manufacturer was recognized with the Company receiving ISO9001:2000 certification on March 31, 2005. This is an international monitoring agency that requires all companies who are certified to comply with a set standard of policies on quality and manufacturing.

Material Contracts and Relationships

We generally use form agreements with standard industry terms as the basis for our contracts with our customers. The form agreements typically specify the general terms of our economic arrangement with the customer (number of units to

be manufactured, price per unit and delivery schedule) and contain additional provisions that are generally accepted in the industry regarding payment terms, risk of loss and other matters. We also use a form agreement with our independent marketing representatives that features standard terms typically found in such agreements.

Cogent Agreement

On September 14, 2003, we entered into an agreement with Cogent Capital Corp. ("Cogent"), under which we engaged Cogent to provide strategic planning and advisory services relating to acquisitions and with a view to obtaining a listing on either the American Stock Exchange or the NASDAQ. In a September 2003 press release, we mentioned that Cogent was assisting us in connection with a proposed direct investment in CirTran, but that transaction was not closed. We continue to work with Cogent, and they continue to provide strategic planning and advice.

MET Advisors Agreement

In August 2003, we entered into an agreement with MET Advisors ("MET") under which we retained MET to identify and provide detailed information on potential acquisition targets. Pursuant to the MET agreement, we agreed to pay MET a transaction fee equal to 5% of the total value of the transaction (but not less than $100,000), together with expenses incurred by MET in connection with the potential acquisition.

In January and March 2004, we issued press releases relating to a new agreement with a contract electronics manufacturer. The January 21, 2004, press release stated that we had entered into a Letter of Intent to purchase all the assets of a leading contract electronics manufacturer of printed circuit board assemblies based in Orange County, California. The March 2, 2004 press release was issued to give an update on the due diligence process. However, the letter of intent expired on March 5, 2004, and no agreement was reached regarding an extension. We have decided not to pursue further negotiations relating to this matter.

In March 2004, we issued two additional press releases relating to our potential acquisition of an interest in a manufacturer of digital fiber optic cable equipment. On March 18, 2004, we announced that we had signed a letter of intent to acquire a minority interest in a manufacturer based in southern California, and that in connection with the acquisition, we anticipated that we would enter into an exclusive manufacturing agreement. On March 26, 2004, we announced that we anticipated that we expected to finalize the acquisition of the interest and the exclusive agreement. On April 13, 2004, we entered into a stock purchase agreement with Broadata Communications, Inc., a California corporation ("Broadata") under which we purchased 400,000 shares of Broadata Series B Preferred Stock (the "Broadata Preferred Shares") for an aggregate purchase price of $300,000. The Broadata Preferred Shares are convertible, at our option, into an equivalent number of shares of Broadata common stock, subject to adjustment. The Broadata Preferred Shares are not redeemable by Broadata. As a holder of the Broadata Preferred Shares, we have the right to vote the number of shares of Broadata common stock into which the Broadata Preferred Shares are convertible at the time of the vote. Separate from the acquisition of the Broadata Preferred Shares, we also entered into a Preferred Manufacturing Agreement with Broadata. Under this agreement, we will perform exclusive "turn-key" manufacturing services handling most of Broadata's manufacturing operations from material procurement to complete finished box-build of all of Broadata's products. The initial term of the agreement is three years, continuing month to month thereafter unless terminated by either party.

As of July 20, 2006, we had no other acquisitions planned or anticipated. We continue to work with MET and Cogent with respect to potential acquisitions.

Competition

The electronic manufacturing services industry is large and diverse and is serviced by many companies, including several that have achieved significant market share. Because of our market's size and diversity, we do not typically

compete for contracts with a discreet group of competitors. We compete with different companies depending on the type of service or geographic area. Certain of our competitors may have greater manufacturing, financial, research and development and marketing resources. We also face competition from current and prospective customers that evaluate our capabilities against the merits of manufacturing products internally.

We believe that the primary basis of competition in our targeted markets is manufacturing technology, quality, responsiveness, the provision of value-added services and price. To remain competitive, we must continue to provide technologically advanced manufacturing services, maintain quality levels, offer flexible delivery schedules, deliver finished products on a reliable basis and compete favorably on the basis of price.

Furthermore, the Asian manufacturing market is growing at a rapid pace. Particularly in China, therefore, management feels that the Company is strategically positioned to hedge against unforeseen obstacles and continues its efforts to increase establishing additional relationships with manufacturing partners, facilities and personnel.

Regulation

We are subject to typical federal, state and local regulations and laws governing the operations of manufacturing concerns, including environmental disposal, storage and discharge regulations and laws, employee safety laws and regulations and labor practices laws and regulations. We are not required under current laws and regulations to obtain or maintain any specialized or agency-specific licenses, permits, or authorizations to conduct our manufacturing services. Other than as discussed in "Item 3 - Legal Proceedings" concerning delinquent payroll taxes, we believe we are in substantial compliance with all relevant regulations applicable to our business and operations.

Employees

As of July 20, 2006, we employed a total staff of 104 persons in the United States. In our Salt Lake headquarters, we employed 101 persons: 6 in administrative positions, 5 in engineering and design, 88 in clerical and manufacturing, and 2 in sales. In our sales office in Los Angeles, we employed 3 persons: 1 administrative and sales, 1 project manager, and 1 clerical assistant. At this time we are actively searching for additional qualified sales staff for our new office. In our CirTran-Asia division, we employed 7 people: 1 administrative, 2 accounting staff, 2 quality engineers, and 2 design engineers. We believe that our relationship with our employees is good.

Corporate Background

Our core business was commenced by Circuit Technology, Inc. ("Circuit"), in 1993 by our president, Iehab Hawatmeh. Circuit enjoyed increasing sales and growth in the subsequent five years, going from $2.0 million in sales in 1994 to $15.4 million in 1998, leading to the purchase of two additional SMT assembly lines in 1998 and the acquisition of Racore Computer Products, Inc., in 1997. During that period, Circuit hired additional management personnel to assist in managing its growth, and Circuit executed plans to expand its operations by acquiring a second manufacturing facility in Colorado. Circuit subsequently determined in early 1999, however, that certain large contracts that accounted for significant portions of our total revenues provided insufficient profit margins to sustain the growth and resulting increased overhead. Furthermore, internal accounting controls then in place failed to apprise management on a timely basis of our deteriorating financial position.

We were incorporated in Nevada in 1987, under the name Vermillion Ventures, Inc., for the purpose of acquiring other operating corporate entities. We were largely inactive until July 1, 2000, when we issued a total of 10,000,000 shares of our common stock (150,000,000 of our shares as presently constituted) to acquire, through our wholly-owned subsidiary, CirTran Corporation (Utah), substantially all of the assets and certain liabilities of Circuit.

In 1987, Vermillion Ventures, Inc. filed an S-18 registration statement with the United States Securities and Exchange Commission ("SEC") but did not at that time become a registrant under the Securities Exchange Act of 1934 ("1934 Act").

From 1989 until 2000, Vermillion did not make any filings with the SEC under the 1934 Act. In July 2000, we commenced filing regular annual, quarterly, and current reports with the SEC on Forms 10-KSB, 10-QSB, and 8-K, respectively, and have made all filings required of a public company since that time. In February 2001, we filed a Form 8-A with the SEC and became a registrant under the 1934 Act. We may be subject to certain liabilities arising from the failure of Vermillion to file reports with the SEC from 1989 to 1990, but we believe these liabilities are minimal because there was no public market for the common shares of Vermillion from 1989 until the third quarter of 1990 (when our shares began to be traded on the Pink Sheets) and it is likely that the statute of limitations has run on whatever public trades in the shares of our common stock may have taken place during the period during which Vermillion failed to file reports.

On August 6, 2001, we effected a 1:15 forward split and stock distribution which increased the number of our issued and outstanding shares of common stock from 10,420,067 to 156,301,005. We also increased our authorized capital from 500,000,000 to 750,000,000 shares.

The short- and long-term success of CirTran is subject to certain risks, many of which are substantial in nature and outside the control of CirTran. You should consider carefully the following risk factors, in addition to other information contained herein. When used in this Report, words such as "believes," "expects," "intends," "plans," "anticipates," "estimates," and similar expressions are intended to identify forward-looking statements, although there may be certain forward-looking statements not accompanied by such expressions. You should understand that several factors govern whether any forward-looking statement contained herein will or can be achieved. Any one of those factors could cause actual results to differ materially from those projected herein. These forward-looking statements include plans and objectives of management for future operations, including the strategies, plans and objectives relating to the products and the future economic performance of CirTran and its subsidiaries discussed above.

Description of Property

On December 17, 2003, we entered into a ten-year lease agreement (the "Lease") with PFE Properties, LLC, a Utah limited liability company (the "Lessor"), for our existing 40,000 square-foot headquarters and manufacturing facility, located at 4125 South 6000 West in Salt Lake City, Utah. The workspace includes 10,000 square feet of office space to support the Company's Administration, Sales, and Engineering Staff. The 30,000 square feet of manufacturing space includes a highly secured inventory area, shipping and receiving areas, and manufacturing and assembly space that support six full surface-mount lines with state-of-the-art equipment capable of placing over 360 million components per year.

On March 31, 2005, the Company entered into a Membership Acquisition Agreement (the "Acquisition Agreement") with Rajayee Sayegh (the "Seller") for the purchase of one hundred percent (100%) of the membership interests in PFE Properties LLC, a Utah limited liability company ("PFE"). Under the Acquisition Agreement, the Company agreed to issue twenty million (20,000,000) shares of its restricted common stock, with a fair value of $800,000 on the date of issuance. No registration rights were granted. The shares were issued without registration under the 1933 Act in reliance on Section 4(2) of the Securities Act of 1933, as amended (the "1933 Act"), and the rules and regulations promulgated thereunder.

The primary asset of PFE is its rights, titles and interests in and to a parcel of real property, together with any improvements, rents and profits thereon or associated therewith, located at 4125 S. 6000 W., West Valley City, Utah, 84128, where the Company presently has its headquarters and manufacturing facility.

Following the acquisition of the PFE interests, PFE will continue to own the building. PFE will remain a separate LLC due to liability issues and the Company will continue to make intercompany lease payments under the 2003 lease.

Our facilities in Shenzhen, China, constitute a sales and business office. We have no manufacturing facilities in China. Our office in Shenzhen is approximately 1,600 square feet. Under the terms of our lease on the space, the

monthly payment is 15,000 Renminbi, which in was approximately $1,900 on July 20, 2006. The term of the lease is for two years, running from July 18, 2004.

As of December, 2005, CirTran had begun occupying a commercial space in the Century City district of Los Angeles located at 1875 Century Park East, Suite 1790. The space is approximately 2,500 square feet of office space. The office will serve as the Business Development, Sales, Marketing and Strategic Planning Headquarters company-wide and for all divisions and subsidiaries. The sublease, which was signed in October of 2005 expires in October of 2007. The lease payment is $4,500 per month, all inclusive.

We believe that the facilities and equipment described above are generally in good condition, are well maintained, and are generally suitable and adequate for our current and projected operating needs.

Where to get additional information

Federal securities laws require us to file information with the Commission concerning our business and operations. Accordingly, we file annual, quarterly, and special reports, and other information with the Commission. You can inspect and copy this information at the public reference facility maintained by the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549.

You can get additional information about the operation of the Commission's public reference facilities by calling the Commission at 1-800-SEC-0330. The Commission also maintains a web site (http://www.sec.gov) at which you can read or download our reports and other information.

CirTran's internet address' are www.cirtran.com., www.cirtran-asia.com, www.racore.com.

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Overview

We provide a mixture of high and medium size volume turnkey manufacturing services using surface mount technology, ball-grid array assembly, pin-through-hole and custom injection molded cabling for leading electronics OEMs in the communications, networking, peripherals, gaming, law enforcement, consumer products, telecommunications, automotive, medical, and semiconductor industries. Our services include pre-manufacturing, manufacturing and post-manufacturing services. Through our subsidiary, Racore Technology Corporation, we design and manufacture Ethernet technology products. Our goal is to offer customers the significant competitive advantages that can be obtained from manufacture outsourcing, such as access to advanced manufacturing technologies, shortened product time-to-market, reduced cost of production, more effective asset utilization, improved inventory management, and increased purchasing power.

During 2004, we established a new division, CirTran-Asia, Inc, which has contributed to a large portion of the increase in revenue since that time. This division is an Asian-based, wholly owned subsidiary of CirTran Corporation and provides a myriad of manufacturing services to the direct response and retail consumer markets. Our experience and expertise in manufacturing enables CirTran-Asia to enter a project at any phase: engineering and design, product development and prototyping, tooling, and high-volume manufacturing. We anticipate that CirTran-Asia will pursue manufacturing relationships beyond printed circuit board assemblies, cables, harnesses and injection molding systems by establishing complete "box-build" or "turn-key" relationships in the electronics, retail, and direct consumer markets. This strategic move into the Asian market has helped to elevate CirTran to an international contract manufacturer status for multiple products in a wide variety of industries, and has, in short order, allow us to target large-scale contracts.

CirTran has established a dedicated satellite office for CirTran-Asia, and has retained Mr. Charles Ho to lead the new division. Having proven the value and reliability of its core products, CirTran Corporation has chosen to expand into previously untapped product lines.

On December 2, 2005, we announced that we had formed a new division, CirTran Products, which will offer products for sale at retail. The new division will be run from our new Los Angeles office, with Trevor Saliba, our executive vice president for worldwide business development, working to develop sales. We anticipate that consumer products built by our CirTran Asia subsidiary, as well as other products which we plan to acquire, will be available for retail sale in 2006.

On March 21, 2006, we announced that we had formed a new subsidiary to provide end-to-end services to the direct response and entertainment industries. The new division will provide product marketing, production, media funding and merchandise manufacturing services. Forming this new division was a necessary step to maximize product manufacturing opportunities for CirTran's proprietary products and to provide marketing services for individual entrepreneurs and inventors. The new division will be headquartered in CirTran's Los Angeles

(Century City) offices and be headed by Mr. Saliba. We are presently in development of proprietary programs to be launched in the product marketing division, production services and media funding divisions.

Significant Accounting Policies

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 of the Notes to the Financial Statements contained in our Annual Report on form 10-KSB includes a summary of the significant accounting policies and methods used in the preparation of our Financial Statements. The following is a brief discussion of the more significant accounting policies and methods used by us.

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in

accordance with accounting principles generally accepted in the United States. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Estimated amounts may differ under different assumptions or conditions, and actual results could differ from the estimates.

Revenue Recognition

Revenue is recognized when products are shipped. Title passes to the customer or independent sales representative at the time of shipment. Returns for defective items are repaired and sent back to the customer. Historically, expenses experienced with such returns have not been significant and have been recognized as incurred.

Inventories

Inventories are stated at the lower of average cost or market value. Costs include labor, material, and overhead costs. Overhead costs are based on indirect costs allocated among cost of sales, work-in-process inventory, and finished goods inventory. Indirect overhead costs have been charged to cost of sales or capitalized as inventory based on management's estimate of the benefit of indirect manufacturing costs to the manufacturing process.

When there is evidence that the inventory's value is less than original cost, the inventory is reduced to market value. The Company determines market value on current resale amounts and whether technological obsolescence exists. The Company has agreements with most of its customers that require the customer to purchase inventory items related to their contracts in the event that the contracts are cancelled. The market value of related inventory is based upon those agreements.

The Company typically orders inventory on a customer-by-customer basis. In doing so the Company enters into binding agreements that the customer will purchase any excess inventory after all orders are complete. Almost 80% of the total inventory in the electronics manufacturing division is secured by these agreements.

Related Party Transactions

Certain transactions involving Abacas Ventures, Inc., the Saliba Private Annuity Trust and the Saliba Living Trust are regarded as related party transactions under FAS 57. Disclosure concerning these transactions is set out in this section under "Liquidity and Capital Resources - Liquidity and Financing Arrangements," and in "Certain Relationships and Related Transactions."

Results of Operations - Comparison of Periods ended March 31, 2006 and 2005, and Years Ended December 31, 2005 and 2004

Sales and Cost of Sales

Net sales decreased to $1,737,824 for the three month period ended March 31, 2006, as compared to $2,920,465 during the same period in 2005, for a decrease of 40.5%. This decrease was attributed to the loss of sales in the CirTran Asia division due to legal issues with the Ab King Pro and ABS (see Legal Proceedings section). Cost of sales decreased by 48.2%, to $990,370 during the three month period ended March 31, 2006, from $1,949,773 during the same period in 2005. The decrease in cost of sales is directly due to the decrease in revenue. Our gross profit margin for the three month period ended March 31, 2006, was 43.0%, up from 33.2% for the same period in 2005. The majority of the increase is due to a considerable decrease in CirTran-Asia sales which have more favorable margins compared to the electronics assembly and Ethernet technology business operations. The sales in these divisions have remained consistent.

Net sales increased 46.6% to $12,992,512 for the year ended December 31, 2005, as compared to $8,862,715 for the year ended December 31, 2004. This sales increase can be attributed to several factors. The biggest factor contributed to the increase of net sales during the 2005 was the establishment of the new division CirTran-Asia, which has contributed $4,569,221 of the increase in revenue. Another factor was the strengthening of the overall marketing strategy of the Company. We have added many new customers mostly in CirTran Asia which contributed to the large increase. Also, industry-wide, we are seeing more OEMs release larger order commitments with extended time tables. The second significant factor directly related to CirTran is our marketing approach. Most contract manufacturers approach customers on a job-by-job basis. CirTran approaches customers on a partner basis. We have developed a program where we can be more effective when we control the material procurement, purchasing, and final assembly, providing the customer a final quality product delivered on time and at a lower market cost. This approach for the electronics assembly and manufacture division has resulted in sales to new customers of $170,504 during the year ended December 31, 2005. The biggest factor contributing to the increase of net sales during 2005 was our contract manufacturing division, which has resulted in sales to new customers of $4,598,211.

Cost of sales decreased by 4.6%, from $7,030,934 during year ended December 31, 2004, to $6,706,135 during year ended December 31, 2005. The decrease in cost of sales is due to an increase in revenue. Our gross profit margin for the year ended December 31, 2005, was 48.1%, up from 20.5% from the year ended December 31, 2004. The increase in margins is attributable to the outsourcing strategy of most of CirTran Asia's business to other subcontractors in China to better control cost of materials, direct labor, and scrap.

The following charts present (i) comparisons of sales, cost of sales and gross profit generated by our two main areas of operations, i.e., Asia Division, electronics assembly and Ethernet technology, during 20043 and 2005; and (ii) comparisons during these two years for each division between sales generated by pre-existing customers and sales generated by new customers.

	Period	Sales	Cost of Sales	Gross Loss/Margin
Contract Manufacture	Three months ended March 31, 2006	$ 941,239	$ 735,136	$ 206,103
	Three months ended March 31, 2005	2,124,844	1,609,774	515,070
	Year ended December 31, 2005	9,865,023	5,739,436	4,125,587
	Year ended December 31, 2004	5,458,944	4,736,479	722,465
Electronics Assembly	Three months ended March 31, 2006	774,359	244,877	529,482
	Three months ended March 31, 2005	773,013	329,239	443,774
	Year ended December 31, 2005	3,002,038	973,953(2)	2,028,085
	Year ended December 31, 2004	3,354,057	2,282,253(1)	1,071,804
Ethernet Technology	Three months ended March 31, 2006	22,226	10,357	11,869
	Three months ended March 31, 2005	22,608	10,760	11,848
	Year ended December 31, 2005	125,451	79,850(3)	45,601
	Year ended December 31, 2004	49,714	25,202	24,512

	Period	Total Sales	Pre-existing Customers	New Customers
Contract Manufacture	Three months ended March 31, 2006	$ 941,239	$ 725,543	$ 215,696
	Three months ended March 31, 2005	2,124,844	1,339,957	784,887
	Year ended December 31, 2005	9,865,023	5,266,812	4,598,211
	Year ended December 31, 2004	5,458,944	0	5,458,944

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Electronics Assembly	Three months ended March 31, 2006	774,359	768,105	6,254
	Three months ended March 31, 2005	773,013	5,562	767,451
	Year ended December 31, 2005	3,002,038	2,831,534	170,504
	Year ended December 31, 2004	3,354,057	2,796,720	557,337
Ethernet Technology	Three months ended March 31, 2006	22,226	19,361	2,865
	Three months ended March 31, 2005	22,608	18,645	3,963
	Year ended December 31, 2005	125,451	101,004	24,447
	Year ended December 31, 2004	49,714	30,257	19,457

(1) Includes the write-down of carrying value of inventories of $13,000
(2) Includes the write-down of carrying value of inventories of $17,364
(3) Includes the write-down of carrying value of inventories of $20,725

Inventory

We use just-in-time manufacturing, which is a production technique that minimizes work-in-process inventory and manufacturing cycle time, while enabling us to deliver products to customers in the quantities and time frame required. This manufacturing technique requires us to maintain an inventory of component parts to meet customer orders. Inventory at March 31, 2006, was $2,203,537, as compared to $2,271,604 at December 31, 2005. The decrease in inventory is nominal.

Inventory at December 31, 2005 was $2,271,604, as compared to $1,453,754 at December 31, 2004. The increase in inventory is due to the repossession of ABS finished goods inventory.

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Selling, General and Administrative Expenses

During the three months ended March 31, 2006, selling, general and administrative expenses were $837,520 versus $959,891 for the same period in 2005, a 12.7% decrease. The decrease in selling, general and administrative expenses is nominal.

During the year ended December 31, 2005, selling, general and administrative expenses were $5,923,075 versus $3,362,933 for 2004, a 76.1% increase. The increase was due to expenses related to the CirTran-Asia division, along with our efforts to aggressively market our products. Selling, general and administrative expenses as a percentage of sales as of December 30, 2005 were 45.6% as compared to 37.9% during 2004. This increase is due to expenses related to the CirTran-Asia division, along with our efforts to aggressively market our products

Other Income and Expense

Interest expense for three months ended March 31, 2006, was $1,086,253 as compared to $143,770 for the same period in 2005, an increase of 655.5%. The increase is primarily due to the derivative treatment of the convertible debenture, discussed below. The estimated fair value of the derivative liability decreased for the three months ended March 31, 2006. This decrease resulted in a gain on derivative valuation of $893,651.

The Company determined that the features of the Debentures fell under derivative accounting treatment. Accordingly, the Company recognizes these derivatives as liabilities on its balance sheet and measures them at their estimated fair value and recognizes the change in the estimated fair value as a gain or (loss) in the period of the change. The Company estimates the fair value of theses embedded derivatives using the Black-Scholes Model, which is based on a sophisticated analysis of historical factors that affect the value of the company's common stock. The fair value of the derivatives instruments is measured each quarter and the resultant change in value is; recorded as an adjustment to the derivative's carrying value and the attendant gain or loss is recognized for the period. During the 1st quarter of 2006, the estimated value of the derivatives decreased by $893,561 which is reported as a "Gain on derivative valuation" for the period.

As a result of the above factors, we had net loss of $277,998 for the quarter ended March 31, 2006, as compared to $201,728 for the quarter ended March 31, 2005. This net loss is attributed to a substantial decrease in sales.

Interest expense for 2005 was $1,225,252 as compared to $495,637 for 2004, a increase of 147.2%. The increase is primarily due to the increase in interest expense related the convertible debentures, accretion expense and interest accrued. Also, included are the settlement of various notes payable and interest income charged to delinquent accounts receivable accounts. As of December 31, 2005 and 2004, the amount of our liability for delinquent state and federal payroll taxes and estimated penalties and interest thereon was $98,316 and $723,660, respectively. We had a gain on forgiveness of debt related to previously unpaid liabilities in the amount of $337,761 and a gain on derivative valuation of $169,570.

Our overall net loss decreased 19.8% to $527,708 for the year ended December 31, 2005, as compared to $658,322 for the year ended December 31, 2004.

Details of the ABS transaction

In connection with the Advanced Beauty Solutions, LLC ("ABS") bankruptcy proceedings, the Company acquired all of the assets of ABS for an aggregate purchase price of $2,310,000. The assets purchased included inventory of a product which had been the subject of an agreement between the Company and ABS, the True Ceramic Pro flat iron. Pursuant to the asset purchase agreement, the Company must pay a royalty to the ABS bankruptcy estate in connection with the sale by the Company of the True Ceramic Pro units. The royalty portion of the purchase price is contingent, based on sales of each True Ceramic Pro flat iron unit. The amount of the royalty to be paid is $3 per unit and is limited to total of $4,135,000. The minimum guaranteed royalty payment of $435,000, guaranteed by the Company, is due within two years of the date of the asset purchase agreement. Pursuant to the bankruptcy court's orders, the initial $435,000 amount of royalty payments paid into the ABS estate will be disbursed

to other individuals and entities with claims against ABS's estate. After the guaranteed payment of $435,000 has been made, the royalty payments into the estate shall be prorated among five individuals and entities with claims against ABS's bankruptcy estate who have an aggregate claim against the ABS estate of $2,100,000 (constituting approximately 56.7% of the remaining claims against the estate) and the Company, which has an aggregate claim against the ABS estate of $1,600,000 (constituting approximately 43.3% of the remaining claims against the estate). Following the payment of an aggregate of $4,135,000 in royalty payments to the ABS estate, the Company shall have no further royalty obligations to the estate.

The purchase price of $2,310,000 for the ABS assets will be allocated as follows: to the assets acquired, which include a contractually agreed-upon estimated inventory value of $376,000, which is subject to adjustment for any decrease in the actual inventory value, with that adjustment being applied against the purchase price; the ABS website, with an estimated value of $10,000; and intangible assets, including registered trademarks, copyrights, infomercial master tapes, and patents, the aggregate value of which is $1,924,000.

Purchase of Assets

In connection with agreements between the Company and ABS, the Company had an approved claim against the ABS estate of $2,350,000. The Company and ABS agreed upon, and the bankruptcy court approved, the purchase by the Company of assets of ABS. The aggregate purchase price paid was $2,310,000, consisting of the following: $1,125,000 in cash, which was paid at the time of the finalization of the purchase of the assets; a reduction of the Company's approved claim against the ABS estate in the amount of $750,000; and a guaranteed royalty payment to the ABS estate of $435,000. The cash portion of the purchase price funded with the proceeds of sales of the Company's restricted stock and from operations. The Company's approved claim was reduced by $750,000, which went from being an account receivable to being part of the carrying value of the assets purchased, leaving an approved claim against the ABS estate of $1,600,000. The guaranteed royalty payment of $435,000 is discussed above.

A summary of the ABS asset purchase transaction is as follows:

Purchase of Assets by CirTran Corporation	
Cash	$ 1,125,000
Reduction of ABS Accounts Receivable	750,000
Guaranteed Royalty Payment	435,000
Total Purchase Price	$ 2,310,000

A summary of the treatment of the account receivable from ABS is as follows:

Allocation of Accounts Receivable from ABS	
Assets Purchased w/ Accts. Rec.	$ 750,000
Note Receivable from Bankruptcy Estate	1,600,000
Total Allocation of Accounts Receivable Balance	$ 2,350,000

Funds for the payment of the ABS asset purchase consisted of $1,000,000 that the Company raised through a private placement of 14,285,715 shares of the Company's common stock, and $125,000 which was obtained from Company operations. The shares in the private offering were purchased by and issued to ANAHOP, Inc. The Company disclosed the sale of the shares and accompanying warrants in a Current Report on Form 8-K filed with the SEC on May 30, 2006.

Liquidity and Capital Resources

Our expenses are currently greater than our revenues. We have had a history of losses preceeding this quarter, and our accumulated deficit increased to $19,605,311 at March 31, 2006, compared to $19,327,310 at December 31, 2005. Our

net loss for the quarter ending March 31, 2006, was $277,998, compared to $201,728 for the quarter ended March 31, 2005. Our current assets exceeded our current liabilities by $300,528 as of March 31, 2006, and our current liabilities exceeded our current assets by $1,142,874 as of December 31, 2005. The change was mostly attributable to settlements of notes payable. For the three months ended March 31, 2006 and 2005, we had negative cash flows from operations of $719,698 and $385,701 respectively.

Through July 20, 2006, Highgate had converted $750,000 of the Convertible Debentures, into 24,193,548 shares of our restricted common stock in accordance with the terms of the Convertible Debenture agreement.

On June 1, 2006 the company, through its newly formed subsidiary Diverse Media Group ("Diverse Media"), signed an exclusive services agreement with the Diverse

Talent Group, Inc. ("DTG") and DTG's CEO, Christopher Nassif. The agreement covers a five-year period that commenced on April 1, 2006. Included in the terms of the agreement, Diverse Media will provide DTG with a $200,000 line of credit. The line will be available to DTG in increments of $20,000 per week, which DTG will use to cover operating expenses during its seasonally slow periods from June until August, which coincides with the lull in industry production prior to the new fall programming releases. Diverse Media will initially fund the line of credit with proceeds from operations of CirTran Corporation, its parent company. As of July 20, 2006, DTG had not drawn any funds on the line of credit.

Our accumulated deficit was $19,327,310 at December 31, 2005, and $18,799,602 at December 31, 2004. Our net loss for the year ending December 31, 2005 was $527,708, compared to $658,322 for the year ending December 31, 2004. Our current liabilities exceeded our current assets by $1,142,874 as of December 31, 2005, and $3,558,826 as of December 31, 2004. The decrease in the difference is due to the settlement of notes payable and the agreement with the Internal Revenue Service. Also, in the difference is an increase in cash, net inventory and trade accounts payable. For the years ended December 31, 2005 and 2004, we recorded negative cash flows from operations of $1,751,744 and $1,680,054, respectively.

Cash

We had cash on hand of $443,637 at March 31, 2006, and $1,427,865 at December 31, 2005.

Net cash used in operating activities was $719,898 for the three months ended March 31, 2006. Cash received from customers of $2,076,845 was not sufficient to offset cash paid to vendors, suppliers, and employees of $2,128,964.

The non-cash charges were for depreciation and amortization of $114,939 and accretion expense of $965,512. Because the Company has negative cash flows from operations, it must rely on sources of cash other than customers to support its operations. It is anticipated that various methods of equity financing will be required to support operations until cash flows from operations are positive.

Net cash used in investing activities during the three months ended March 31, 2006, consisted of equipment and furniture purchases of $166,730. Net cash used by financing activities was $97,600 during the three months ended March 31, 2006 and was primarily related to payments on notes payable to stockholders of $95,806.

We had cash on hand of $1,427,865 at December 31, 2005, compared to $81,101 at December 31, 2004. The increase in cash on hand is due to a new cash management system that was established during 2003, and cash proceeds from the Cornell convertible debenture.

Net cash used in operating activities was $1,751,744 for the fiscal year ended December 31, 2005. During 2005, net cash used in operations was primarily attributable to $527,708 in net losses from operations, a gain on forgiveness of debt of $337,761, an increase in accounts receivable of $2,126,097, and a decrease in accrued liabilities of $446,452, partially offset by increases in accounts payable of $291,143 and in accrued prepaid expenses of $277,987. The non-cash charge was for depreciation and amortization of $324,955.

Net cash used in investing activities during the fiscal year ended December 31, 2005, consisted of the property and equipment purchases of $295,346.

Net cash provided by financing activities was $3,354,523 during the fiscal year ended December 31, 2005. Principal sources of cash were proceeds from stockholder notes payable of $123,220, proceeds of $3,102,067 from convertible debentures, net of cash paid for offering costs; proceeds from the exercise of options and warrants to purchase common stock of $33,000, and proceeds from notes payable to related parties of $95,586.

Accounts Receivable

At March 31, 2006, we had receivables of $3,019,960, net of a reserve for doubtful accounts of $158,374, as compared to $3,358,981 at December 31, 2005, net of a reserve of $158,374. This decrease was primarily attributed to decreased sales in the last two months of the first quarter as compared to the last two months in 2005. Receivables include the unpaid balance from ABS. (See ABS discussion immediately following this paragraph.) The Company has implemented an aggressive process to collect past due accounts over the past two years. Individual accounts are continually monitored for collectibilty. As part of monitoring individual customer accounts, the Company evaluates the adequacy of its allowance for doubtful accounts. Since the implementation of the new collection process, very few accounts have been deemed uncollectible.

ABS

We did not reserve for doubtful accounts on the amount of $2,350,000 for the ABS receivable while awaiting the outcome of the settlement offer we had submitted the to the bankruptcy court adjudicating ABS's bankruptcy (the "ABS Bankruptcy Court"). The ABS Bankruptcy Court ultimately accepted our offer, and the amount will be removed from the account receivable as part of the settlement.

As discussed below in the "Legal Proceedings" section, we entered into an agreement with ABS, which was approved by the ABS Bankruptcy Court, to purchase certain assets of ABS pursuant to an asset purchase agreement (the "Asset Purchase Agreement"). Under the Asset Purchase Agreement, we agreed to purchase substantially all of ABS's assets in exchange for:

i) a cash payment in the amount of $1,125,000;

ii) a reduction of CirTran's allowed claim in the Bankruptcy Case by $750,000;

iii) the assumption of any assumed liabilities; and

iv) the obligation to pay ABS a royalty equal to $3.00 per True Ceramic Pro flat iron unit sold by ABS (the "Royalty Obligation").

For further details, see the "Legal Proceedings" Section.

At December 31, 2005, we had receivables of $3,358,981, net of a reserve for doubtful accounts of $158,374, as compared to $1,288,719 at December 31, 2004, net of a reserve of $41,143.

This increase was primarily attributed to sales having substantially increased in the last months of the year as compared to the last two months in 2005. Also included is the unpaid balance of accounts receivable from ABS. (See ABS history beginning on page 13). The Company has implemented an aggressive process to collect past due accounts over the past two years. Individual accounts are continually monitored for collectibilty. As part of monitoring individual customer accounts, the Company evaluates the adequacy of its allowance for doubtful accounts. Since the implementation of the new collection process, very few accounts have been deemed uncollectible.

Accounts Payable

Accounts payable were $528,963 at March 31, 2006, as compared to $1,239,519 at December 31, 2005. The decrease is related to a drop in sales and paying vendors in a timely manner.

Accounts payable were $1,239,519 at December 31, 2005, as compared to $1,104,392 at December 31, 2004. This increase is due to an increase in sales.

Liquidity and Financing Arrangements

We have a history of substantial losses from operations and using rather than providing cash in operations. We had an accumulated deficit of $19,605,311 and a total stockholders' equity of $3,165,931 at March 31, 2006. As of March 31, 2006, our monthly operating costs and interest expenses averaged approximately $640,000 per month.

We had an accumulated deficit of $19,327,310 and a total stockholders' equity of $1,268,054 at December 31, 2005. In addition, during 2005 and 2004, we have used, rather than provided, cash in our operations. As of December 31, 2005, our monthly operating costs and interest expenses averaged approximately $607,000 per month.

Since February 2000, we have operated without a line of credit. Abacas Ventures, Inc., an entity whose shareholders include the Saliba Private Annuity Trust, one of our major shareholders (see "Item 11 - Security Ownership of Certain Beneficial Owners and Management") and a related entity, the Saliba Living Trust, purchased our line of credit of $2,792,609, and this amount was converted into a note payable to Abacas bearing an interest rate of 10%. As of December 31, 2001, a total of $2,405,507, plus $380,927 in accrued interest, was owed to Abacas pursuant to this note payable. During 2002, we entered into agreements with the Saliba Private Annuity Trust and the Saliba Living Trust to exchange 19,987,853 shares of our common stock for $1,499,090 in principal amount of this debt and to issue an additional 6,666,667 shares to these trusts for $500,000 cash which was used for working capital for the Company. During December 2002, an additional $1,020,154 of principal and $479,846 of accrued interest owed to Abacas was converted to 30,000,000 shares of our common stock. We issued no common stock to Abacas during 2003. During 2003 and 2002, the Company received $350,000 and $845,000 of cash proceeds under the terms of a bridge loan from Abacas. The Company made principal payments of $875,000 and 156,268 during 2003 and 2002, respectively, on the bridge loan. At December 31, 2003, the balance owed on the bridge loan was $163,742. See "Item 12 - Certain Relationships and Related Transactions."

During 2003 and 2002, we converted approximately $34,049 and $316,762, respectively of trade payables into notes and stock. During January 2002, in addition to the above-described transactions with the Saliba trusts, we issued 16,666,666 shares of restricted common stock at a price of $0.075 per share in exchange for the cancellation of $1,250,000 of notes payable to various stockholders. See "Item 12 - Certain Relationships and Related Transactions." We continue to work with vendors in an effort to convert other trade payables into long-term notes and common stock and to cure defaults with lenders with forbearance agreements that we are able to service.

Despite our efforts to make our debt-load more serviceable, significant amounts of additional cash will be needed to reduce our debt and fund our losses until such time as we are able to become profitable.

During the year ended December 31, 2004, Abacas completed negotiations with several vendors of the Company, whereby Abacas purchased various past due amounts for goods and services provided by vendors, as well as notes payable (see Note 7). The total of these obligations was $1,263,713. The Company has recorded this transaction as a $1,263,713 non-cash increase to the note payable owed to Abacas, pursuant to the terms of the Abacas agreement.

The total principal amount owed to Abacas between the note payable and the bridge loan was zero and $1,530,587 as of December 31, 2005 and 2004, respectively. The total accrued interest owed to Abacas between the note payable and the bridge loan was zero and $430,828 as of December 31, 2005 and 2004, respectively, and is included in accrued liabilities.

In March 2005, the shareholders of Abacas agreed to cancel $2,050,000 to principal and accrued interest in return for the Company's issuing 51,250,000 shares of our restricted common stock to the shareholders of Abacas. No registration rights were granted.

As of December 31, 2004, the Company had accrued liabilities in the amount of $500,000 for delinquent payroll taxes, including interest and penalties, owed to the Internal Revenue Service. The Company, in response to collection notices, filed a due process appeal with the Internal Revenue Service's Appeals Office. The appeal was resolved by an agreement with the Appeals Office that allowed the Company to file an offer in compromise of all federal tax liabilities owed by the Company based on its ability to pay. The Company filed its offer in compromise with the IRS in November 2003, and after meeting with IRS personnel, filed a revised offer in compromise on August 31, 2004. The Company was notified in November 2004 that the IRS had accepted the offer in compromise. Under the offer, the Company was required to pay an aggregate amount of $500,000 (representing payments of $350,000 by Circuit Technology, Inc., $100,000 by CirTran Corporation, and $50,000 by Racore Technology, Inc.), not later than February 3, 2005. These amounts were paid. Additionally, the Company must remain current in its payment of taxes for 5 years, and may not claim any NOLs for the years 2001 through 2015, or until the three companies pay taxes in an amount equal to the taxes waived by the offer in compromise.

Management believes that each of the related party transactions were as fair to the Company as could have been made with unaffiliated third parties.

In conjunction with our efforts to improve our results of operations, discussed above, we are also actively seeking infusions of capital from investors and are seeking to replace our operating line of credit. It is unlikely that we will be able, in our current financial condition, to obtain additional debt financing; and if we did acquire more debt, we would have to devote additional cash flow to paying the debt and securing the debt with assets. We may therefore have to rely on equity financing to meet our anticipated capital needs. There can be no assurances that we will be successful in obtaining such capital. If we issue additional shares for debt and/or equity, this will dilute the value of our common stock and existing shareholders' positions.

Subsequent to our acquisition of Circuit in July 2000, we took steps to increase the marketability of our shares of common stock and to make an investment in our Company by potential investors more attractive. These efforts consisted primarily of seeking to become current in our filings with the Securities and Exchange Commission and of seeking approval for quotation of our stock on the NASD Over the Counter Electronic Bulletin Board. NASD approval for quotation of our stock on the Over the Counter Electronic Bulletin Board was obtained in July

2002.

There can be no assurance that we will be successful in obtaining more debt and/or equity financing in the future or that our results of operations will materially improve in either the short or the long term. If we fail to obtain such financing and improve our results of operations, we will be unable to meet our obligations as they become due. That would raise substantial doubt about our ability to continue as a going concern.

Notes Payable to Equity Line Investor - During 2003, we borrowed a total of $1,830,000 from Cornell Capital Partners, LP, pursuant to nine unsecured promissory notes. The loans were made and the notes were issued from June 2003 through December 2003. In lieu of interest, we paid fees to the lender, ranging from 5% to 10%, of the amount of the loan. These fees have been recorded as interest expense. The fees were negotiated in each instance and agreed upon by us and by the lender and its affiliate. The notes were repayable over periods ranging from 70 days to 131 days. Each of the notes stated that if we did not repay the notes when due, a default interest rate of 24% would apply to the unpaid balance. Through December 31, 2003, we directed the repayment of $1,180,000 of these notes from proceeds generated under the Equity Line Agreement, as discussed below. At December 31, 2003, the balance owing on these notes was $650,000. All notes were paid when due or before, and at no time did we incur the 24% penalty interest rate.

During the year ended December 31, 2004, Cornell loaned us an additional $3,200,000 pursuant to four additional unsecured promissory notes, $1,700,000 of which remained outstanding at December 31, 2004. The loans were made and the

notes were issued in January through June 2004, bringing the total aggregate loans from Cornell to $5,030,000. As before, in lieu of interest, we paid fees to the lender, ranging from 4% to 5%, of the amount of the loan. The fees were negotiated in each instance and agreed upon by us and by the lender and its affiliate. The notes were repayable over periods of 88 days and 193 days. Each of the notes stated that if we did not repay the notes when due, a default interest rate of 24% would apply to the unpaid balance.

As noted above, we received proceeds of $5,030,000 from notes payable to Cornell. We used the proceeds from these notes to fund operating losses of approximately $2,938,000, pay down accounts payable, notes payable and other settlements of approximately $1,401,000, purchase equipment and tooling in the amount of $391,000, and to invest in Broadata in the amount of $300,000. During January 2005, the Company received proceeds of $565,000 from an additional note payable to Cornell to fund the settlement with the Internal Revenue Service

With the sale of the Convertible Debenture in May 2005 to Highgate, $2,265,000 of the proceeds were paid to Cornell to repay promissory notes in the amount of $1,700,000 and $565,000.

Prior Equity Line of Credit Agreement - In conjunction with efforts to improve the results of our operations, discussed above, on November 5, 2002, we entered into an Equity Line of Credit Agreement with Cornell. We subsequently terminated that agreement, and on April 8, 2003, we entered into an amended equity line agreement (the "Equity Line Agreement") with Cornell. Under the Equity Line Agreement, we had the right to draw up to $5,000,000 from Cornell against an equity line of credit (the "Equity Line"), and to put to Cornell shares of our common stock in lieu of repayment of the draw. The number of shares to be issued was determined by dividing the amount of the draw by the lowest closing bid price of our common stock over the five trading days after the advance notice was tendered. Cornell was required under the Equity Line Agreement to tender the funds requested by us within two trading days after the five-trading-day period used to determine the market price.

During the year ended December 31, 2004, we drew an aggregate amount of $2,150,000 under the Equity Line Agreement, pursuant to draws on the Equity Line, net of fees of $86,000, and issued a total of 57,464,386 shares of common stock to Cornell under the Equity Line Agreement. At our direction, Cornell retained the proceeds of the draws under the Equity Line Agreement and applied them as payments on the notes to Cornell, discussed above.

Pursuant to the Equity Line Agreement, in connection with each draw, we agreed to pay a fee of 4% of the amount of the draw to Cornell as consideration for its providing the Equity Line. Total fees paid for the year ended December 31, 2004 were $128,000. Of these payments, $86,000 was offset against additional paid-in capital as shares were issued under the Equity Line Agreement and $68,000 was recorded as deferred offering costs for total deferred offering costs of $68,000 at December 31, 2004. These deferred offering costs were expensed as the Equity Line Agreement was terminated in conjunction with the sale of the Convertible Debenture in May 2005.

Standby Equity Distribution Agreement - We entered into a Standby Equity Distribution Agreement (the "Agreement") dated May 21, 2004, with Cornell. Under the Agreement, we had the right, at our sole discretion, to sell periodically to Cornell shares of our common stock for an aggregate purchase price of up to $20 million. The purchase price for the shares sold to Cornell was to be equal to the lowest volume-weighted average price of our common stock during the pricing period consisting of the five consecutive trading days after we gave an advance notice. The periodic sale of shares was known as an advance. We could request an advance, by giving a written advance notice to Cornell, and could not request advances more frequently than every seven trading days. A closing was to be held on the first trading day after the end of the pricing period. The maximum advance amount was one million dollars ($1,000,000) per advance, with a minimum of seven trading days between advances. In addition, we could not request advances if the shares to be issued in connection with such advances would result in Cornell owning more than 9.9% of our outstanding common stock.

Cornell was to retain a commitment fee of 5% of the amount of each advance under the Agreement.

With the sale of the Convertible Debenture in May 2005, the Standby Equity Distribution Agreement and related agreements were terminated.

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Convertible Debenture - On May 26, 2005, we entered into a securities purchase agreement (the "Purchase Agreement") with Highgate, relating to the issuance of a 5% Secured Convertible Debenture, due December 31, 2007, in the aggregate principal amount of $3,750,000 (the "Convertible Debenture").

In connection with the issuance of the Convertible Debenture, we used $2,265,000 to repay two promissory notes to Cornell Capital Partners, LP ("Cornell"), one in the amount of $1,700,000, and the other in the amount of $565,000. Highgate and Cornell have the same general partner, Yorkville Advisors, but have different portfolio managers.

We also paid a commitment fee of $240,765, a structuring fee of $10,000 to Highgate, and legal fees of $5,668. As such, of the total purchase amount of

$3,750,000, the net proceeds to us were $1,228,567, which we received following the closing of the issuance of the Convertible Debenture. We used these proceeds for general corporate and working capital purposes.

The Convertible Debenture bears interest at a rate of 5%. Highgate is entitled to convert, at its option, all or part of the principal amount owing under the Convertible Debenture into shares of our common stock at a conversion price equal to the lesser of (a) $0.10 per share, or (b) an amount equal to the lowest closing bid price of the Common Stock as listed on the OTC Bulletin Board, as quoted by Bloomberg L.P. for the twenty (20) trading days immediately preceding the conversion date. Except as otherwise set forth in the Convertible Debenture, Highgate's right to convert principal amounts owing under the Convertible Debenture into shares of our common stock is limited as follows:

1. Highgate may convert up to $250,000 worth of the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the market price of our stock is $0.10 per share or less at the time of conversion;

2. Highgate may convert up to $500,000 worth of the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the price of our stock is greater than $0.10 per share at the time of conversion, provided, however, that Highgate may convert in excess of the foregoing amounts if we and Highgate mutually agree; and

3. Upon the occurrence of an event of default (as defined in the Convertible Debenture), Highgate may, in its sole discretion, accelerate full repayment of all debentures outstanding and accrued interest thereon or may, notwithstanding any limitations contained in the Convertible Debenture and/or the Purchase Agreement, convert the Convertible Debenture and accrued interest thereon into shares of our common stock pursuant to the Convertible Debenture.

Pursuant to the Convertible Debenture, interest is to be paid at the time of maturity or conversion. We may, at our option, pay accrued interest in cash or in shares of common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either (i) the date the interest payment is due; or (ii) if the interest payment is not made when due, the date on which the interest payment is made.

The Company granted Highgate registration rights, pursuant to which the Company agreed to file, within 120 days of the closing of the purchase of the debenture, a registration statement to register the resale of shares of the Company's common stock issuable upon conversion of the principal amount of the Convertible Debenture. The Company agreed to register the resale of up to 100,000,000 shares, and to keep such registration statement effective until all of the shares issuable upon conversion of the principal of the Convertible Debenture have been sold. In the event that the Company issues more than 100,000,000 shares of its common stock, it will file additional registration statements as necessary.

On June 15, 2006, we entered into an agreement with Highgate to amend the registration rights agreement, pursuant to which we agreed to use our best efforts to have the registration statement declared effective by July 31, 2006. Under the amendment, if the registration statement has not been declared effective by July 31, 2006, Highgate may declare us in default under the Convertible Debenture.

As noted above, through July 20, 2006, Highgate had converted $750,000 of the Convertible Debentures, into 24,193,548 shares of our restricted common stock in accordance with the terms of the Convertible Debenture agreement.

Additional Convertible Debenture Transaction - On December 30, 2005, we entered into a securities purchase with Cornell Capital, relating to the issuance of a 5% Secured Convertible Debenture, due July 30, 2008, in the aggregate principal amount of $1,500,000 (the "Cornell Debenture").

We also paid a commitment fee of $120,000 and a structuring fee of $10,000 to Cornell Capital. As such, of the total amount of $1,500,000, the net proceeds to us were $1,370,000. We will use these proceeds for general corporate and working capital purposes, at our discretion.

The Cornell Debenture bears interest at a rate of 5%. Cornell Capital is entitled to convert, at its option, all or part of the principal amount owing under the Debenture into shares of the Company's common stock at a conversion price equal one hundred percent (100%) of the lowest closing bid price of the Common Stock as listed on the OTC Bulletin Board, as quoted by Bloomberg L.P. for the twenty (20) trading days immediately preceding the Conversion Date, subject to certain restrictions and limitations set forth in the Cornell Debenture.

Under the terms of the Cornell Debenture, except upon an event of default as defined in the Cornell Debenture, Cornell Capital may not convert the Cornell Debenture for a number of shares of common stock in excess of that number of shares of common stock which, upon giving effect to such conversion, would cause the aggregate number of shares of Common Stock beneficially owned by Cornell Capital and its affiliates to exceed 4.99% of the outstanding shares of the common stock following such conversion.

Pursuant to the Cornell Debenture, interest is to be paid at the time of maturity or conversion. We may, at our option, pay accrued interest in cash or in shares of our common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either (i) the date the interest payment is due; or (ii) if the interest payment is not made when due, the date on which the interest payment is made.

Also pursuant to the Cornell Debenture, we have the right to redeem, by giving 3 days' written notice to Cornell Capital, a portion or all of the Cornell Debenture then outstanding by paying an amount equal to one hundred five percent (105%) of the amount redeemed plus interest accrued thereon. In the event that we redeem only a portion of the outstanding principal amount of the Cornell Debenture, Cornell Capital may convert all or any portion of the unpaid principal or interest of the Cornell Debenture not being redeemed by us. Additionally, if after the earlier to occur of (x) fifteen (15) months following the date of the purchase of the Cornell Debenture or (y) twelve (12) months following the date on which the initial registration statement is declared effective, all or any portion of the Cornell Debenture remains outstanding, then we, at the request of Cornell Capital, are required to redeem such amount outstanding at the rate of five hundred thousand dollars ($500,000) per each 30-day period. Finally, upon the occurrence of an event of default as defined in the Cornell Debenture, Cornell Capital can convert all outstanding principal and accrued interest under the Cornell Debenture irrespective of any of the limitations set forth in the Cornell Debenture and/or the Purchase Agreement, and in such event, all such principal and interest shall become immediately due and payable.

In connection with the Purchase Agreement, we also agreed to grant to Cornell

Capital warrants (the "Warrants") to purchase up to an additional 10,000,000 shares of our common stock. The Warrants have an exercise price of $0.09 per share, and expire three years from the date of issuance. The Warrants also provide for cashless exercise if at the time of exercise there is not an effective registration statement or if an event of default has occurred.

Additionally, we entered into an investor registration rights agreement (the "Registration Rights Agreement") with Cornell Capital, pursuant to which we agreed to file, within 120 days of the closing of the purchase of the Cornell Debenture, a registration statement to register the resale of shares of our common stock issuable to Cornell Capital upon conversion of the Cornell Debenture. We agreed to register the resale of up to 42,608,696 shares, consisting of 32,608,696 shares underlying the Cornell Debenture, and 10,000,000 shares underlying the Warrants. We agreed to keep such registration statement effective until all of the shares issuable upon conversion of the Cornell Debenture have been sold. In the event that we issue more than 32,608,696 shares of its common stock upon conversion of the Cornell Debenture, we will file additional registration statements as necessary.

On June 15, 2006, we entered into an agreement with Cornell to amend the registration rights agreement, pursuant to which we agreed to file the registration statement not later than August 15, 2006, instead of 120 days following the closing of the issuance of the Cornell Debenture. Under the amendment, if the registration statement has not been filed by August 15, 2006, Cornell may declare us in default under the Cornell Debenture.

We also entered into a security agreement (the "Security Agreement") with Cornell Capital, pursuant to which we granted a second position security interest in all of our property, including goods; inventory; contract rights and general intangibles; documents, receipts, and chattel paper; accounts and other receivables; products and proceeds; and any interest in any subsidiary, joint venture, or other investment interest to secure our obligation under the Cornell Debenture and the related agreements.

We also entered into an escrow agreement (the "Escrow Agreement") with Cornell Capital relating to the holding and disbursement of payment of the purchase price of the Cornell Debenture and cash payments made by us in payment of the obligations owing under the Cornell Debenture. We agreed with Cornell Capital to appoint David Gonzalez as the Escrow Agent under the Escrow Agreement.

A chart showing the number of shares issuable upon hypothetical conversions at particular conversion prices is set forth in the "Risk Factors" section on page 23.

Through July 20, 2006, Cornell had not converted any principal amount of the Cornell Convertible Debenture. On July 20, 2006, we entered into an agreement with Cornell (the "Cornell Agreement"). Pursuant to the Cornell Agreement, Cornell agreed that it would not convert any of the principal or interest on the Cornell Debenture or exercise any of the Warrants granted to Cornell until we had taken the steps necessary to increase our authorized capital.

By way of background, we have previously entered into financing transactions with Cornell Capital. In April 2003, we had entered into an equity line of credit agreement with Cornell Capital. Between December 2003 and March 2004, we drew a total of $2,150,000 on the equity line, and issued a total of 57,464,386 shares of common stock to Cornell Capital. In May 2004, we entered into a standby equity distribution agreement with Cornell Capital, but the agreement was terminated before any funds were drawn or any shares were issued. Between June 2003 and January 2005, Cornell Capital loaned to us an aggregate of $5,595,000 pursuant to promissory notes issued to Cornell Capital. These notes were paid in full by May 2005.

Highgate and Cornell have the same general partner, Yorkville Advisors, but have different portfolio managers. Additionally, the escrow agent appointed in connection with the purchase and sale of both the Cornell Capital debenture transaction and the Highgate debenture transaction is David Gonzalez, who is an officer of Cornell Capital.

The Company does not anticipate that it will use any of the proceeds of the sale of the Cornell Debenture to Cornell Capital to repay the debenture sold to Highgate.

Purchase of ABS Assets

Funds for the payment of the cash portion of the purchase of the ABS assets consisted of $1,000,000 that the Company raised through a private offering of 14,285,715 shares of the Company's common stock, and $125,000 which was obtained from Company operations. The shares in the private offering were issued to ANAHOP, Inc. The Company disclosed the sale of the shares and accompanying warrants in a Current Report on Form 8-K filed with the SEC on May 30, 2006.

In connection with the Advanced Beauty Solutions, LLC ("ABS") bankruptcy proceedings, the Company acquired all of the assets of ABS for an aggregate purchase price of $2,310,000. The assets purchased included inventory of a product which had been the subject of an agreement between the Company and ABS, the True Ceramic Pro flat iron. Pursuant to the asset purchase agreement and the orders of the bankruptcy court, the Company is required to make royalty payments to the ABS estate of $3 per unit of the True Ceramic Pro sold. Pursuant to the bankruptcy court's orders, the initial $435,000 amount of royalty payments paid into the ABS estate will be disbursed to other individuals and entities with claims against ABS's estate. After the guaranteed payment of $435,000 has been made, the royalty payments into the ABS estate will be prorated among five individuals and entities with claims against ABS's bankruptcy estate who have an aggregate claim against the ABS estate of $2,100,000 and the Company, which has an aggregate claim against the ABS estate of $1,600,000.

In connection with its efforts to sell the True Ceramic Pro units, the Company recently entered into a marketing and distribution contract (the "MD Agreement") with Media Syndication Global, LLC ("MSG"), granting worldwide exclusive rights to MSG to advertise, promote, market, sell and otherwise distribute the True Ceramic Pro units. The Company disclosed the MD Agreement in a Current Report filed on Form 8-K, filed July 10, 2006.

Under the terms of the agreement with MSG, the initial minimum sales quantity is 10,000 units and the minimum subsequent orders is 50,000 units in any three month period, which can be prorated, but not less than 400,000 units in any 12 month period. The initial term of the MD Agreement is for three years, after which the agreement will renew for terms of one year each, provided that MSG has purchased the minimum requirements under the MD Agreement.

Based on the terms of the MD Agreement and the terms of the bankruptcy court's orders, the Company anticipates that it will need to sell at least 1,378,333 units to generate enough royalty income to repay (A) the guaranteed royalty payment of $435,000 (which is the equivalent of 145,000 units), and (B) the

$3,700,000 in royalty payments consisting of (i) $2,100,000 (the equivalent of 700,000 units) to five individuals and entities with claims against the ABS estate, and (ii) $1,600,000 (the equivalent of 533,333 units) to the Company as payment of the Company's claim against the ABS estate. Based on minimum sales quantity included in the terms of the MD Agreement with MSG, the Company anticipates that it would take the Company approximately forty-two months to achieve the necessary unit sales to make the full $4,135,000 payment.

Forward-looking statements

All statements made in this prospectus, other than statements of historical fact, which address activities, actions, goals, prospects, or new developments that we expect or anticipate will or may occur in the future, including such things as expansion and growth of operations and other such matters are forward-looking statements. Any one or a combination of factors could materially affect our operations and financial condition. These factors include competitive pressures, success or failure of marketing programs, changes in pricing and availability of parts inventory, creditor actions, and conditions in the capital markets. Forward-looking statements made by us are based on knowledge of our business and the environment in which we currently operate. Because of the factors listed above, as well as other factors beyond our control, actual results may differ from those in the forward-looking statements. We disclaim any obligation or intention to update any forward-looking statement.

5% Convertible Debenture

On May 26, 2005, we entered into a securities purchase agreement (the "Purchase Agreement") with Highgate House Funds, Ltd., a Cayman Island exempted company ("Highgate" or the "Selling Shareholder"), relating to the issuance by us of a

5% Secured Convertible Debenture, due December 31, 2007, in the aggregate principal amount of $3,750,000 (the "Convertible Debenture").

In connection with the issuance of the Convertible Debenture, we used $2,265,000 to repay two promissory notes to Cornell Capital Partners, LP ("Cornell"), one in the amount of $1,700,000, and the other in the amount of $565,000. Highgate and Cornell have the same general partner, Yorkville Advisors, but have different portfolio managers.

We also paid a commitment fee of $240,765, a structuring fee of $10,000 to the Selling Shareholder, and legal fees of $5,668. As such, of the total purchase amount of $3,750,000, the net proceeds to us were $1,228,567, which we received following the closing of the purchase of the Convertible Debenture. We used these proceeds for general corporate and working capital purposes.

The Convertible Debenture bears interest at a rate of 5%. The Selling Shareholder is entitled to convert, at its option, all or part of the principal amount owing under the Convertible Debenture into shares of our common stock at a conversion price equal to the lesser of (a) $0.10 per share, or (b) an amount equal to the lowest closing bid price of the Common Stock as listed on the OTC Bulletin Board, as quoted by Bloomberg L.P. for the twenty (20) trading days immediately preceding the conversion date. Except as otherwise set forth in the Convertible Debenture, the Selling Shareholder's right to convert principal amounts owing under the Convertible Debenture into shares of our common stock is limited as follows:

1. The Selling Shareholder may convert up to $250,000 worth of

the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the market price of our stock is $0.10 per share or less at the time of conversion;

2. The Selling Shareholder may convert up to $500,000 worth of the principal amount plus accrued interest of the Convertible Debenture in any consecutive 30-day period when the price of our stock is greater than $0.10 per share at the time of conversion, provided, however, that the Selling Shareholder may convert in excess of the foregoing amounts if we and the Selling Shareholder mutually agree; and

3. Upon the occurrence of an event of default (as defined in the Convertible Debenture), the Selling Shareholder may, in its sole discretion, accelerate full repayment of all debentures outstanding and accrued interest thereon or may, notwithstanding any limitations contained in the Convertible Debenture and/or the Purchase Agreement, convert the Convertible Debenture and accrued interest thereon into shares of our common stock pursuant to the Convertible Debenture.

A chart showing the number of shares issuable upon hypothetical conversions at particular conversion prices is set forth in the "Risk Factors" section on page 16.

Pursuant to the Convertible Debenture, interest is to be paid at the time of maturity or conversion. We may, in our option, pay accrued interest in cash or in shares of common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either (i) the date the interest payment is due; or (ii) if the interest payment is not made when due, the date on which the interest payment is made.

Under the terms of the Convertible Debenture, except upon an event of default as defined in the Convertible Debenture, the Selling Shareholder may not convert the Convertible Debenture for a number of shares of common stock in excess of that number of shares of common stock which, upon giving effect to such conversion, would cause the aggregate number of shares of Common Stock beneficially owned by the Selling Shareholder and its affiliates to exceed 4.99% of the outstanding shares of the common stock following such conversion.

Also pursuant to the Convertible Debenture, we have the right to redeem, by giving 3 days' written notice to the Selling Shareholder, a portion or all of the Convertible Debenture then outstanding by paying an amount equal to one

hundred five percent (105%) of the amount redeemed plus interest accrued thereon. In the event that we redeem only a portion of the outstanding principal amount of the Convertible Debenture, the Selling Shareholder may convert all or any portion of the unpaid principal or interest of the Convertible Debenture not being redeemed. Additionally, if after the earlier to occur of (x) fifteen (15) months following the date of the purchase of the Convertible Debenture or (y) twelve (12) months following the date on which the initial registration statement is declared effective, all or any portion of the Convertible Debenture remains outstanding, then we, at the request of the Selling Shareholder, shall redeem such amount outstanding at the rate of five hundred thousand dollars ($500,000) per each 30-day period. Finally, upon the occurrence of an event of default as defined in the Convertible Debenture, the Selling Shareholder can convert all outstanding principal and accrued interest under the Convertible Debenture irrespective of any of the limitations set forth in the Convertible Debenture and/or the Purchase Agreement, and in such event, all such principal and interest shall become immediately due and payable.

In connection with the Purchase Agreement, we entered into an investor registration rights agreement (the "Registration Rights Agreement") with the Selling Shareholder, pursuant to which, we agreed to file, within 120 days of the closing of the purchase of the Convertible Debenture, a registration statement to register the resale of shares of the Company's common stock issuable to the Selling Shareholder upon conversion of the principal or interest on the Convertible Debenture. We agreed to register the resale of up to 100,000,000 shares, and to keep such registration statement effective until all of the shares issuable upon conversion of the principal or accrued interest on the Convertible Debenture have been sold. In the event that we issue more than 100,000,000 shares of common stock upon conversion of the Convertible Debenture, we will file additional registration statements as necessary.

This registration statement does not register the resale of any shares issued to Highgate as payment of interest accrued on the Convertible Debenture, and neither this registration statement nor the prospectus may be used to sell shares issued to Highgate as payment of interest accrued on the Convertible Debenture. The number of shares issuable in connection with this registration statement is also limited by our authorized capital, which as of July 20, 2006, was 750,000,000 shares. In other words, we are not authorized to issue more than 750,000,000 shares of our common stock, irrespective of how many shares are covered by this registration statement and prospectus, unless we increase our authorized capital, as discussed above in the "Risk Factors" section on page 22.

We also entered into a security agreement (the "Security Agreement") with the Selling Shareholder, pursuant to which we pledged all of our property, including goods; inventory; contract rights and general intangibles; documents, receipts, and chattel paper; accounts and other receivables; products and proceeds; and any interest in any subsidiary, joint venture, or other investment interest to secure our obligation under the Convertible Debenture and the related agreements.

We also entered into an escrow agreement (the "Escrow Agreement") with the Selling Shareholder relating to the holding and disbursement of payment of the purchase price of the Convertible Debenture and cash payments made by us in payment of the obligations owing under the Convertible Debenture. David Gonzalez was appointed as the Escrow Agent under the Escrow Agreement.

We sold the Convertible Debenture without registration under the Securities Act of 1933, as amended (the "1933 Act") in reliance on Section 4(2) of the 1933 Act, and the rules and regulations promulgated thereunder. Upon future conversions, if any, of the Convertible Debenture into shares of our common stock, we intend to issue the shares without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act, and the rules and regulations promulgated thereunder. As noted above, we anticipate that any resales by the Selling Shareholder of the shares issued upon conversion of the Convertible Debenture will be made pursuant to this registration statement.

Through July 20, 2006, Highgate had converted $750,000 of the Convertible Debentures, for 24,193,548 shares of our restricted common stock. Once this registration statement has been declared effective by the SEC, Highgate may sell those shares under this registration statement, although there is no guarantee that Highgate will sell any or all of the shares.

Selling shareholder

One of our investors, Highgate House Funds, Ltd., a Cayman Island exempted company, is the Selling Shareholder in connection with this prospectus and the registration statement of which it is a part. Highgate is not affiliated in any way with CirTran or any of our affiliates, except that the escrow agent appointed in connection with the Purchase Agreement and the Escrow Agreement, David Gonzalez, is an officer of Cornell Capital Partners, LLP ("Cornell"), an entity with which we previously entered into two transactions, an equity line of credit agreement and a standby equity distribution agreement. Highgate and Cornell have the same general partner, Yorkville Advisors, but have different portfolio managers. Both the equity line of credit agreement and the standby equity distribution agreement have been terminated. Additionally, as described above, prior to our entering into the Purchase Agreement with Highgate, Cornell had previously made loans to us in the aggregate amounts of $5,595,000, all of which have been repaid, including two notes for $1,700,000 and $565,000, respectively, which loans we repaid with part of the proceeds of the sale of the Convertible Debenture.

This prospectus, and the registration statement of which it is a part, cover the resales of the shares to be issued to Highgate, the Selling Shareholder, in connection with conversions of the Convertible Debenture.

Through July 20, 2006, Highgate had converted $750,000 of the Convertible Debentures, for 24,193,548 shares of our restricted common stock. Once this registration statement has been declared effective by the SEC, Highgate may sell those shares under this registration statement, although there is no guarantee that Highgate will sell any or all of the shares.

The following table provides information about the actual and potential ownership of shares of our common stock by Highgate in connection with the Convertible Debenture as of July 20, 2006, and the number of our shares registered for sale in this prospectus. The number of shares of common stock issuable to Highgate in connection with conversions of the Convertible Debenture varies according to the market price at and immediately preceding the date of a conversion by Highgate. Solely for purposes of estimating the number of shares of common stock that would be issuable to Highgate as set forth in the table below, we have assumed a hypothetical conversion by Highgate on July 20, 2006, of the full remaining amount of $3,000,000 principal amount of the Convertible Debenture (with no interest accrued) at a per share price of $0.03. The actual per share price and the number of shares issuable upon actual conversions by Highgate could differ substantially. This prospectus and the registration statement of which it is a part covers the resale of up to 100,000,000 shares of our common stock issuable to Highgate in connection with conversions of the principal or interest on the Convertible Debenture. The number of shares issuable in connection with this registration statement is also limited by our authorized capital, which as of July 20, 2006, was 750,000,000 shares. In other words, we are not authorized to issue more than 750,000,000 shares of our common stock, irrespective of how many shares are covered by this registration statement and prospectus, unless we increase our authorized capital.

Under the terms and conditions of the Convertible Debenture and the Purchase Agreement, Highgate is prohibited from converting amounts under the Convertible Debenture that would cause Highgate to beneficially own more than 4.99% of the then-outstanding shares of our common stock following such issuance. This restriction does not prevent Highgate from receiving and selling shares and thereafter receiving additional shares. In this way, Highgate could sell more than 4.99% of our outstanding common stock in a relatively short time frame while never beneficially owning more than 4.99% of the outstanding CirTran common stock at any one time. For purposes of calculating the number of shares of common stock issuable to Highgate assuming a conversion of the full amount of the Convertible Debenture, as set forth below, the effect of such 4.99% limitation has been disregarded. The number of shares issuable to Highgate as described in the table below therefore may exceed the actual number of shares Highgate may be entitled to beneficially own under the Convertible Debenture. The following information is not determinative of Highgate's beneficial ownership of our common stock pursuant to Rule 13d-3 or any other provision under the Securities Exchange Act of 1934, as amended.

Name of Selling Shareholder	Shares of Common Stock Owned by Selling Share-hold Prior to Offering (1)	Shares of Common Stock Issuable to Selling Shareholder in Connection with Debenture	Percentage of Common Stock Issuable to Selling Shareholder in Connection with Debenture (2)	Number of Shares of Common Stock Registered Hereunder (3)	Number of Shares of Common Stock Owned After Offering	Percentage of Common Stock Beneficially Owned After the Offering
Highgate House Funds, Ltd.	0	124,193,548(4)	16.90%	100,000,000	0(5)	0%(5)

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(1) To our knowledge, and based on representations from Highgate's management, Highgate owned 24,193,548 shares of our common stock as of July 20, 2006. Highgate House Funds, Ltd., is an entity managed by Yorkville Advisors, LLC. Adam Gottbetter is the co-portfolio manager of Yorkville Advisors, LLC.

(2) As noted above, Highgate is prohibited by the terms of the Convertible Debenture from converting amounts of the Convertible Debenture that would cause it to beneficially own more than 4.99% of the then outstanding shares of our common stock following such put. The percentages set forth are not determinative of the Selling Shareholder's beneficial ownership of our common stock pursuant to Rule 13d-3 or any other provision under the Securities Exchange Act of 1934, as amended.

(3) The registration statement of which this prospectus is a part covers up to 100,000,000 shares of common stock issuable in connection with the Convertible Debenture. Because the specific circumstances of the issuances under the Convertible Debenture are within the discretion of Highgate and are therefore unascertainable at this time, the precise total number of shares of our common stock offered by the Selling Shareholder cannot be fixed at this time, but cannot exceed 100,000,000 unless we file additional registration statements registering the resale of the additional shares. The amount set forth in the table represents the number of shares of our common stock that have been issued and that would be issuable, and hence offered in part hereby, assuming a conversion of the full principal amount of the Convertible Debenture (excluding any interest accrued thereon) as of December 12, 2005. The actual number of

shares of our common stock offered hereby may differ according to the actual number of shares issued upon such conversions.

(4) Includes:

24,193,548	shares of common stock issued upon conversion by Highgate of $750,000 principal amount of the Debenture as of July 20, 2006; and
100,000,000	shares of common stock issuable upon a hypothetical conversion of the remaining $3,000,000 principal amount of the Convertible Debenture as of July 20, 2006. This prospectus registers only up to 100,000,000 shares of common stock issuable in connection with the Convertible Debenture. Accordingly, we may not issue shares in excess of 100,000,000 unless we file additional registration statements registering the resale of the additional shares.

(5) Assumes a hypothetical conversion of the remaining $3,000,000 principal amount of the Convertible Debenture as of July 20, 2006, and the issuance of 100,000,000 shares of our common stock, in addition to the 24,193,548 shares previously issued to Highgate upon conversion of $750,000 principal amount of the Debenture, together with the sale by Highgate of all such shares. There is no assurance that Highgate will sell any or all of the shares offered hereby. However, Highgate is contractually prohibited from converting amounts of the Convertible Debenture that would cause it to hold shares in excess of 4.99% of the then-issued and shares of our common stock.

This number and percentage may change based on Highgate's decision to sell or hold the Shares. There is no assurance that Highgate will sell any or all of the shares offered hereby. If Highgate sells all of the shares issued to it in connection with the Convertible Debenture, the number of shares held following such sales would be 0 and the percentage of ownership would be 0%. Additionally, as noted, this registration statement registers the resale of up to 100,000,000 shares by Highgate. In the event that we issue more than 100,000,000 shares to Highgate in connection with conversions of the Debenture, we will be required to file additional registration statements to cover the resale of such shares. As noted above, the number of shares issuable in connection with this registration statement is also limited by our authorized capital, which as of July 20, 2006, was 750,000,000 shares. In other words, we are not authorized to issue more than 750,000,000 shares of our common stock, irrespective of how many shares are covered by this registration statement and prospectus, unless we increase our authorized capital.

Plan of Distribution

The Selling Shareholder, its pledgees, donees, transferees or other successors in interest, may from time to time sell the Shares of our Common Stock directly to purchasers or indirectly to or through underwriters, broker-dealers or agents. The Selling Shareholder may sell all or part of its shares in one or more transactions at fixed prices, varying prices, prices at or related to the then-current market price or at negotiated prices. The Selling Shareholder will determine the specific offering price of the Shares from time to time that, at that time, may be higher or lower than the market price of our Common Stock quoted on the OTC Bulletin Board.

The Selling Shareholder and any underwriters, broker-dealers or agents participating in the distribution of the Shares of our Common Stock may be deemed to be "underwriters" within the meaning of the Securities Act of 1933, and any profit from the sale of such shares by the Selling Shareholder and any compensation received by any underwriter, broker-dealer or agent may be deemed to be underwriting discounts under the Securities Act. The Selling Shareholder may agree to indemnify any underwriter, broker-dealer or agent that participates in transactions involving sales of the Warrants or shares against certain liabilities, including liabilities arising under the Securities Act.

Because the Selling Shareholder may be deemed to be an "underwriter" within the meaning of the Securities Act, the Selling Shareholder will be subject to the prospectus delivery requirements of the Securities Act. We have informed the Selling Shareholder that the anti-manipulative provisions of Regulation M promulgated under the Exchange Act may apply to its sales in the market. With certain exceptions, Regulation M precludes the Selling Shareholder, any affiliated purchasers, and any broker-dealer or other person who participates in such distribution from bidding for or purchasing, or attempting to induce any person to bid for or purchase any security which is the subject of the distribution until the entire distribution is complete. Regulation M also prohibits any bids or purchases made in order to stabilize the price of a security in connection with the distribution of that security.

The method by which the Selling Shareholder, or its pledgees, donees, transferees or other successors in interest, may offer and sell their Shares may include, but are not limited to, the following:

* sales on the over-the-counter market, or other securities exchange on which the Common Stock is listed at the time of sale, at prices and terms then prevailing or at prices related to the then-current market price;
* sales in privately negotiated transactions;
* sales for their own account pursuant to this prospectus;
* through the writing of options, whether such options are listed on an options exchange or otherwise through the settlement of short sales;
* cross or block trades in which broker-dealers will attempt to sell the shares as agent, but may position and resell a portion of the block as a principal in order to facilitate the transaction;
* purchases by broker-dealers who then resell the shares for their own account;
* brokerage transactions in which a broker solicits purchasers;
* any combination of these methods of sale; and

* any other method permitted pursuant to applicable law.

Any Shares of Common Stock covered by this prospectus that qualify for sale under Rule 144 or Rule 144A of the Securities Act may be sold under Rule 144 or Rule 144A rather than under this prospectus. The Shares of our Common Stock may be sold in some states only through registered or licensed brokers or dealers. In addition, in some states, the Shares of our Common Stock may not be sold unless they have been registered or qualified for sale or the sale is entitled to an exemption from registration.

The Selling Shareholder may enter into hedging transactions with broker-dealers or other financial institutions. In connection with such transactions, broker-dealers or other financial institutions may engage in short sales of our securities in the course of hedging the positions they assume with the Selling Shareholder. The Selling Shareholder may also enter into options or other transactions with broker-dealers or other financial institutions which require the delivery to such broker-dealer or other financial institution of the securities offered hereby, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

To our knowledge, there are currently no plans, arrangements or understandings between the Selling Shareholder and any underwriter, broker-dealer or agent regarding the sale of Shares of our Common Stock by the Selling Shareholder.

The Selling Shareholder will pay all fees, discounts and brokerage commissions in connection with any sales, including any fees to finders. We will pay all expenses of preparing and reproducing this prospectus, including expenses or compliance with state securities laws and filing fees with the SEC.

Under applicable rules and regulations under Regulation M under the Exchange Act, any person engaged in the distribution of securities may not simultaneously engage in market making activities, subject to certain exceptions, with respect to the securities for a specified period set forth in Regulation M prior to the commencement of such distribution and until its completion. In addition and with limiting the foregoing, the Selling Shareholder will be subject to the applicable provisions of the Securities Act and the Exchange Act and the rules and regulations thereunder, including, without limitation, Regulation M, which provisions may limit the timing of purchases and sales of the securities by Selling Shareholder. The foregoing may affect the marketability of the securities offered hereby.

The Selling Shareholder may be deemed to be an "underwriter" as such term is defined in the Securities Act, and any commissions paid or discounts or concessions allowed to any such person and any profits received on resale of the securities offered hereby may be deemed to be underwriting compensation under the Securities Act.

Prior History and Dealings with Selling Shareholder and Related Entities

As noted above in the "Recent Developments" section, Highgate House Funds, Ltd., the Selling Shareholder under this registration statement, and Cornell Capital have the same general partner, Yorkville Advisors, but have different portfolio managers. In addition to the Convertible Debentures issued to Cornell in December 2005, we have entered into prior financing transactions with Cornell in the past four years.

- In April 2003, we entered into an equity line of credit agreement with Cornell, pursuant to which we drew a total of $3,330,000 on the equity line, and issued a total of 121,717,894 shares of common stock to Cornell Capital. We registered the resale by Cornell of those shares into the market on a registration statement on Form SB-2.

- In May 2004, we entered into a standby equity distribution agreement with Cornell Capital, but the agreement was terminated before any funds were drawn or any shares were issued.

- Between June 2003 and January 2005, Cornell Capital loaned to us an aggregate of $5,595,000 pursuant to promissory notes issued to Cornell Capital. These notes were paid in full by May 2005.

In the prior financing deals with Cornell, specifically the Equity Line of Credit transaction, Cornell sold all of the shares of our common stock that were issued in connection with the Equity Line. Although we do not have a history of dealing with Highgate, there is a strong possibility that Highgate will also sell all of the shares that we issue to it in connection with the conversions of the Convertible Debentures, rather than holding any of the shares for any extended period of time. Such sales could result in substantial dilution.

As noted immediately above in the "Selling Shareholder" section, through July 20, 2006, Highgate had converted $750,000 of the Convertible Debenture, for 24,193,548 shares of our restricted common stock. Once this registration statement has been declared effective by the SEC, Highgate may sell those shares under this registration statement, although there is no guarantee that Highgate will sell any or all of the shares.

Additionally, with respect to sales by Highgate, the following factors should be considered:

- We have limited funds to use to repay the Convertible Debentures issued both to Highgate and to Cornell, and as such, it is likely that we will rely on the conversions of the Convertible Debentures into shares of our common stock for repayment, which will result in dilution to the positions of our current shareholders;

- The Convertible Debentures issued to Highgate include a conversion cap, pursuant to which Highgate cannot convert principal amounts of the Convertible Debentures that would result in its owning more than 4.99% of our issued and outstanding common stock. These restrictions, however, do not prevent Highgate from selling shares of common stock received in connection with a conversion, and then receiving additional shares of common stock in connection with a subsequent conversion. In this way, Highgate could sell more than 4.99% of the outstanding common stock in a relatively short time frame while never holding more than 4.99% at one time. As a result, existing shareholders and new investors could experience substantial dilution in the value of their shares of our common stock.

- Our average daily trading volume as of July 20, 2006, as reported by the OTC Bulletin Board, was approximately 2,089,000 shares. As such, there can be no assurance that there will be sufficient volume to support the sales by Highgate of a substantial number of shares issued or issuable to it upon conversion of the Convertible Debentures. To the extent that Highgate is unable to sell sufficient shares and to reduce the principal amount of the Debentures, we will be required to continue to pay interest on the outstanding principal balance.

- The Convertible Debentures mature on December 31, 2007. As such, assuming that we make no principal payments on the Convertible Debentures, as of July 20, 2006, the remaining outstanding balance of $3,000,000 would convert into approximately 100,000,000 shares of our common stock, which Highgate would need to sell into the market. Although there can be no way to accurately determine the effect of such sales on our share price, it is likely that the introduction of such a large volume of shares could significantly depress the share price, which would result in our obligation to issue more shares, in light of the floating conversion price.

- Each of the factors listed above could be worsened by the actions of Cornell Capital in selling shares issuable upon conversion of the convertible debentures issued to Cornell Capital in December 2005. Although the resale by Cornell Capital is not covered by this prospectus or the registration statement of which it is a part, we have contractually agreed with Cornell Capital that we will file a registration statement to register its resales into the market. If both

Highgate and Cornell are selling into the market at the same time, such sales could have a material adverse impact on our sales price.

- Although we are permitted under the Convertible Debentures issued both to Highgate and to Cornell Capital to pay the principal amounts due in cash, we may not be in a financial position to do so, and as such, we may rely on conversions by Highgate and Cornell Capital of outstanding principal amounts to reduce our obligations under the Convertible Debentures.

As noted above, we are not selling any shares under this prospectus or the registration statement of which it is a part. Highgate is the sole selling shareholder hereunder. As such, any decisions with respect to whether or when to sell any shares issued or issuable to Highgate upon conversion of principal amounts of the Convertible Debentures are completely within Highgate's discretion, and we will not participate or be involved in any such sales.

Regulation M

We have informed the Selling Shareholders that Regulation M promulgated under the Securities Exchange Act of 1934 may be applicable to them with respect to any purchase or sale of our common stock. In general, Rule 102 under Regulation M prohibits any person connected with a distribution of our common stock from directly or indirectly bidding for, or purchasing for any account in which it has a beneficial interest, any of the Shares or any right to purchase the Shares, for a period of one business day before and after completion of its participation in the distribution.

During any distribution period, Regulation M prohibits the Selling Shareholders and any other persons engaged in the distribution from engaging in any stabilizing bid or purchasing our common stock except for the purpose of preventing or retarding a decline in the open market price of the common stock. None of these persons may effect any stabilizing transaction to facilitate any offering at the market. As the Selling Shareholders will be offering and selling our common stock at the market, Regulation M will prohibit them from effecting any stabilizing transaction in contravention of Regulation M with respect to the Shares.

We also have advised the Selling Shareholders that they should be aware that the anti-manipulation provisions of Regulation M under the Exchange Act will apply to purchases and sales of shares of common stock by the Selling Shareholders, and that there are restrictions on market-making activities by persons engaged in the distribution of the shares. Under Regulation M, the Selling Shareholders or their agents may not bid for, purchase, or attempt to induce any person to bid for or purchase, shares of our common stock while such Selling Shareholders are distributing shares covered by this prospectus. Regulation M may prohibit the Selling Shareholders from covering short sales by purchasing shares while the distribution is taking place, despite any contractual rights to do so under the Agreement. We have advised the Selling Shareholders that they should consult with their own legal counsel to ensure compliance with Regulation M.

Legal Proceedings

We assumed certain liabilities of Circuit Technology, Inc., in connection with our transactions with that entity in the year 2000, and as a result we are defendant in a number of legal actions involving nonpayment of vendors for goods and services rendered. We have accrued these payables and have negotiated settlements with respect to some of the liabilities, including those detailed below, and are currently negotiating settlements with other vendors. As of July 20, 2006, the only remaining liability of Circuit Technology is C/S Utilities, discussed below.

C/S Utilities notified the Company that (as successor to Circuit Technology, Inc.) it believes it has a claim against the Company in the amount of $32,472 regarding utilities services. The claim was assigned to BC Services, Inc., which obtained a judgment against Circuit Technology, Inc., for $37,966 in El Paso County, Colorado, District Court on February 13, 2003. The Company is reviewing its records in an effort to confirm the validity of the claims and is evaluating its options.

CirTran Asia v. Mindstorm Civil No. 050902290, Third Judicial District Court, Salt Lake County, State of Utah. In February, 2005, CirTran Asia brought suit against Mindstorm Technologies, LLC, for nonpayment for goods provided. On April 22, 2005, the defendant filed its answer and counterclaim, following which defendant's counsel withdrew from representation. CirTran Asia notified defendant that under governing rules it was required to appoint successor counsel. The defendant failed to do so, and failed to prosecute its claim. CirTran Asia moved for default judgment, which was granted. CirTran Asia submitted a proposed order of default judgment in the amount of $288,529 to the court in September 2005, which has been signed.

CirTran Asia v. Robinson, Civil No. 050915272, Third Judicial District Court, Salt Lake County, State of Utah. On August 30, 2005, CirTran Asia brought suit against Glenn Robinson, one of the principals of Mindstorm Technologies, LLC, for nonpayment for goods provided. Mr. Robinson filed an answer and subsequently filed for personal bankruptcy. CirTran Asia is reviewing its options and intends to vigorously pursue this action. On March 30, 2006, CirTran Asia filed a complaint against Mr. Robinson under Section 523 of the U.S. Bankruptcy Code seeking a determination that any debts owed by Mr. Robinson to CirTran Asia is excepted from any discharge granted to Mr. Robinson. As of the date of this Report, the case was proceeding in discovery.

CirTran Asia, et al. v. International Edge, et al., Civil No. 2:05 CV 413BSJ, U.S. District Court, District of Utah. On May 11, 2005, CirTran Asia, UKING System Industry Co., Ltd., and Charles Ho filed suit against International Edge, Inc., Michael Casey Enterprises, Inc., Michael Casey, David Hayek, and HIPMG, Inc., for breach of contract, breach of the implied covenant of good faith and fair dealing, interference with economic relationships, and fraud in relation to certain licensing issues relating to the Ab King Pro. The defendants counterclaimed, alleging breach of contract, fraud, defamation and related claims, all related to the Ab King Pro, seeking damages in the amount of $10,000,000. CirTran Asia and the other plaintiffs filed their reply to the counterclaim, disputing all of the allegations and claims. International Edge filed a motion to dismiss for lack of jurisdiction, which was denied. The case is presently in the discovery stage. Sales from this product in the year ended December 31, 2004 were approximately $3,510,000, and in the year ended December 31, 2005, were approximately $960,000. CirTran Asia intends to vigorously pursue this action.

CirTran Corporation vs. Advanced Beauty Solutions, LLC, and Jason Dodo, Civil No. 060900332, Third Judicial District Court, Salt Lake County, State of Utah. On January 9, 2006, CirTran Corporation brought suit against Advanced Beauty Solutions ("ABS") and Jason Dodo, asserting claims including breach of contract, breach of the implied covenant of good faith and fair dealing, interference with economic relations, fraud and unjust enrichment.

On January 24, 2006, ABS filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Central District of California, San Fernando Valley Division (the "ABS Bankruptcy Court"), Case No. SV 06-10076 GM. On January 30, 2006, a hearing ("Hearing") was held to consider the Emergency Motion for Order Approving the Settlement and Compromise of the Disputed Secured Claims of Inventory Capital Group, Inc. ("ICG"), and Media Funding Corporation ("MFC") (the "Settlement Motion") filed by ABS. The continued Hearing on the Settlement Motion was held on February 16, 2006, at which time the settlement was modified. Prior to a separate hearing held on March 24, 2006, on ABS's Motion for Order: (1) Approving Sale and Assignment of Substantially All Assets of the Estate Free and Clear of Liens; (2) Approving Assumption and Assignment of Leases and Executory Contracts Included in the Sale and Rejection of Leases and Executory Contracts Not Included in the Sale; and (3) Granting Related Relief (the "Sale Motion"), the settlement was further modified. The modifications to the proposed settlement were read into the ABS Bankruptcy Court's record at the Hearing on the Settlement Motion and the March 24, 2006 hearing on the Sale Motion ("Proposed Modifications"). Written notice of the Proposed Modifications was provided to creditors and parties in interests on March 27, 2006, and the Declaration of James C. Bastian, Jr., attesting that no objections to the Proposed Modifications have been received by ABS, was filed with the ABS Bankruptcy Court.

On June 6, 2006, the Company and ABS signed an agreement (the "Asset Purchase Agreement"), subject to the ABS Bankruptcy Court's approval. On June 7, 2006, the ABS Bankruptcy Court entered orders approving the Asset Purchase Agreement

and granting the Sale Motion, and approving the settlement and compromise of certain disputed claims against ABS.

Pursuant to the settlement of ABS's bankruptcy proceedings and the Asset Purchase Agreement, the Company has an allowed claim against the ABS's estate in the amount of $2,350,000, of which $750,000 is to be credited to the purchase of substantially all of ABS's assets. Under the settlement, the Company shall be allowed to participate as a general unsecured creditor of ABS's estate in the amount of $1,600,000 on a pari passu basis with the $2,100,000 general unsecured claim of certain insiders of ABS and subject to the prior payment of certain secured, priority, and non-insider claims in the amount of approximately $1,507,011.

Under the Asset Purchase Agreement, the Company agreed to purchase substantially all of ABS's assets in exchange for:

- i) a cash payment in the amount of $1,125,000;
- ii) a reduction of CirTran's allowed claim in the Bankruptcy Case by $750,000;
- iii) the assumption of any assumed liabilities; and
- iv) the obligation to pay ABS a royalty equal to $3.00 per True Ceramic Pro flat iron unit sold by ABS (the "Royalty Obligation").

The Assets include personal property; intellectual property; certain executory contracts and unexpired leases; inventory; ABS's rights under certain insurance policies; deposits and prepaid expenses; books and records; goodwill; certain causes of action; permits; customer and supplier lists; and telephone numbers and listings (collectively, the "Assets").

Under the Asset Purchase Agreement, the Royalty Obligation is capped at $4,135,000. To the extent the amounts paid to ABS on account of the Royalty Obligation equal less than $435,000 on the 2 year anniversary of the Closing, then, within 30 days of such anniversary, the Company agreed to pay ABS an amount equal to $435,000 less the royalty payments made to date. As part of the settlement, the Company agreed to exchange general releases with, among others, ABS, Jason Dodo (the manager of ABS), Inventory Capital Group ("ICG"), and Media Funding Corporation ("MFC"). The settlement also resolved a related dispute with ICG in which ICG assigned $65,000 of its secured claim against ABS to the Company.

Pursuant to the court-approved settlement, payments under the Royalty Obligation will be made in the following order:

- a) The Royalty Obligation payments will be made exclusively to ICG and MFC (collectively, the "Secured Parties") until (i) the Secured Parties have been paid in full on account of their $1,243,208.44 secured claim, or (ii) the Secured Parties have been paid $100,000 in payments under the Royalty Obligation, whichever comes first.

- b) The next $70,000 Royalty Obligation payments will be made to a service provider to ABS (in the amount of $50,000) and to an individual with an allowed claim (in the amount of $20,000).

- c) Following the payments to the Secured Parties and others as set forth immediately above, the remaining Royalty Obligation payments will be used for distribution to allowed general unsecured claims not including those of the Company and certain insiders with unpaid notes (the "Insider Noteholders").

- d) Following payments as set forth in (a), (b), and (c) above, the Royalty Obligation payments will be shared pro rata among the Insider Noteholders (with a total allowed aggregate claim of $2,100,000), and the Company (with a general unsecured claim in the amount of $1,600,000), until paid in full.

The total claims against ABS's estate that must be paid before the Company begins to share in the Royalty Obligation payments is $435,000.

CirTran v. Guthy-Renker Corporation and Ben Van De Bunt, Civil No. 20060980298, Third Judicial District Court, Salt Lake County, State of Utah. In May 2006, the Company filed suit against Guthy-Renker Corporation and one of its officers, claiming breach of contract, breach of the implied covenant of good faith and fair dealing, interference with economic relationships, misrepresentation, and punitive damages. The suit seeks damages in an amount to be proven at trial. The defendants filed a motion to stay litigation and compel arbitration in the matter. As of July 20, 2006, the Company had not filed a response to the motion.

Directors, Executive Officers, Promoters and Control Persons

Directors and Officers

The following sets forth the names, ages and positions of our directors and officers and the officers of our operating subsidiaries, CirTran Corporation (Utah) and CirTran Asia, along with their dates of service in such capacities.

Name	Age	Positions
Iehab J. Hawatmeh	39	President, Chief Executive Officer, Secretary and Director of CirTran Corporation; President of CirTran Corporation (Utah). Served since July 2000.
Trevor Saliba	32	Director since June 2001. Senior Vice-President, Sales and Marketing. Served since January 2002.
Shaher Hawatmeh	40	Chief Operating Officer Served since June 2004
Charles Ho	51	President, CirTran-Asia Served since June 2004
Richard T. Ferrone	58	Chief Financial Officer Served since May 2006

Iehab J. Hawatmeh, MBA
Chairman, President & CEO

Mr. Iehab Hawatmeh founded CirTran Corporation in 1993 and has been its Chairman, President and CEO since its inception. He also served previously as the Company's Chief Financial Officer until the hiring of Richard T. Ferrone in May 2006. Mr. Hawatmeh oversees all daily operation including financial, technical, operational and sales functions for the company. Under Mr. Hawatmeh's direction, the company has seen its annual sales exceed $20 million, its employment exceed 360 and completed two strategic acquisitions. Prior to forming the company, Mr. Hawatmeh was the Processing Engineering Manager for Tandy Corporation overseeing the company's entire contract manufacturing printed circuit board assembly division. In addition, Mr. Hawatmeh was responsible for developing and implementing Tandy's facility Quality Control and Processing Plan model which is used by CirTran today. Mr. Hawatmeh received his Master's of Business Administration from University of Phoenix and his Bachelor's of Science in Electrical and Computer Engineering from Brigham Young University. Iehab and Shaher Hawatmeh are brothers.

Raed Hawatmeh.

Mr. Raed Hawatmeh resigned as a Director as of May 10, 2006.

Trevor M. Saliba, MS
Senior Vice President,
Worldwide Business Development

Mr. Saliba is responsible for sales and marketing activities worldwide and is responsible for overseeing all worldwide business development strategies for the company. Mr. Saliba was elected to the Board of Directors in 2001. From 1997 - 2001 he was President and CEO of Saliba Corp., a privately held contracting firm he founded. From 1995-1997 he was an Associate with Morgan Stanley. From 1992 - 1995 he was Vice President of Sales and Marketing for SNJ Industries. Mr. Saliba holds a Bachelors Degree in Business Administration and a Masters Degree in Finance from La Salle University and has completed an Advanced Graduate Program in Engineering and Management at the University of California, Berkeley.

In June 2002 Mr. Saliba filed for personal bankruptcy in the U.S. Bankruptcy Court in Los Angeles, California, which has not yet been discharged. The bankruptcy was unrelated to Mr. Saliba's involvement in CirTran.

James Snow
Vice President,
Product Development
President - Racore Technology Corporation

Mr. Snow is the Vice President of Product Development for CirTran Corporation and also President of Racore Technology Corp., a wholly owned subsidiary of the company. Mr. Snow directly oversees the design, planning and management of Racore's proprietary Local Area Network (LAN) products and provides network consulting services to clients. Mr. Snow held the position of Director of Forward Planning and Project Engineering for Phillips Telecommunications and Data Systems (a Division of N.V. Phillips) from 1982 - 1992. In addition he was a Principle Engineer for Digital Equipment Corp. from 1992 - 1994. Mr. Snow holds a Bachelor's degree in Electrical Engineering from Brigham Young University and Business Management from Brookhaven College.

Shaher Hawatmeh
Chief Operating Officer

Mr. Shaher Hawatmeh joined the company in 1993 as its Controller shortly after its founding. Today, Mr. Hawatmeh directly oversees all daily manufacturing production, customer service, budgeting and forecasting for the company. Following the companies acquisition of Pro Cable Manufacturing in 1996, Mr. Hawatmeh directly managed the entire company, supervising all operations for approximately two years and successfully oversaw the integration of this new division into the company. Prior to joining CirTran, Mr. Hawatmeh worked for the Utah State Tax Commission. Mr. Hawatmeh earned his Master's of Business Administration with an emphasis in Finance from the University of Phoenix and his Bachelor's of Science in Business Administration and a Minor in Accounting. Iehab and Shaher Hawatmeh are brothers.

Charles Ho
President, CirTran-Asia

Mr. Ho, who became the President of our CirTran-Asia division on June 15, 2004, served for six years as the chairman of Meicer Semiconductor Co., Ltd., one of the leading semiconductor manufacturers located in China, and was a co-founder of two of the leading design and manufacturing firms of DVD and CD players: Lead Data Co., Ltd., and Media Group. Mr. Ho has served as CEO for Uking System Inc. since 1986 and is still holds that position. Mr. Ho has a Master of Business Administration Degree from the University of South Australia and Bachelor of Science degree in Industrial Design from National Taipei University of Technology.

Richard T. Ferrone
Chief Financial Officer

Prior to joining the Company, Mr. Ferrone had headed his own accounting firm, Ferrone & Associates, which he established in Salt Lake City in 1994. Previously, he was vice president and CFO for then-publicly-held GCI Industries, Inc./Golf Card International for seven years, and served as CFO of Huntsman, Christensen Real Estate & Development Co. Mr. Ferrone had also served as vice president and chief financial officer for BSD Medical Corporation after he started his career with a regional CPA firm in Salt Lake City. Mr. Ferrone has a B.S. in Accounting from the University of Utah, where he also studied for a Master of Professional Accountancy with a tax emphasis.

Indemnification Provisions

Our Bylaws provide, among other things, that our officers or directors are not personally liable to us or to our stockholders for damages for breach of fiduciary duty as an officer or director, except for damages for breach of such duty resulting from (a) acts or omissions which involve intentional misconduct, fraud, or a knowing violation of law, or (b) the unlawful payment of dividends. Our Bylaws also authorize us to indemnify our officers and directors under certain circumstances. We anticipate we will enter into indemnification agreements with each of our executive officers and directors pursuant to which we will agree to indemnify each such person for all expenses and liabilities incurred by such person in connection with any civil or criminal action brought against such person by reason of their being an officer or director of the Company. In order to be entitled to such indemnification, such person must have acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the Company and, with respect to criminal actions, such person must have had no reasonable cause to believe that his conduct was unlawful.

Commission's Position on Indemnification for Securities Act Liabilities

Our Bylaws provide, among other things, that our officers or directors are not personally liable to us or to our stockholders for damages for breach of fiduciary duty as an officer or director, except for damages for breach of such duty resulting from (a) acts or omissions which involve intentional misconduct, fraud, or a knowing violation of law, or (b) the unlawful payment of dividends. Our Bylaws also authorize us to indemnify our officers and directors under certain circumstances. We anticipate we will enter into indemnification agreements with each of our executive officers and directors pursuant to which

we will agree to indemnify each such person for all expenses and liabilities incurred by such person in connection with any civil or criminal action brought against such person by reason of their being an officer or director of the Company. In order to be entitled to such indemnification, such person must have acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the Company and, with respect to criminal actions, such person must have had no reasonable cause to believe that his conduct was unlawful.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to our directors, officers or controlling persons pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable.

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Security Ownership of Certain Beneficial Owners and Management

The following table sets forth the number and percentage of the 634,853,832 outstanding shares of our common stock which, according to the information supplied to us, were beneficially owned, as of July 20, 2006, by (i) each person who is currently a director, (ii) each executive officer, (iii) all current directors and executive officers as a group and (iv) each person who, to our knowledge, is the beneficial owner of more than 5% of our outstanding common stock.

Except as otherwise indicated, the persons named in the table have sole voting and dispositive power with respect to all shares beneficially owned, subject to community property laws where applicable. Beneficial ownership is determined according to the rules of the Securities and Exchange Commission, and generally means that person has beneficial ownership of a security if he or she possesses sole or shared voting or investment power over that security. Each director, officer, or 5% or more shareholder, as the case may be, has furnished us information with respect to beneficial ownership. Except as otherwise indicated, we believe that the beneficial owners of the common stock listed below, based on the information each of them has given to us, have sole investment and voting power with respect to their shares, except where community property laws may apply.

Name and Address	Relationship	Common Shares	Percent of Class
Saliba Private Annuity Trust (1) 115 S. Valley Street Burbank, CA 91505	5% Shareholder	75,698,990	11.92%
Iehab J. Hawatmeh 4125 South 6000 West West Valley City, Utah 84128	Director, Officer & 5% Shareholder	62,288,465	9.81%
Raed Hawatmeh (3) 10989 Bluffside Drive Studio City, CA 91604	5% Shareholder	31,007,530	4.84%

Trevor Saliba (2) 13848 Valleyheart Drive Sherman Oaks, CA 91423	Director	13,275,000	2.09%
Charles Ho 4125 South 6000 West West Valley City, Utah 84128	Officer of Subsidiary of Company	0	0.00%
Shaher Hawatmeh 4125 South 6000 West West Valley City, Utah 84128	Chief Operating Officer	6,107,079	0.96%
Richard T. Ferrone 4125 South 6000 West West Valley City, Utah 84128	Chief Financial Officer	0	0.00%
All Officers and Directors as a Group (4 persons)		81,670,544	12.84%

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(1) Includes 13,189,620 shares held by the Saliba Living Trust. Thomas L. Saliba and Betty R. Saliba are the trustees of The Saliba Living Trust and Thomas L. Saliba is the sole trustee of The Saliba Private Annuity Trust. These persons control the voting and investment decisions of the shares held by the respective trusts. Mr. Thomas L. Saliba is a nephew of the grandfather of Mr. Trevor Saliba, one of our directors and officers. Mr. Trevor Saliba is one of five passive beneficiaries of Saliba Private Annuity Trust and has no control over its operations or management. Mr. Saliba disclaims beneficial control over the shares indicated.

(2) Includes options to purchase up to 1,000,000 shares each that can be exercised anytime at exercise prices of $0.027 per share.

(3) Includes options to purchase up to 6,250,000 shares that can be exercised anytime at exercise prices of $0.02 - $0.03 per share.

Description of Common Stock

Effective August 6, 2001, our authorized capital was increased from 500,000,000 to 750,000,000 shares of common stock, $0.001 par value, and we also effected, effective the same date, a 1:15 forward split of our issued and outstanding shares of common stock through a forward split and share distribution. As of July 20, 2006, 636,874,906 (post forward-split) shares of our common stock were issued and outstanding. We are not authorized to issue preferred stock.

Each holder of our common stock is entitled to a pro rata share of cash distributions made to shareholders, including dividend payments, and are entitled to one vote for each share of record on all matters to be voted on by shareholders. There is no cumulative voting with respect to the election of our directors or any other matter. Therefore, the holders of more than 50% of the shares voted for the election of directors can elect all of the directors. The holders of our common stock are entitled to receive dividends when, as and if declared by our board of directors, in its sole discretion, from funds legally available for such use. In the event of our liquidation, dissolution or winding up, the holders of common stock are entitled to share ratably in all assets remaining available for distribution to them after payment of our liabilities and after provision has been made for each class of stock, if any, having any preference in relation to our common stock. Holders of our common stock have no conversion, preemptive or other subscription rights, and there are no redemption provisions applicable to our common stock.

Our obligations to issue shares of our common stock include the following:

- Highgate Convertible Debenture: Assuming a hypothetical conversion of the remaining $3,000,000, at a hypothetical conversion price of $0.03 per share, we would issue 100,000,000 shares of our common stock.
- Cornell Convertible Debenture: Assuming a hypothetical conversion of the remaining $1,500,000, at a hypothetical conversion price of $0.03 per share, we would issue 50,000,000 shares of our common stock.
- ANAHOP, Inc.: Pursuant to a private offering in June 2006, we agreed to issue an aggregate of 28,571,428 shares of our common stock in two tranches. The first tranche involved the payment by ANAHOP of $500,000 and our issuance of 7,142,857 shares of common stock, and the second tranche involving the payment by ANAHOP of an additional $1,500,000 and our issuance of 21,428,571 shares of common stock. As of July 20, 2006, ANAHOP had paid $300,000 of the amount due for the first tranche, and we had not issued the 7,142,857 shares of common stock. Also, as of July 20, 2006, ANAHOP had not made the payment for the second tranche, and we had not issued the 21,428,571 shares of common stock.
- Warrants: As of July 20, 2006, we had warrants outstanding to issue 110,000,000 shares of our common stock.
- Options: As of July 20, 2006, we had options outstanding to issue 11,250,500 shares of our common stock.

On July 20, 2006, we entered into lock down agreements with Cornell Capital (with respect to the 50,000,000 shares underlying the Cornell Debenture and 10,000,000 shares underlying a warrant held by Cornell) and with ANAHOP and its designees (with respect to 93,000,000 shares underlying warrants and the 21,428,571 shares in the second tranche). Under the agreements, Cornell agreed not to convert any of the Cornell Debenture or exercise any of its warrants, and ANAHOP and its designees agreed not to exercise any of the 93,000,000 warrants or to make the second tranche payment, until we have taken the steps necessary to amend our articles of incorporation and increase our authorized capital.

We have never declared or paid a cash dividend on our capital stock, nor do we expect to pay cash dividends on our common stock in the foreseeable future. We currently intend to retain our earnings, if any, for use in our business. Any dividends declared in the future will be at the discretion of our board of directors and subject to any restrictions that may be imposed by our lenders.

We have elected not to be governed by the terms and provisions of the Nevada Private Corporations Law that are designed to delay, defer or prevent a change in control of the Company.

Registration Rights and Related Matters

Pursuant to an agreement dated November 3, 2000, and as part of our debt settlement with Future Electronics Corporation ("Future"), we granted certain registration rights to Future with respect to 5,281,050 (352,070 pre-forward split) shares of our common stock. These rights provide Future with the opportunity, subject to certain terms and conditions, to include up to 50% of our common stock that it holds in any registration statement filed by us. Among other things, we have agreed to pay any costs incurred with the registration of such stock and to keep any registration statement we file active for a period of 180 days or until the distribution contemplated in the registration statement has been completed. Future's registration rights are assignable and transferable to any individual or entity that does not directly compete with us. These registration rights are not exercisable, however, with respect to registration statements relating solely to the sale of securities to participants in a company stock plan or relating solely to corporate reorganizations. In addition, the rights would not be fully exercisable if an underwriter managing a public offering determined in good faith that market factors required a limitation on the number of shares that Future (or its assignee) would otherwise be entitled to have registered.

In connection with our debt settlement with Future, our three largest shareholders, Iehab Hawatmeh, Raed Hawatmeh and Roger Kokozyon (see "Security Ownership of Certain Beneficial Owners and Management"), entered into lock-up agreements with Future, whereby they agreed not to sell to the public any shares of our common stock held by them. Such lock-up agreements expired of their terms, were not renewed, and are no longer in effect.

In May 2005, in connection with our issuance of the Convertible Debenture, we granted to Highgate registration rights, pursuant to which we agreed to file, within 120 days of the closing of the purchase of the Convertible Debenture, a registration statement to register the resale of shares of our common stock issued or issuable upon conversion of the debenture. We also agreed to use our best efforts to have the registration statement declared effective within 270 days after filing the registration statement. We agreed to register the resale of up to 100,000,000 shares, and to keep such registration statement effective until all of the shares issued or issuable upon conversion of the Convertible Debenture have been sold.

In December 2005, in connection with our issuance of the Cornell Debenture, we granted to Cornell registration rights, pursuant to which we agreed to file, within 120 days of the closing of the purchase of the Cornell Debenture, a registration statement to register the resale of shares of our common stock issued or issuable upon conversion of the Cornell Debenture. We also agreed to use our best efforts to have the registration statement declared effective within 270 days after filing the registration statement. We agreed to register the resale of up to 32,608,696 shares and 10,000,000 shares underlying warrants, and to keep such registration statement effective until all of the shares issued or issuable upon conversion of the Cornell Debenture have been sold.

In connection with the settlement of litigation with Salamon Brothers, an investment firm, we issued of 4 million restricted shares and a warrant to purchase an additional 7 million shares exercisable at $.05 per share, and agreed to register the resale by the investment firm of the shares issued and those underlying the warrants.

In connection with the offerings to ANAHOP, we granted registration rights with respect to the resale of shares issuable upon conversion of the warrants held by ANAHOP's designees. The rights granted were piggyback rights, and state that upon the exercise by a holder of all of the warrants with a particular exercise price, we agreed to include the resale of such shares in the next registration statement filed by the Company following such exercise.

Certain Relationships and Related Transactions

An explanation of the relationship between CirTran and Abacas Ventures, Inc., is as follows:

Two trusts, the Saliba Living Trust and the Saliba Private Annuity Trust (collectively, the "Saliba Trusts"), were investors in Circuit Technology, a Utah corporation and predecessor entity of the Company. The trustees of the trusts are Tom and Betty Saliba, and Tom Saliba, respectively. (Tom Saliba is the nephew of the grandfather of Trevor Saliba, one of the directors of CirTran.) In July 2000, CirTran Corporation merged with Circuit Technology. Through that merger, the Saliba Trusts became shareholders of CirTran. The Saliba Trusts are also two of the shareholders of an entity named Abacas Ventures, Inc. ("Abacas"). At the time of the merger, CirTran was in default on several of its obligations, including an obligation to Imperial Bank. The Saliba Trusts, through Abacas, purchased the bank's claim against CirTran to protect their investment in CirTran. Since that time, Abacas has continued to settle debts of CirTran to improve Abacas's position and to take advantage of certain discounts that creditors of CirTran offered to settle their claims. On two occasions, the Abacas shareholders have agreed to convert outstanding debt owed by CirTran to Abacas into shares of CirTran common stock (discussed below). Abacas continues to work with the company to settle claims by creditors against CirTran, and, on occasion, to provide funding. There can be no assurance that Abacus will agree to convert its existing debt, or any debt it acquires in the future, into shares of CirTran, or that conversions will occur at a price and on terms that are favorable to CirTran. If Abacus and CirTran cannot agree on acceptable conversion terms, Abacus may demand payment of some or all of the debt. If CirTran does not have sufficient cash or credit facilities to pay the amount then due and owing by CirTran to Abacus, Abacus may exercise its rights as a senior secured lender and commence foreclosure or other proceedings against the assets of CirTran. Such actions by Abacus could have a material adverse effect upon CirTran and its ability to continue in business.

In January, 2002, the Company entered into an agreement with Abacas under which the Company issued an aggregate of 19,987,853 shares of common stock to four of Abacas's shareholders in exchange for cancellation by Abacas of an aggregate amount of $1,499,090 in senior debt owed to the creditors by the Company. The shares were issued with an exchange price of $0.075 per share, for the aggregate amount of $1,500,000.

In December, 2002, the Company entered into an agreement with Abacas under which the Company issued an aggregate of 30,000,000 shares of common stock to four of Abacas's shareholders in exchange for cancellation by Abacas of an aggregate amount of $1,500,000 in senior debt owed to the creditors by the Company. The shares were issued with an exchange price of $0.05 per share, for the aggregate amount of $1,500,000.

During 2002, the Company entered into a verbal bridge loan agreement with Abacas. This agreement allows the Company to request funds from Abacas to finance the build-up of inventory relating to specific sales. The loan bears interest at 24% and is payable on demand. There are no required monthly payments. During the years ended December 31, 2004 and 2003, the Company was advanced $3,128,281 and $350,000, respectively, and made cash payments of $3,025,149 and $875,000, respectively.

During the year ended December 31, 2004, Abacas completed negotiations with several vendors of the Company, whereby Abacas purchased various past due amounts for goods and services provided by vendors, as well as notes payable (see Note 6). The total of these obligations was $1,263,713. The Company has recorded this transaction as a $1,263,713 non-cash increase to the note payable owed to Abacas, pursuant to the terms of the Abacas agreement.

The total principal amount owed to Abacas between the note payable and the bridge loan was $1,530,587 and $163,742 as of December 31, 2004 and 2003, respectively. The total accrued interest owed to Abacas between the note payable and the bridge loan was $430,828 and $230,484 as of December 31, 2004 and 2003, respectively, and is included in accrued liabilities.

In March 2005, the shareholders of Abacas agreed to cancel $2,050,000 of principal and accrued interest in return for the Company's issuing 51,250,000 shares of our restricted common stock to certain shareholders of Abacas. No registration rights were granted. As of July 20, 2006, Abacas had no claims against us.

Additional Information

As of December 31, 2001, Iehab Hawatmeh had loaned us a total of $1,390,125. The loans were demand loans, bore interest at 10% per annum and were unsecured. Effective January 14, 2002, we entered into four substantially identical agreements with existing shareholders pursuant to which we issued an aggregate of 43,321,186 shares of restricted common stock at a price of $0.075 per share for $500,000 in cash and the cancellation of $2,749,090 principal amount of our debt. Two of these agreements were with the Saliba Private Annuity Trust, one of our principal shareholders, and a related entity, the Saliba Living Trust. The Saliba trusts are also principals of Abacas Ventures, Inc., which entity purchased our line of credit in May 2000. Pursuant to the Saliba agreements, the trusts were issued a total of 26,654,520 shares of common stock in exchange for $500,000 cash and the cancellation of $1,499,090 of debt. We used the $500,000 cash from the sale of the shares for working capital. As a result of this transaction, the percentage of our common stock owned by the Saliba Private Annuity Trust and the Saliba Living Trust increased from approximately 6.73% to approximately 17.76%. Mr. Trevor Saliba, one of our directors and officers, is a passive beneficiary of the Saliba Private Annuity Trust. Pursuant to the other two agreements made in January 2002, we issued an aggregate of 16,666,666 shares of restricted common stock at a price of $0.075 per share in exchange for the cancellation of $1,250,000 of notes payable by two shareholders, Mr. Iehab Hawatmeh (our president, a director and our principal shareholder) and Mr. Rajai Hawatmeh. Of these shares, 15,333,333 were issued to Iehab Hawatmeh in exchange for the cancellation of $1,150,000 in debt. As a result of this transaction, the percentage of our common stock owned by Mr. Hawatmeh increased from 19.9% to approximately 22.18%.

In February 2000, prior to its acquisition of Vermillion Ventures, Inc., a public company, Circuit Technology, Inc., while still a private entity, redeemed 680,145 shares (as presently constituted) of common stock held by Raed Hawatmeh, who was a director of Circuit Technology, Inc. at that time, in exchange for $80,000 of expenses paid on behalf of the director. No other stated or unstated rights, privileges, or agreements existed in conjunction with this redemption. This transaction was consistent with other transactions where shares were offered for cash.

In 1999, Circuit entered into an agreement with Cogent Capital Corp., or "Cogent," a financial consulting firm, whereby Cogent agreed to assist and provide consulting services to Circuit in connection with a possible merger or acquisition. Pursuant to the terms of this agreement, we issued 800,000 (pre-forward split) restricted shares (12,000,000 post-forward split shares) of our common stock to Cogent in July 2000 in connection with our acquisition of the assets and certain liabilities of Circuit. The principal of Cogent was appointed a director of Circuit after entering into the financial consulting agreement and resigned as a director prior to the acquisition of Circuit by Vermillion Ventures, Inc. on July 1, 2000.

Also, as of December 31, 2004 the company owed I&R Properties, LLC, the previous owner of our principal office and manufacturing facility for unpaid accrued rent and accrued interest. The Company settled with owed I&R Properties, LLC., on accrued rent and interest of $400,000 by issuing 10,000,000 shares of unregistered common stock in March 2005. I&R Properties, LLC, is an entity that is owned as follows: 40% by Iehab Hawatmeh, our President, CEO, and Chairman; 10% by Shaher Hawatmeh, Chief Operating Officer of CirTran and the brother of Iehab Hawatmeh; and 50% by Raed Hawatmeh, a director of CirTran, but who is not related to Iehab or Shaher Hawatmeh.

Management believed at the time of each of these transactions and continues to believe that each of these transactions were as fair to the Company as could have been made with unaffiliated third parties.

Purchase of Interests in Landlord

On March 31, 2005, the Company entered into a Membership Acquisition Agreement (the "Acquisition Agreement") with Rajayee Sayegh (the "Seller") for the purchase of one hundred percent (100%) of the membership interests in PFE Properties LLC, a Utah limited liability company ("PFE"). Under the Acquisition Agreement, the Company agreed to issue twenty million (20,000,000) shares of its restricted common stock, with a fair value of $800,000 on the date of issuance. No registration rights were granted. The shares were issued without registration under the 1933 Act in reliance on Section 4(2) of the Securities Act of 1933, as amended (the "1933 Act"), and the rules and regulations promulgated thereunder.

The primary asset of PFE is its rights, titles and interests in and to a parcel of real property, together with any improvements, rents and profits thereon or associated therewith, located at 4125 S. 6000 W., West Valley City, Utah, 84128, where the Company presently has its headquarters and manufacturing facility.

Prior to the purchase of the membership interests, on December 17, 2003, the Company had entered into a ten-year lease with PFE for the property. The lease payments were $16,974. Following the acquisition of the PFE interests, PFE will continue to own the building, and the Company will continue to make lease payments under the 2003 lease.

Market for Common Equity and Related Stockholder Matters

Our common stock traded sporadically on the Pink Sheets under the symbol "CIRT" from July 2000 to July 2002. Effective July 15, 2002, the NASD approved our shares of common stock for quotation on the NASD Over-the-Counter Electronic Bulletin Board. The following table sets forth, for the calendar years ending December 31, 2004, 2003, and 2002, the prices of our common stock as reported and summarized on the Pink Sheets. These prices are based on inter-dealer bid and asked prices, without markup, markdown, commissions, or adjustments and may not represent actual transactions.

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Calendar Quarter Ended	High Bid	Low Bid
March 31, 2006	$0.04	$0.04
December 31, 2005	$0.03	$0.02
September 30, 2005	$0.04	$0.03
June 30, 2005	$0.05	$0.03
March 31, 2005	$0.05	$0.03
December 31, 2004	$0.04	$0.02
September 30, 2004	$0.06	$0.03
June 30, 2004	$0.09	$0.04
March 31, 2004	$0.08	$0.01
December 31, 2003	$0.03	$0.02
September 30, 2003	$0.03	$0.01
June 30, 2003	$0.04	$0.01
March 31, 2003	$0.04	$0.01
December 31, 2002	$0.12	$0.03
September 30, 2002	$0.16	$0.03
June 30, 2002	$0.07	$0.02
March 31, 2002	$0.08	$0.02

As of July 20, 2006, we had approximately 526 shareholders of record holding 636,874,906 shares of common stock.

We have not paid, nor declared, any dividends on our common stock since our inception and do not intend to declare any such dividends in the foreseeable future. Our ability to pay dividends is subject to limitations imposed by Nevada law. Under Nevada law, dividends may be paid to the extent the corporation's assets exceed its liabilities and it is able to pay its debts as they become due in the usual course of business.

Recent Sales of Unregistered Securities

On June 30, 2006, we closed a second private placement of shares of our common stock and warrants (the "June Private Offering"). Pursuant to a securities purchase agreement (the "June Agreement"), the Company agreed to sell Twenty-Eight Million, Five Hundred Seventy-One Thousand, Four Hundred Twenty-Eight (28,571,428) shares of its Common Stock (the "June Shares") to ANAHOP, Inc., a California corporation. The total consideration to be paid for the Shares will be Two Million Dollars ($2,000,000) if all tranches of the sale close. We also issued warrants (the "June Warrants") to purchase up to an additional 63,000,000 shares of our common stock to designees of ANAHOP.

With respect to the shares underlying the June Warrants, we granted piggyback registration rights as follows: (A) once all of the warrants with an exercise price of $0.15 (the "Fifteen Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifteen Cent Warrants; (B) once all of the warrants with an exercise price of $0.25 (the "Twenty-five Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Twenty-five Cent Warrants; and (C) once all of the warrants with an exercise price of $0.50 (the "Fifty Cent Warrants") have been exercised, we agreee to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifty Cent Warrants. We did not grant any registration rights with respect to the Shares sold in the June private placement.

The Shares and the June Warrants sold in the June 2006 private placement were issued without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act and the rules and regulations promulgated thereunder. We intend to use the proceeds from the Private Offering for working capital and general business purposes.

On May 24, 2006, we closed a private placement of shares of our common stock and warrants in which we sold Fourteen Million, Two Hundred Eighty-five Thousand,

Seven Hundred Fifteen (14,285,715) shares of our Common Stock (the "Shares") to ANAHOP, and issued warrants to purchase up to an additional 30,000,000 shares of our common stock to designees of ANAHOP. The consideration paid for the Shares was One Million Dollars ($1,000,000).

With respect to the shares underlying the Warrants, we granted piggyback registration rights as follows: (A) once all of the warrants with an exercise price of $0.15 (the "Fifteen Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifteen Cent Warrants; (B) once all of the warrants with an exercise price of $0.25 (the "Twenty-five Cent Warrants") have been exercised, we agreed to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Twenty-five Cent Warrants; and (C) once all of the warrants with an exercise price of $0.50 (the "Fifty Cent Warrants") have been exercised, we agreee to include in the next registration statement that is filed by us the resales of the shares issued upon exercise of the Fifty Cent Warrants. We did not grant any registration rights with respect to the Shares.

The Shares and the Warrants were issued without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act and the rules and regulations promulgated thereunder. We used the proceeds from the Private Offering for working capital and general business purposes, including the purchase of the assets of ABS (discussed above in the "Recent Developments" section).

In January 2006, Highgate converted $750,000 of its convertible debenture into 24,193,548 shares of the Company's restricted common stock at a conversion rate of $0.031 per share, which was the lower of $0.10 or 100% of the lowest closing bid price of the Company's commons stock over the 20 trading days preceding the conversion.

In February 2006, we issued 4,000,000 shares of our restricted common stock and a warrant to purchase an additional 7,000,000 shares with an exercise price of $0.06 per share in settlement of litigation.

In each case the securities were issued in connection with private transactions with accredited investors pursuant to Section 4(2) of the Securities Act of 1933 and the regulations promulgated thereunder.

In December 2005, we entered into a securities purchase agreement with Cornell Capital Partners ("Cornell"), concerning the issuance of an aggregate principal amount of $1,500,000 of Convertible Debentures. The issuance of the Convertible Debentures to Cornell was made in reliance on Section 4(2) of the Securities Act of 1933, as amended (the "1933 Act") and rules and regulations promulgated thereunder, as a transaction not involving any public offering. No advertising or general solicitation was employed in offering the securities, and the Convertible Debenture was issued to only one investor which represented that it is an "accredited investor" as that term is defined in Regulation D promulgated pursuant to the Securities Act of 1933. Through April 17, 2006, we had issued no shares of our common stock in connection with any conversions of the Convertible Debentures, and we had received notice of no conversions from Cornell.

In May 2005, we entered into a securities purchase agreement with Highgate concerning the issuance of the Convertible Debenture. The issuance of the Convertible Debenture to Highgate was made in reliance on Section 4(2) of the 1933 Act, and rules and regulations promulgated thereunder, as a transaction not involving any public offering. No advertising or general solicitation was employed in offering the securities, and the Convertible Debenture was issued to only one investor which represented that it is an "accredited investor" as that term is defined in Regulation D promulgated pursuant to the Securities Act of 1933. Through April 17, 2006, we had issued 24,193,548 shares of our restricted common stock in connection with conversions of $750,000 of the Convertible Debentures, and we had received notice of the conversion from Highgate. This registration statement is filed to register the resale of shares into the market that Highgate will receive upon conversion of the Convertible Debenture, and our issuances of shares to Highgate will be made without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act, and the rules and regulations promulgated thereunder.

In March 2005, the Company entered into agreements with eight individuals or entities (collectively, the "Lenders") to whom the Company was indebted, in an aggregate amount of $2,450,000, pursuant to which, the Company agreed to issue an aggregate of 61,250,000 shares of its restricted common stock in exchange for the Lenders' agreeing to cancel the debt obligations owed by the Company. With respect to $2,050,000 of the indebtedness, that amount was owed to Abacas Ventures, Inc. ("Abacas"), a company that had purchased certain of the Company's obligations. Abacas agreed to the cancellation of the Company's obligation to Abacas in return for the Company's issuing shares to certain of Abacas's shareholders and the other named individuals. Trevor Saliba, who is a beneficiary of the Saliba Private Annuity Trust, has been a director of the

Company since June 2001. The remaining $400,000 was due to I&R Properties in connection with past rent on the Company's headquarters building. I&R Properties is a company owned and controlled by individuals who are officers, directors and principal stockholders. The issuances of shares to the Lenders were made in reliance on Section 4(2) of the 1933 Act, and rules and regulations promulgated thereunder, as a transaction not involving any public offering. No advertising or general solicitation was employed in the issuance of the securities.

On March 31, 2005, the Company entered into a Membership Acquisition Agreement (the "Acquisition Agreement") with Rajayee Sayegh (the "Seller") for the purchase of one hundred percent (100%) of the membership interests in PFE Properties LLC, a Utah limited liability company ("PFE"). Under the Acquisition Agreement, the Company agreed to issue twenty million (20,000,000) shares of its restricted common stock, with an estimated value of $800,000. No registration rights were granted. The shares were issued without registration under the 1933 Act in reliance on Section 4(2) of the Securities Act of 1933, as amended (the

"1933 Act"), and the rules and regulations promulgated thereunder, as a transaction not involving any public offering. No advertising or general solicitation was employed in the issuance of the securities

Pursuant to the Equity Line of Credit Agreement, we were entitled to put to the Equity Line Investor, in lieu of repayment of amounts drawn on the Equity Line, shares of the Company's common stock. Although the Company filed a registration statement to register the resale by the Equity Line Investor of the shares put to it by the Company, the issuances of shares to the Company were made in reliance on Section 4(2) of the 1933 Act, and rules and regulations promulgated thereunder, as a transaction not involving any public offering. No advertising or general solicitation was employed in offering the securities, and the shares were issued to only one investor which represented that it is an "accredited investor" as that term is defined in Regulation D promulgated pursuant to the Securities Act of 1933. Through December 31, 2003, we issued 64,253,508 shares of common stock to the Equity Line Investor in connection with draws on the Equity Line. Subsequent to December 31, 2003, and through August 31, 2004, we issued an aggregate of 57,464,386 shares of Common Stock to the Equity Line Investor in connection with draws on the Equity Line. We used the proceeds of the draws on the Equity Line to pay outstanding liabilities, including notes to Cornell, the Equity Line Investor, discussed above. As noted above, the Company has terminated the Equity Line of Credit Agreement.

In December, 2002, the Company entered into an agreement with Abacas under which the Company issued an aggregate of 30,000,000 shares of common stock in exchange for cancellation of an aggregate amount of $1,500,000 in senior debt owed to the creditors by the Company. The shares were issued with an exchange price of $0.05 per share, for the aggregate amount of $1,500,000. The Company did not grant registration rights to the four creditors. The shares were issued without registration under the 1933 Act in reliance on Section 4(2) of the 1933 Act, as amended (the "1933 Act"), and the rules and regulations promulgated thereunder.

In January, 2002, the Company entered into an agreement with Abacas under which the Company issued an aggregate of 19,987,853 shares of common stock in exchange for cancellation of an aggregate amount of $1,499,090 in senior debt owed to the creditors by the Company. The shares were issued with an exchange price of $0.075 per share, for the aggregate amount of $1,500,000. The Company did not grant registration rights to the four creditors. The shares were issued without registration under the 1933 Act in reliance on Section 4(2) of the Securities Act of 1933, as amended (the "1933 Act"), and the rules and regulations promulgated thereunder.

Penny Stock Rules

Our shares of common stock are subject to the "penny stock" rules of the Securities Exchange Act of 1934 and various rules under this Act. In general terms, "penny stock" is defined as any equity security that has a market price less than $5.00 per share, subject to certain exceptions. The rules provide that any equity security is considered to be a penny stock unless that security is registered and traded on a national securities exchange meeting specified criteria set by the SEC, authorized for quotation from the NASDAQ stock market, issued by a registered investment company, and excluded from the definition on the basis of price (at least $5.00 per share), or based on the issuer's net tangible assets or revenues. In the last case, the issuer's net tangible assets must exceed $3,000,000 if in continuous operation for at least three years or $5,000,000 if in operation for less than three years, or the issuer's average revenues for each of the past three years must exceed $6,000,000.

Trading in shares of penny stock is subject to additional sales practice requirements for broker-dealers who sell penny stocks to persons other than established customers and accredited investors. Accredited investors, in general, include individuals with assets in excess of $1,000,000 or annual income exceeding $200,000 (or $300,000 together with their spouse), and certain institutional investors. For transactions covered by these rules, broker-dealers must make a special suitability determination for the purchase of the security and must have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, the rules require the delivery, prior to the first transaction, of a risk disclosure document relating to the penny stock. A broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, and current quotations for the security. Finally, monthly statements must be sent disclosing recent price information for the penny stocks. These rules may restrict the ability of broker-dealers to trade or maintain a market in our

common stock, to the extent it is penny stock, and may affect the ability of shareholders to sell their shares.

Executive Compensation

The following table sets forth certain information regarding the annual and long-term compensation for services to us in all capacities (including Circuit Technologies, Inc.) for the prior fiscal years ended December 31, 2005, 2004, and 2003, of those persons who were either (i) the chief executive officer during the last completed fiscal year or (ii) one of the other four most highly compensated executive officers as of the end of the last completed fiscal year. The individuals named below received no other compensation of any type, other than as set out below, during the fiscal years indicated.

	Annual Compensation		Long-Term Compensation Awards		
Name and	Salary	Bonus/ Commission	Restricted Stock Awards	Stock Options	All Other

Principal Position	Year	($)	($)	($)	(#)	Compensation
Iehab J. Hawatmeh	2005	225,000	114,219	-	6,000,000	-
President, Secretary,	2004	200,000	-	-	3,500,000	-
Treasurer and Director	2003	175,000	-	-	6,500,000	-
	2002	175,000	-	-	1,850,000	-
Trevor M. Saliba	2005	120,000	31,895	-	5,000,000	-
Sr. Vice President	2004	108,000	-	-	4,250,000	-
and Director of	2003	127,000	-	-	3,000,000	-
CirTran Corporation	2002	118,000	-	-	500,000	-
Raed S. Hawatmeh	2005	-	-	-	4,000,000	-
Resigned as Director	2004	-	-	-	2,500,000	-
of CirTran	2003	-	-	-	3,000,000	-
Corporation	2002	-	-	-	500,000	-
May 10, 2006.						
Charles Ho	2005	-	460,126	-	500,000	-
President of	2004	-	157,389	-	-	-
CirTran Asia	2003	-	-	-	-	-
	2002	-	-	-	-	-

There have not been any employee options or stock appreciation rights granted to executives from January 1, 2006 to July 20, 2006.

Option/SAR Grants in the Year Ended December 31, 2005

Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price ($/Sh)	Expiration Date
Iehab Hawatmeh	6,000,000	30.00%	$0.022 - $0.027	Jan - Dec 2010
Trevor Saliba	5,000,000	25.00%	$0.022 - $0.027	Jan - Dec 2010
Raed Hawatmeh	4,000,000	20.00%	$0.022 - $0.027	Jan - Dec 2010
Charles Ho	500,000	2.00%	$0.06	Jan 2006

Option/SAR Grants in the Year Ended December 31, 2004

Name	Number of Securities Underlying Options/SARs Granted (#)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price ($/Sh)	Expiration Date
Iehab Hawatmeh	3,500,000	14.58%	$0.015 - $0.03	Jan - Dec 2009

Trevor Saliba	4,250,000	17.71%	$0.015 - $0.03	Jan - Dec 2009
Raed Hawatmeh	3,500,000	14.58%	$0.015 - $0.03	Jan - Dec 2009

Aggregated Option/SAR Exercises in the Year Ended December 31, 2005 and December 31, 2005 Option/SAR Values

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at FY End (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options/SARs at FY-End ($) Exercisable/ Unexercisable
Iehab Hawatmeh	8,000,000	$198,000	-	$ -
Trevor Saliba	4,000,000	$100,000	3,000,000/0	$ 71,000/0
Raed Hawatmeh	3,000,000	$73,000	5,250,000/0	$123,500/0
Charles Ho	-	-	500,000/0	-

Aggregated Option/SAR Exercises in the Year Ended December 31, 2004 and December 31, 2004 Option/SAR Values

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options/SARs at FY End (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options/SARs at FY-End ($) Exercisable/ Unexercisable
Iehab Hawatmeh	1,500,000	$33,750	-	$ -
Trevor Saliba	2,250,000	$56,250	-	$ -
Raed Hawatmeh	750,000	$11,250	2,250,000/0	$52,500/0

Options issuable in connection with Manufacturing Agreement -- On June 10, 2004, we entered into an exclusive manufacturing agreement with certain Developers, including Charles Ho, the President of CirTran-Asia. Under the terms of the agreement, we, through our wholly owned subsidiary CirTran-Asia, have the exclusive right to manufacture certain products developed by the Developers or any of their affiliates. In connection with this agreement, through January 17, 2006, we had identified seven products, in connection with which we agreed to issue options to purchase shares common stock to the Developers upon the sale, shipment and payment for specified amounts of units of a the identified products, as set forth below. The options will be exercisable at $0.06 per share, vest on the grant date and expire one year after issuance. The schedule of units and potential options that will be issued follows:

Product	Initial Units	Options for Initial Units Sold(1)	Each Multiple of Units Above Initial Units	Options for Each Multiple of Units	Options Issued Through July 20, 2006
Ab King Pro	500,000	500,000	100,000	100,000	1,500,000 (3)
Ab Roller	500,000	500,000	200,000	100,000	-
Ab Trainer Club Pro	25,000	500,000	15,000	100,000	-
Instant Abs	100,000	500,000	50,000	100,000	-
Hot Dog Express (2)	300,000	1,000,000	100,000	200,000	-
Condiment Caddy	200,000	250,000	100,000	100,000	-
Denise Austin Pilates	200,000	500,000	100,000	100,000	-

(1) Except as set forth in Notes (2) and (3), the options set forth in this table are issuable to Charles Ho, President of our subsidiary CirTran-Asia.

(2) Of the options for initial units sold for this product, Mr. Ho, President of CirTran-Asia, is entitled to receive 700,000, with the remaining 300,000 going to the other developer. For each multiple of units above the initial units, Mr. Ho and the other developers are each entitled to receive an additional 100,000 options, for an aggregate of 200,000 options.

(3) Of the options issued in connection with this product, Mr. Ho received 500,000, and two other developers each received 500,000 options.

As of July 20, 2006, we had issued a total of 1,500,000 options pursuant to the agreement relating to the Ab King Pro, but had not received sufficient orders or shipped sufficient quantities of the other products listed in the table to trigger the issuance of additional options. Of the 1,500,000 options issued, Mr. Ho received 500,000 options. The 1,500,000 options were issued with an exercise price of $0.06 per share, and all 1,500,000 options expired in January 2006 pursuant to their terms.

During 2004, Mr. Ho received approximately $157,400 in commissions in connection with the manufacturing agreement. During 2005, Mr. Ho received approximately $460,200 in commissions in connection with the manufacturing agreement. As of July 20, 2006, Mr. Ho had received approximately $112,000 in commissions in connection with the manufacturing agreement.

Mr. Ho's commissions are calculated by predetermined percentages from manufacturing agreements and/or appendixes. Most of the commissions are calculated using the sales price less freight and cost of sales to the factory, that amount is then multiplied by the contract percentage, per unit for each product, after the payment has been received.

Employment Agreements

On July 1, 2004, CirTran Corporation entered into an employment agreement with Iehab Hawatmeh, dated as of June 26, 2004. The agreement, which is for a term of five years and renews automatically on a year-to year basis, provides for a base salary of $225,000, plus a bonus of 5% of our earnings before interest, taxes, depreciation, and amortization, payable quarterly, as well as any other bonus our board of directors may approve. Under the Agreement, Mr. Hawatmeh agreed to serve as our Chief Executive Officer and President and to perform such other duties as delegated by our board of directors. The agreement provides for benefits including health insurance coverage, cell phone, car allowance, life insurance, and D&O insurance. Under the Agreement, Mr. Hawatmeh's employment may be terminated for cause, or upon his death or disability. In the event that Mr. Hawatmeh is terminated without cause, we are obligated to pay him, as a severance payment, an amount equal to five full years of his then-current annual base compensation, half upon such termination and half one year later, together with a continuation of insurance benefits for a period of five years.

Additionally, on July 1, 2004, CirTran Corporation entered into an employment agreement with Trevor Saliba, dated as of June 26, 2004. The agreement, which is for a term of three years and renews automatically on a year-to year basis, provides for a base salary of $120,000, plus a bonus of 1% of our gross sales generated directly by Mr. Saliba, a bonus of 5% of all gross investments made into CirTran which are directly generated and arranged by Mr. Saliba, a bonus of 1% of the net purchase price of any acquisitions completed by us which are directly generated and arranged by Mr. Saliba (payable in CirTran common stock), as well as any other bonus our board of directors may approve. Under the Agreement, Mr. Saliba agreed to serve as our Executive Vice President of Sales and Marketing, and to perform such other duties as delegated by our board of directors. The agreement provides for benefits including health insurance coverage, cell phone, car allowance, life insurance, and D&O insurance. Under the Agreement, Mr. Saliba's employment may be terminated for cause, or upon his death or disability. In the event that Mr. Saliba is terminated without cause, we are obligated to pay him, as a severance payment, an amount equal to one years' salary. If the Agreement expires of its terms or is terminated for any reason, Mr. Saliba may not compete with us for a period of one year from the date of termination of the agreement. Mr. Saliba also agreed not to solicit our employees or customers, or attempt to induce anyone to cease doing business with us for a period of two years after the termination of the agreement.

On July 1, 2004, we also entered into an employment agreement, dated as of June 26, 2004, with Shaher Hawatmeh, the brother of Iehab Hawatmeh. The agreement, which is for a term of three years and renews automatically on a year-to year basis, provides for a base salary of $150,000, plus a bonus of 1% of our earnings before interest, taxes, depreciation, and amortization, payable quarterly, as well as any other bonus our board of directors may approve. Under the Agreement, Mr. Shaher Hawatmeh agreed to serve as our Chief Operating Officer, and to perform such other duties as delegated by our board of directors. The agreement provides for benefits including health insurance coverage, cell phone, life insurance, and D&O insurance. Under the Agreement, Mr. Shaher Hawatmeh's employment may be terminated for cause, or upon his death or disability. In the event that Mr. Shaher Hawatmeh is terminated without cause, we are obligated to pay him, as a severance payment, an amount equal to one years' salary. If the Agreement expires of its terms or is terminated for any reason, Mr. Shaher Hawatmeh may not compete with us for a period of one year from the date of termination of the agreement. Mr. Shaher Hawatmeh also agreed not to solicit our employees or customers, or attempt to induce anyone to cease doing business with us for a period of two years after the termination of the agreement.

On June 15, 2004, our subsidiary, CirTran-Asia, entered into an employment agreement with Charles Ho. The agreement, which is for a term of three years and renews automatically on a year-to year basis, provides that for each additional product that Mr. Ho procures pursuant to the agreement between CirTran-Asia and Michael Casey Enterprises, LTD., Mr. Ho shall be entitled to receive such compensation as provided for in that agreement in the form of options to purchase shares of CirTran common stock. Under the Agreement, CirTran-Asia will not provide benefits to Mr. Ho., and his employment may be terminated for cause, or upon his death or disability. If the Agreement expires of its terms or is terminated for any reason, Mr. Ho may not compete with us for a period of one year from the date of termination of the agreement. Mr. Ho also agreed not to solicit our employees or customers, or attempt to induce anyone to cease doing business with us for a period of two years after the termination of the agreement.

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On May 15, 2006, Richard T. Ferrone entered into a three-year employment contract with the Company to serve as the Chief Financial Officer of the Company to perform those duties delegated by the Board of Directors and the President of the Company and all other duties consistent with such description. The term of his employment started on May 15, 2006, and will continue for three years thereafter, unless sooner terminated by either party as provided in the agreement. Thereafter, the agreement will be automatically renewed on a year-to-year basis after the expiration of the initial or any subsequent term of the Agreement unless terminated by either party as provided in the agreement. Mr. Ferrone will receive, commencing on May 15, 2006, a base salary of $120,000 per year. The base salary shall be reviewed by the Board annually and may be increased as determined by the Board. The Board's determination of salary will be based primarily on Mr. Ferrone's ability to meet, and to cause the Company to meet, annually established goals. He is also entitled to a bonus of $30,000 per year, payable in quarterly increments. In addition, he may be granted options to purchase shares of the Company's common stock as determined from time to time by the Board or the Committee established pursuant to the Company's Stock Option Plan.

2001 Stock Plan

The 2001 Stock Plan has been fully distributed.

2002 Stock Plan

The 2002 Stock Plan has been fully distributed.

2003 Stock Plan

In November 2003, our board approved and adopted our 2003 Stock Plan, or the 2003 Plan, subject to shareholder approval. An aggregate of 35,000,000 shares of our common stock are subject to the 2003 Plan, which provides for grants to employees, officers, directors and consultants of both non-qualified (or non-statutory) stock options and "incentive stock options" (within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended). The 2003 Plan also provides for the grant of certain stock purchase rights, which are subject to a purchase agreement between us and the recipient. The purpose of the 2003 Plan is to enable us to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to such persons, and to promote the success of our business.

The 2003 Plan is administered by our board of directors, which designates from time to time the individuals to whom awards are made under the 2003 Plan, the amount of any such award and the price and other terms and conditions of any such award. The 2003 Plan shall continue in effect until the date which is ten years from the date of its adoption by the board of directors, subject to earlier termination by our board. The board may suspend or terminate the 2003 Plan at any time.

The board determines the persons to whom options are granted, the option price, the number of shares to be covered by each option, the period of each option, the times at which options may be exercised and whether the option is an incentive or non-statutory option. No employee may be granted options or stock purchase rights under the 2003 Plan for more than an aggregate of 15,000,000 shares in any given fiscal year. We do not receive any monetary consideration upon the granting of options. Options are exercisable in accordance with the terms of an option agreement entered into at the time of grant.

The board may also award our shares of common stock under the 2003 Plan as stock purchase rights. The board determines the persons to receive awards, the number of shares to be awarded and the time of the award. Shares received pursuant to a stock purchase right are subject to the terms, conditions and restrictions determined by the board at the time the award is made, as evidenced by a restricted stock purchase agreement.

As of April 8, 2005, 35,000,000 options to purchase shares of common stock and no stock purchase rights had been granted under the 2003 Plan. Therefore, the 2003 Plan had been fully distributed.

2004 Stock Plan

In December 2004, our board approved and adopted our 2004 Stock Plan, or the 2004 Plan, subject to shareholder approval. An aggregate of 40,000,000 shares of our common stock are subject to the 2003 Plan, which provides for grants to employees, officers, directors and consultants of both non-qualified (or non-statutory) stock options and "incentive stock options" (within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended). The 2004 Plan also provides for the grant of certain stock purchase rights, which are subject to a purchase agreement between us and the recipient. The purpose of the 2004 Plan is to enable us to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to such persons, and to promote the success of our business.

The 2004 Plan is administered by our board of directors, which designates from time to time the individuals to whom awards are made under the 2004 Plan, the amount of any such award and the price and other terms and conditions of any such award. The 2004 Plan shall continue in effect until the date which is ten years from the date of its adoption by the board of directors, subject to earlier termination by our board. The board may suspend or terminate the 2004 Plan at any time.

The board determines the persons to whom options are granted, the option price, the number of shares to be covered by each option, the period of each option, the times at which options may be exercised and whether the option is an incentive or non-statutory option. No employee may be granted options or stock purchase rights under the 2004 Plan for more than an aggregate of 15,000,000 shares in any given fiscal year. We do not receive any monetary consideration upon the granting of options. Options are exercisable in accordance with the terms of an option agreement entered into at the time of grant.

The board may also award our shares of common stock under the 2004 Plan as stock purchase rights. The board determines the persons to receive awards, the number of shares to be awarded and the time of the award. Shares received pursuant to a stock purchase right are subject to the terms, conditions and restrictions determined by the board at the time the award is made, as evidenced by a restricted stock purchase agreement.

As of July 20, 2006, 40,000,000 options to purchase shares of common stock and no stock purchase rights had been granted under the 2004 Plan.

The following table sets forth information about the Company's equity compensation plans, including the number of securities to be issued upon the exercise of outstanding options, warrants, and rights; the weighted average exercise price of the outstanding options, warrants, and rights; and the number of securities remaining available for issuance under the specified plan through July 20, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted average exercise price of outstanding options, warrants, and rights	Number of secur remaining avail future issuance equity compensa
Equity compensation plans approved by shareholders	0	0	0
Equity compensation plans not approved by shareholders	2002 Plan: 500 options 2003 Plan: 3,750,000 options 2004 Plan: 5,500,000 options	2002 Plan: $0.0001/share 2003 Plan: $0.01/share 2004 Plan: $0.03/share	2002 Plan: 0 o 2003 Plan: 0 o 2004 Plan: 0 o
Total	9,250,500	$0.03/share	

Changes in and disagreements with accountants on accounting and financial disclosure

None.

Index to Financial Statements

Experts

Our consolidated balance sheets as of December 31, 2005 and 2004, and the consolidated statements of operations, stockholders' deficit, and cash flows, for the years then ended, have been included in the registration statement on Form SB-2 of which this prospectus forms a part, in reliance on the report of Hansen, Barnett & Maxwell, independent certified public accountants, given on the authority of that firm as experts in auditing and accounting.

Legal matters

The validity of the Shares offered hereby will be passed upon for us by Durham Jones & Pinegar, P.C., 111 East Broadway, Suite 900, Salt Lake City, Utah 84111.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The following financial statements of CirTran Corporation and related notes thereto and auditors' report thereon are filed as part of this Form 10-KSB:

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HANSEN, BARNETT & MAXWELL
A Professional Corporation
CERTIFIED PUBLIC ACCOUNTANTS
AND
BUSINESS CONSULTANTS
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Registered with the Public Company
Accounting Oversight Board

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Directors and the Stockholders
CirTran Corporation

We have audited the accompanying consolidated balance sheets of CirTran Corporation and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CirTran Corporation and Subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has an accumulated deficit, has suffered losses from operations and has negative working capital that raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

HANSEN, BARNETT & MAXWELL

Salt Lake City, Utah
March 29, 2006

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CIRTRAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31,	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents	$ 1,427,865	$ 81,101
Trade accounts receivable, net of allowance for doubtful accounts of $158,374 and $41,143, respectively	3,358,981	1,288,719
Inventory, Net of reserve of $751,296 and $547,405, respectively	2,271,604	1,453,754
Prepaid Deposits	142,188	-
Other	252,941	153,062
Total Current Assets	7,453,579	2,976,636
Property and Equipment, Net	2,686,737	840,793
Investment in Securities, at Cost	300,000	300,000
Other Assets, Net	361,581	8,000
Deposits	100,000	100,000
Deferred Offering Costs	-	68,000
Total Assets	$ 10,901,897	$ 4,293,429
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable	$ 1,239,519	$ 1,104,392
Accrued liabilities	1,222,018	2,066,022
Deferred revenue	119,945	-
Derivative liability	4,910,303	-
Convertible Debenture	996,252	-

Current maturities of long-term notes payable	12,610	1,815,875
Notes payable to stockholders	95,806	18,586
Notes payable to related parties	-	1,530,587
Total Current Liabilities	8,596,453	6,535,462
Long-Term Notes Payable, Less Current Maturities	1,037,390	-
Commitments and Contingencies		
Stockholders' Equity (Deficit)		
Common stock, par value $0.001; authorized 750,000,000 shares; issued and outstanding shares: 583,368,569 and 474,118,569 net of 0 and 3,000,000 shares held in treasury at no cost at December 31, 2005 and 2004, respectively	583,364	474,114
Additional paid-in capital	20,012,000	16,083,455
Accumulated deficit	(19,327,310)	(18,799,602)
Total Stockholders' Equity (Deficit)	1,268,054	(2,242,033)
Total Liabilities and Stockholders' Equity (Deficit)	$ 10,901,897	$ 4,293,429

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31,	2005	2004
Net Sales	$ 12,992,512	$ 8,862,715
Cost of Sales	(6,706,135)	(7,030,934)
Writedown of carrying value of inventories	(38,089)	(13,000)
Gross Profit	6,248,288	1,818,781
Operating Expenses		
Selling, general and administrative expenses	5,923,075	3,362,933
Non-cash employee compensation expense	135,000	332,181
Total Operating Expenses	6,058,075	3,695,114
Loss From Operations	190,213	(1,876,333)
Other Income (Expense)		
Interest	(1,225,252)	(495,637)
Gain on forgiveness of debt	337,761	1,713,648

Gain on derivative valuation	169,570	-
Total Other Expense, Net	(717,921)	1,218,011
Net Loss	$ (527,708)	$ (658,322)
Basic and diluted loss per common share	$ (0.00)	$ (0.00)
Basic and diluted weighted-average common shares outstanding	554,085,007	451,620,617

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2005

	Common Stock			
	Number of Shares	Amount	Additional Paid-in Capital	Accumulated Deficit
Balance - December 31, 2003	349,087,699	$ 349,088	$ 12,876,941	$(18,141,280)
Shares issued for conversion of notes payable to equity line investor	57,464,386	57,460	2,006,540	-
Shares issued for settlement of notes payable	1,542,495	1,542	53,458	-
Shares issued for settlement expense	1,000,000	1,000	59,000	-
Shares issued as settlement of salaries, accrued salaries and related interest	45,273,989	45,274	498,014	-
Options granted to employees, consultants and attorneys	-	-	334,952	-
Exercise of stock options by directors and employees	14,250,000	14,250	259,500	-
Exercise of stock options by consultants and attorneys	5,500,000	5,500	(4,950)	-
Net loss	-	-	-	(658,322)

Balance - December 31, 2004	474,118,569	474,114	16,083,455	(18,799,602)
Shares issued for purchase of PFE	20,000,000	20,000	780,000	-
Shares issued for settlement of notes payable & accrued interest	51,250,000	51,250	2,004,694	-
Shares issued for settlement expense	13,000,000	13,000	491,371	-
Options granted to employees, consultants and attorneys	-	-	229,330	-
Exercise of stock options by directors and employees	18,500,000	18,500	429,000	-
Exercise of stock options by consultants and attorneys	6,500,000	6,500	(5,850)	-
Net loss	-	-	-	(527,708)
Balance - December 31, 2005	583,368,569	$ 583,364	$ 20,012,000	$(19,327,310)

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31,	2005	2004
Cash flows from operating activities		
Net loss	$ (527,708)	$ (658,322)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	324,955	249,395
Accretion expense	826,124	-
Provision for doubtful accounts	117,231	12,267
Provision for obsolete inventory	38,090	13,000
Loss on disposal of property and equipment	-	33,238
Gain on forgiveness of debt	(337,761)	(1,713,881)
Non-cash compensation expense	135,000	226,250
Abandoned offering costs expensed	68,000	-
Amortization of loan discount and loan costs	108,719	-
Intrinsic value of options issued to employees	12,000	-
Loan costs and interest witheld from loan proceeds	67,168	145,000
Stock issued for employee compensation	-	105,931
Stock and warrants issued for settlement expense	654,153	60,000
Options issued to attorneys and consultants for		

services	217,330	209,952
Change in valuation of derivative	(169,569)	
Accrued Interest Expense	111,986	-
Changes in assets and liabilities:		
Trade accounts receivable	(2,128,289)	(1,211,799)
Prepaid Deposits	(99,879)	-
Inventories	(855,940)	(219,326)
Prepaid expenses and other assets	(277,987)	14,419
Accounts payable	291,143	515,690
Accrued liabilities	(446,455)	538,132
Deferred revenue	119,945	-
Total adjustments	(1,224,036)	(1,021,732)
Net cash used in operating activities	(1,751,744)	(1,680,054)
Cash flows from investing activities		
Cash aquired with PFE acquisition	39,331	-
Purchase of investment	-	(300,000)
Net change in deposits	-	(100,000)
Purchase of property and equipment	(295,346)	(545,824)
Net cash used in investing activities	(256,015)	(945,824)
Cash flows from financing activities		
Change in checks written in excess of cash in bank	-	(9,623)
Proceeds from notes payable to stockholders	123,220	18,500
Payments on notes payable to stockholders	-	(31,752)
Proceeds from notes payable, net of cash paid for offering costs	3,102,067	2,927,000
Principal payments on notes payable	-	(466,463)
Proceeds from notes payable to related parties	95,586	3,128,281
Payment on notes payable to related parties	-	(3,025,149)
Proceeds from exercise of options and warrants to purchase common stock	33,000	111,500
Exercise of options issued to attorneys and consultants for services	650	550
Net cash provided by financing activities	3,354,523	2,652,844
Net increase in cash and cash equivalents	1,346,764	26,966
Cash and cash equivalents at beginning of year	81,101	54,135
Cash and cash equivalents at end of period	$ 1,427,865	$ 81,101

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

For the Years Ended December 31,	2005	2004

Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ 173,300	$ 298,542
Noncash investing and financing activities		
Notes issued for accounts payable and capital lease obligations	$ -	$ 711,894
Acquisition of PFE Properties, LLC for stock and assumption of note payable	1,868,974	-
Common stock issued for settlement of note payable and accrued interest	2,148,913	2,204,999
Deposit applied to purchase of property and equipment	100,000	-
Common stock issued for accrued rent and interest	411,402	-
Accrued interest converted to notes payable	-	9,158
Stock options exercised for settlement of accrued interest and accrued compensation	233,500	61,000
Note issued for settlement of notes payable and accrued interest	-	551,819
Fees withheld from notes payable for Equity Line Agreement	-	86,000
Loan costs included in notes payable	50,850	-
Deferred offering costs withheld from notes payable proceeds	-	128,000
Shares issued as settlement of salaries, accrued salaries and related interest	-	437,357
Stock options exercised for settlement of notes payable to stockholders	46,000	-
Loan fees incurred as part of convertible debenture (derivative)	380,765	-
Convertible debenture proceeds used to settle notes payable outstanding	2,315,850	-
Initial recognition of derivative liability	5,079,872	-

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
NOTES CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

Nature of Operations -- CirTran Corporation (the "Company") provides turnkey manufacturing services using surface mount technology, ball-grid array assembly, pin-through-hole, and custom injection molded cabling for leading electronics original equipment manufacturers ("OEMs") in the communications, networking, peripherals, gaming, consumer products, telecommunications, automotive, medical, and semiconductor industries. The Company also designs, develops, manufactures, and markets a full line of local area network products, with emphasis on token ring and Ethernet connectivity.

In June 2004, the Company incorporated CirTran-Asia, Inc., a Utah corporation, as a wholly owned subsidiary. CirTran-Asia was formed to manufacture, either directly or through foreign subcontractors, certain products under exclusive manufacturing agreements.

On March 31, 2005, Cirtran Corporation acquired a 100% ownership interest in PFE Properties, LLC (see Note 6). Following the acquisition of the PFE interests, PFE will continue to own the building. PFE will remain a separate LLC due to liability issues and the Company will continue to make intercompany lease payments under the 2003 lease.

In December 2005, the Company incorporated CirTran Products, Inc., a Utah corporation, as a wholly owned subsidiary. CirTran Products was formed to offer products for sale at retail. The new division will be run from the Company's Los Angeles Office. The Company anticipates that consumer products built by the Company's wholly owned subsidiary CirTran Asia, as well as other products to be acquired, will be available for retail sale in 2006.

Principles of Consolidation -- The consolidated financial statements include the accounts of CirTran Corporation, and its wholly owned subsidiaries, Racore Technology Corporation, CirTran-Asia Inc, CirTran Products, Inc. and PFE Properties, LLC. All significant intercompany transactions have been eliminated in consolidation.

Revenue Recognition -- Revenue is recognized when products are shipped. Title passes to the customer or independent sales representative at the time of shipment. Returns for defective items are repaired and sent back to the customer. Historically, expenses experienced with such returns have not been significant and have been recognized as incurred.

Shipping and handling fees are included as part of net sales. The related freight costs and supplies directly associated with shipping products to customers are included as a component of cost of goods sold.

Cash and Cash Equivalents -- The Company considers all highly-liquid, short-term investments with an original maturity of three months or less to be cash equivalents.

Accounts Receivable -- Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Specific reserves are estimated by management based on certain assumptions and variables, including the customer's financial condition, age of the customer's receivables and changes in payment histories. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received.

Inventories -- Inventories are stated at the lower of average cost or market value. Costs include labor, material and overhead costs. Overhead costs are based on indirect costs allocated among cost of sales, work-in-process inventory and finished goods inventory. Indirect overhead costs have been charged to cost of sales or capitalized as inventory based on management's estimate of the benefit of indirect manufacturing costs to the manufacturing process.

When there is evidence that the inventory's value is less than original cost, the inventory is reduced to market value. The Company determines market value on current resale amounts and whether technological obsolescence exists. The Company has agreements with most of its customers that require the customer to purchase inventory items related to their contracts in the event that the contracts are cancelled.

Preproduction Design and Development Costs -- The Company incurs certain costs associated with the design and development of molds and dies for its contract manufacturing segment. These costs are held as deposits on the balance sheet until the molds or dies are finished and ready for use. At that point the costs are included as part of production equipment in property and equipment and amortized over their useful lives. The company holds title to all molds and dies. At December 31, 2005 and 2004 the company held $100,000 and $100,000, respectively in deposits. Capitalized costs associated with molds and dies included in property and equipment for the years ended December 31, 2005 and 2004 was $761,200 and $412,200, respectively.

Property and Equipment -- Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over the estimated service lives. Leasehold improvements are amortized over the shorter of the life of the lease or the service life of the improvements. The straight-line method of depreciation and amortization is followed for financial reporting purposes. Maintenance, repairs, and renewals which neither materially add to the value of the property nor appreciably prolong its life are charged to expense as incurred. Gains or losses on dispositions of property and equipment are included in operating results.

Depreciation and amortization expense for the years ended December 31, 2005 and 2004 was $324,955 and $249,395, respectively.

Patents -- Legal fees and other direct costs incurred in obtaining patents in the United States and other countries are capitalized. Patents costs are amortized over the estimated useful life of the patent. During the year ended December 31, 2005, the Company capitalized $35,799 in patent related legal costs. The Company is amortizing this patent over its 7 year life. Amortization expense was $5,114 during the year ended December 31, 2005.

Impairment of Long-Lived Assets -- The Company reviews its long-lived assets, including intangibles, for impairment when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The Company evaluates, at each balance sheet date, whether events and circumstances have occurred that indicate possible impairment. The Company uses an estimate of future undiscounted net cash flows from the related asset or group of assets over their remaining life in measuring whether the assets are recoverable. As of December 31, 2005, the Company does not consider any of its long-lived assets to be impaired.

Financial Instruments with Derivative Features -- The Company does not hold or issue derivative instruments for trading purposes. However, the Company has convertible debentures that contain embedded derivatives that require separate valuation from the convertible debentures. The Company recognizes these

CIRTRAN CORPORATION AND SUBSIDIARIES
NOTES CONSOLIDATED FINANCIAL STATEMENTS

derivatives as liabilities in its balance sheet and measures them at their estimated fair value, and recognizes changes in their estimated fair value in earnings (losses) in the period of change. The Company has estimated the fair value of these embedded derivatives using the Black-Scholes model based on the historical volatility of its common stock. The fair value of derivative instruments are re-measured each quarter.

Advertising Costs -- The Company expenses advertising costs as incurred. Advertising expenses for the years ended December 31, 2005 and 2004 were $33,111 and $26,801, respectively.

Stock-Based Compensation -- At December 31, 2005, the Company has one stock-based employee compensation plan, which is described more fully in Note 15. The Company accounts for the plan under APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. During the years ended December 31, 2005 and 2004, the Company recognized compensation expense relating to stock options and warrants of $364,330 and $226,250, respectively. During the years ended December 31, 2005 and 2004, the Company recognized compensation expense relating to the issuance of common stock of $0, and $105,931, respectively. The following table illustrates the effect on net loss and basic and diluted loss per common share as if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

	Years Ended December 31, 2005	Years Ended December 31, 2004
Net loss, as reported	$(527,708)	$(658,322)
Add: Stock-based employee compensation expense included in net loss	364,330	332,181
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(211,247)	(517,924)
Pro forma net loss	$(374,625)	$(844,065)
Basic and diluted loss per common share as reported	$ (0.00)	$ (0.00)
Basic and diluted loss per common share pro forma	$ (0.00)	$ (0.00)

Income Taxes -- The Company utilizes the liability method of accounting for income taxes. Under the liability method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and the carryforward of operating losses and tax credits and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. An allowance against deferred tax assets is recorded when it is more likely than not that such tax benefits will not be realized. Research tax credits are recognized as utilized.

Use of Estimates -- In preparing the Company's financial statements in accordance with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Concentrations of Risk -- Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of trade accounts receivable. The Company sells substantially to recurring customers, wherein the customer's ability to pay has previously been evaluated. The Company generally does not require collateral. Allowances are maintained for potential credit losses, and such losses have been within management's expectations. At December 31, 2005 and 2004, this allowance was $158,374 and $41,143, respectively.

During the year ended December 2005, sales to two customers accounted for 27 percent and 10 percent of net sales, respectively. Sales from both of these customers were part of the contract manufacturing segment. Account receivables from one customer equaled 71% of consolidated accounts receivable at December 31, 2005, which created a concentration of credit risk.

During the year ended December 2004, sales to two customers accounted for 52 percent and 14 percent of net sales, respectively. Sales from these customers were from the contract manufacturing segment and the electronics assembly segment, respectively. No individual customer account receivable balance at December 31, 2004, created a concentration of credit risk.

Fair Value of Financial Instruments -- The carrying amounts reported in the accompanying consolidated financial statements for cash, accounts receivable, notes payable and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. The carrying amounts of the Company's debt obligations approximate fair value.

Reclassifications -- Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

Loss Per Share -- Basic loss per share is calculated by dividing loss available to common shareholders by the weighted-average number of common shares outstanding during each period. Diluted loss per share is similarly calculated, except that the weighted-average number of common shares outstanding would include common shares that may be issued subject to existing rights with dilutive potential when applicable. The Company had 228,673,577 and 14,250,500 in potentially issuable common shares at December 31, 2005 and 2004, respectively. The potentially issuable common shares at December 31, 2005 and 2004 were excluded from the calculation of diluted loss per share because the effects are anti-dilutive.

New Accounting Standards -- In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), "Share-Based Payment," which is an amendment to SFAS No. 123, "Accounting for Stock-Based Compensation." This new standard eliminates the ability to account for share-based compensation transactions using Accounting Principles Board (APB) No. 25, "Accounting for Stock Issued to Employees" (APB 25) and requires such transactions to be accounted for using a fair-value-based method and the resulting cost recognized in the Company's financial statements. This new standard is effective for interim and annual periods beginning after December 15, 2005. The Company is currently evaluating SFAS No. 123 as revised and intends to implement it in the first quarter of 2006. At December 31, 2005, all employee options were fully vested. Therefore, the implementation of this standard will not initially have a material impact on the Company's financial statements.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The Company will be required to apply this statement to inventory costs incurred after December 31, 2005. The Company is currently evaluating what effect this statement will have on the Company's financial position and results of operations.

In December 2004, the FASB issued SFAS No. 153, "Exchange of Non-monetary Assets." SFAS No. 153 amends APB Opinion No. 29, "Accounting for Non-monetary Transactions," to eliminate the exception for non-monetary exchanges of similar productive assets. The Company will be required to apply this statement to non-monetary exchanges after December 31, 2005. The adoption of this standard is not expected to have a material effect on the Company's financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections-A Replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. The Company will be required to apply this statement for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this standard is not expected to have a material effect on the Company's financial position or results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments -- an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities and related interpretations. SFAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies which interest-only strips and principal-only strips are not subject to recognition as liabilities. SFAS 155 eliminates the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for the Company for all financial instruments acquired or issued beginning January 1, 2007. The adoption of this standard is not expected to have a material effect on the Company's financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140 (SFAS 156). SFAS 156 amends SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to use either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for the Company as of January 1, 2007. The adoption of this standard is not expected to have a material effect on the Company's financial position or results of operations.

NOTE 2 - REALIZATION OF ASSETS

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. However, the Company sustained losses of $527,708 and $658,322 for the years ended December 31, 2005 and 2004, respectively. As of December 31, 2005 and 2004, the Company had an accumulated deficit of $19,327,310 and $18,799,602, respectively, and a total stockholders' equity (deficit) of $1,268,054 and ($2,242,033), respectively. In addition, the Company used, rather than provided, cash in its operations in the amounts of $1,751,744 and $1,680,054 for the years ended December 31, 2005 and 2004, respectively. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

In view of the matters described in the preceding paragraphs, recoverability of

a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheets is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain or replace present financing, to acquire additional capital from investors, and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

As discussed in Note 13, the Company had entered into an equity line of credit agreement and a standby equity distribution agreement with a private investor. With the sale by the Company of the Convertible Debenture in May 2005, this and all other agreements relating to the equity line and the standby equity distribution agreement were terminated.

NOTE 3 - INVESTMENT IN SECURITIES AT COST

On April 13, 2004, the Company entered into a stock purchase agreement with an unrelated party under which the Company purchased 400,000 shares of the investee's Series B Preferred Stock (the "Preferred Shares") for an aggregate purchase price of $300,000 cash. This purchase was made at fair value. The Preferred Shares are convertible, at the Company's option, into an equivalent number of shares of investee common stock, subject to adjustment. The Preferred Shares are not redeemable by the investee. As a holder of the Preferred Shares, the Company has the right to vote the number of shares of investee common stock into which the Preferred Shares are convertible at the time of the vote. The investment represents less than a 5% interest in the investee. The investment does not have a readily determinable fair value and is stated at historical cost, less an allowance for impairment when circumstances indicate an investment has been impaired. The Company periodically evaluates its investments as to whether events and circumstances have occurred which indicate possible impairment. No indicators of impairment were noted for the year ended December 31, 2005.

Separate from the purchase of the Preferred Shares, the Company and the investee also entered into a Preferred Manufacturing Agreement. Under this agreement, the Company will perform exclusive "turn-key" manufacturing services handling most of the investee's manufacturing operations from material procurement to complete finished box-build of all of investee products. The initial term of the agreement is three years, continuing month to month thereafter unless terminated by either party. Sales under this agreement totaled $163,473 and $538,233 for the periods ended December 31, 2005, and December 31, 2004, respectively.

NOTE 4 - INVENTORIES

Inventories consist of the following:

	2005	2004
Raw materials	$ 924,101	$ 895,723
Work-in process	144,993	356,160
Finished goods	1,202,510	201,871
	$ 2,271,604	$ 1,453,754

During 2005 and 2004, write downs of $38,090 and $13,000, respectively, were recorded to reduce items considered obsolete or slow moving to their market value.

NOTE 5 - ACQUISITION OF PFE PROPERTIES, LLC

On March 31, 2005, the Company purchased a 100% interest in PFE Properties LLC (PFE). PFE was previously owned by a relative of the President and CEO. PFE owns the land and building in which the Company's manufacturing facilities and administrative offices are located. The liabilities of PFE on the date of acquisition include a mortgage note payable of $1,050,000, secured by the building. The Company acquired PFE by issuing 20,000,000 shares of the Company's restricted common stock with a fair value of $800,000 on the date of acquisition and assuming the mortgage note payable of $1,050,000 and accounts payable of $18,974. The results of operations for PFE have been included beginning March 31, 2005. The additional $800,000 for the purchase of PFE was allocated between the land and building value.

The balance sheet of PFE as of March 31, 2005, is presented as follows:

Current Assets	$ 98,535
Property and Equipment	1,770,439
Total Assets Acquired	1,868,974
Accounts Payable	18,974

Mortgage Note Payable	1,050,000
Total Liabilities Assumed	1,068,974
Net Assets Acquired	$ 800,000

The pro forma information is presented as if the Company had acquired PFE on January 1, 2004, as follows:

	Year Ended December 31, 2005	2004
Net Sales	$ 12,992,512	$ 8,862,715
Net Loss	$ (539,722)	$ (613,378)
Basic loss per share	$ -	$ -
Diluted loss per share	$ -	$ -

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NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment and estimated service lives consist of the following:

	2005	2004	Estimated Service Lives in Years
Land	$ 360,000	$ -	N/A
Building	1,410,439	-	39
Production equipment	3,584,140	3,220,847	5-10
Leasehold improvements	997,714	992,018	7-10
Office equipment	185,556	159,199	5-10
Other	47,789	47,789	3-7
	6,585,638	4,419,853	
Less accumulated depreciation and amortization	3,898,901	3,579,060	
	$ 2,686,737	$ 840,793	

NOTE 7 - RELATED PARTY TRANSACTIONS

Notes Payable to Stockholders -- The Company had amounts due to stockholders from three separate notes. The balance due to stockholders at December 31, 2005 and 2004, was $95,806 and $18,586, respectively. Interest associated with amounts due to stockholders is accrued at 10 percent. Unpaid accrued interest was $0 and $7,976 at December 31, 2005 and 2004, respectively, and is included in accrued liabilities. These notes are due on demand.

During the year ended December 31, 2005, in lieu of a cash exercise price of

$23,000, the stockholders forgave $23,000 of notes payable owed to them by the Company to exercise 1,000,000 options to purchase shares of the Company's common stock.

Notes Payable to Related Party -- During 2002, the Company entered into a verbal bridge loan agreement with Abacas Ventures, Inc. (Abacas). This agreement allowed the Company to request funds from Abacas to finance the build-up of inventory relating to specific sales. The loan bore interest at 24% and was payable on demand. There were no required monthly payments. During the years ended December 31, 2005 and 2004, the Company was advanced $95,586 and $3,128,281, respectively, and made cash payments of $0 and $3,025,149, respectively.

During the year ended December 31, 2004, Abacas completed negotiations with several vendors of the Company, whereby Abacas purchased various past due amounts for goods and services provided by vendors, as well as notes payable. The total of these obligations was $1,263,713. The Company recorded this transaction as a $1,263,713 non-cash increase to the note payable owed to Abacas, pursuant to the terms of the Abacas agreement.

During March 2005, the Company issued 51,250,000 shares of the Company's restricted common stock for payment of $2,055,944 in principal and accrued interest on the note. Because Abacas is a related party, no gain or loss on forgiveness of debt was recognized.

The total principal amount owed to Abacas between the note payable and the bridge loan was $0 and $1,530,587 as of December 31, 2005, and 2004, respectively. The total accrued interest owed to Abacas between the note payable and the bridge loan was $0 and $430,828 as of December 31, 2005 and 2004, respectively.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Settlement of Litigation -- During January 2002, the Company settled a lawsuit that had alleged a breach of facilities sublease agreement involving facilities located in Colorado. The Company's liability in this action was originally estimated to range up to $2.5 million. The Company had filed a counter suit in the same court for an amount exceeding $500,000 for missing equipment.

Effective January 18, 2002, the Company entered into a settlement agreement which required the Company to pay the plaintiff the sum of $250,000. Of this amount, $25,000 was paid upon execution of the settlement, and the balance, together with interest at 8% per annum, was payable by July 18, 2002. As security for payment of the balance, the Company executed and delivered to the plaintiff a Confession of Judgment and also issued 3,000,000 shares of common stock, which were held in escrow and were treated as treasury stock recorded at no cost. The fair value of the 3,000,000 shares was less than the carrying amount of the note payable. Because 75 percent of the balance had not been paid by May 18, 2002, the Company was required to prepare and file with the Securities & Exchange Commission, at its own expense, a registration statement with respect to the escrowed shares.

As of December 31, 2005, the Company was in default of its obligations under the settlement agreement and the total payment due thereunder had not been made. A registration statement with respect to the escrowed shares was not filed and the Company did not replace the escrowed shares with registered, free-trading shares as per the terms of the agreement. The plaintiff filed a Confession of Judgment and proceeded with execution thereon. The shares in escrow were released and issued as partial settlement of $92,969 on the note payable outstanding.

In connection with a separate sublease agreement of these facilities, the Company received a settlement from the sublessee during May 2002, in the amount of $152,500, which was recorded as other income. The Company did not receive cash from this settlement, but certain obligations of the Company were paid directly. $109,125 of the principal balance of the note related to the settlement mentioned above was paid. Also, $7,000 was paid to the Company's legal counsel as a retainer for future services. The remaining $36,375 was paid to the above mentioned plaintiff as a settlement of rent expense.

During September 2002, the plaintiff filed a claim that the $109,125 portion of the payment was to be applied as additional rent expense rather than a principal payment on the note payable. The Company estimated that the probability of the $109,125 being considered additional rent expense was remote and disputed the claim. This lawsuit was settled in 2006. (See Note 17)

Litigation - During 2003 and 2004, an investment firm filed suits in the U.S. District Court for the District of Utah seeking payment of a commission consisting of common stock valued at 1,750,000 for allegedly introducing the Company to the Equity Line Investor (See Note 10). The case was previously dismissed in a New York court. The Company estimated that the risk of loss was remote; therefore no accrual had been made prior to December 31, 2005. These suits were settled in 2006. (See Note 17)

Various vendors have notified the Company that they believe they have claims against the Company totaling $18,810. None of these vendors have filed lawsuits in relation to these claims. The Company has accrued for these claims, and they are included in accounts payable. During the year ended December 31, 2005, the Company determined that the statute of limitations had expired for various vendors. Amounts of $174,990 were written off and recorded as a gain on forgiveness of debt. However, there can be no assurance that any or all of these vendors will agree with the Company's determination, and the Company may be subject to claims or litigation in the future.

In addition, various vendors have notified the Company that they believe they have claims against the Company totaling $164,802. The Company has determined the probability of realizing any loss on these claims is remote. The Company has made no accrual for these claims and is currently in the process of negotiating the dismissal of these claims with the various vendors.

Registration Rights - In connection with the Company's entering into an Equity Line of Credit Agreement, the Company granted to the equity line investor (the "Equity Line Investor") registration rights, in connection with which the Company was required to file a registration statement covering the resale of shares put to the Equity Line Investor under the equity line. The Company was also required to keep the registration statement effective until two years following the date of the last advance under the equity line.

Also, in connection with the Company's entering into a standby equity distribution agreement, the Company granted to the investor registration rights, in connection with which the Company was required to file a registration statement covering the resale of shares put to the investor under the standby equity distribution agreement. The Company was also required to keep the registration statement effective until two years following the date of the last advance under the standby equity distribution agreement.

In connection with the Company's issuance of a convertible debenture (discussed below), the Equity Line of Credit Agreement and the Standby Equity Distribution Agreement, together with all associated registration rights, were terminated.

In May 2005, in connection with the Company's issuance of a convertible debenture (discussed below), the Company granted to the debenture holder registration rights, pursuant to which the Company agreed to file, within 120 days of the closing of the purchase of the debenture, a registration statement to register the resale of shares of the Company's common stock issuable upon conversion of the debenture. The company also agreed to use its best efforts to have the registration statement declared effective within 270 days after filing the registration statement. The Company agreed to register the resale of up to 100,000,000 shares, and to keep such registration statement effective until all of the shares issuable upon conversion of the debenture have been sold. The Company filed the registration statement on September 23, 2005. As of the date of this report, the registration statement had not been declared effective.

In December 2005, in connection with the Company's issuance of a convertible debenture (discussed below), the Company granted to the debenture holder registration rights, pursuant to which the Company agreed to file, within 120 days of the closing of the purchase of the debenture, a registration statement to register the resale of shares of the Company's common stock issuable upon conversion of the debenture. The company also agreed to use its best efforts to have the registration statement declared effective within 270 days after filing the registration statement. The Company agreed to register the resale of up to 32,608,696 shares and 10,000,000 warrants, and to keep such registration statement effective until all of the shares issuable upon conversion of the debenture have been sold.

Accrued Payroll Tax Liabilities -- In November 2004, the Internal Revenue Service (IRS) accepted the Company's Amended Offer in Compromise (Offer) to settle delinquent payroll taxes, interest and penalties. The acceptance of the Offer required the Company to pay $500,000 by February 3, 2005. The Company made the required payment on February 2, 2005. Additionally, the Offer requires the Company to remain current in its payment of taxes for 5 years, and the Company may not claim any net operating losses for the years 2001 through 2015, or until the Company pays taxes in an amount equal to the taxes waived by the offer in compromise. The outstanding balance of delinquent payroll taxes, interest and penalties was $1,955,767 on the settlement date. The future cash payments specified by the Offer, including interest and principal, were less than the carrying amount of the payable; therefore the Company reduced the carrying amount of the liability to the total future cash payments of $500,000 and recorded a gain of $1,455,767 during the year ended December 31, 2004. The payments to the IRS were made according to the settlement agreement during

January 2005.

Further, the Utah State Tax Commission has entered into an agreement to allow the Company to pay the tax liability owing to the State of Utah in equal monthly installments of $4,000. Through December 2005, the Company had made the required payments. The balance owed to the State of Utah as of December 31, 2005, and December 31, 2004, was $98,316 and $223,660, respectively, including taxes, penalties and interest. See Note 17 for the settlement of the remaining balance.

Manufacturing Agreement -- On June 10, 2004, the Company entered into an exclusive manufacturing agreement with certain Developers. Under the terms of the agreement, the Company, through its wholly-owned subsidiary CirTran-Asia, has the exclusive right to manufacture the certain products developed by the Developers or any of their affiliates. The Developers will continue to provide marketing and consulting services related to the products under the agreement. Should the Developers terminate the agreement early, they must pay the Company $150,000. Revenue is recognized when products are shipped. Title passes to the customer or independent sales representative at the time of shipment.

In connection with this agreement the Company agreed to issue options to purchase 1,500,000 shares common stock to the Developers upon the sale, shipment and payment for 200,000 units of a fitness product. In addition, the Company agreed to issue options to purchase 300,000 shares of common stock to the Developers for each multiple of 100,000 units of the fitness product sold in excess of the initial 200,000 units within twenty-four months of the agreement (June 2004). The options will be exercisable at $0.06 per share, vest on the grant date and expire one year after issuance. As of December 31, 2005, the Company had sold, shipped and received payment for, 257,577 units of the fitness product. In January 2005, the Company issued 1,500,000 options under the terms of the agreement. See Note 14.

In connection with the above manufacturing agreement, the Company agreed to issue various options to purchase shares of common stock to the Developers upon the sale, shipment, and payment of certain quantities of the additional products. In addition, the Company agreed to issue additional options to purchase common stock to the developers for each multiple of units sold in excess of the initial units within the first twenty-four months of the agreements. The schedule of units and potential options that will be issued follows:

Product	Initial Units	Options for Initial Units Sold	Each Multiple of Units above Initial Units	Options for Each Multiple of Units
1	500,000	500,000	200,000	200,000
2	25,000	500,000	15,000	100,000
3	100,000	500,000	50,000	100,000
4	300,000	1,000,000	100,000	200,000
5	200,000	250,000	100,000	100,000
6	200,000	500,000	100,000	100,000

As of December 31, 2005, the Company had not sold, shipped and received payment for enough units to require the issuance of options related to the additional products under these agreements. Because the Developers must provide future services for the options to vest, the options are treated as unissued for accounting purposes. The cost of these options will be recognized when the options are earned.

NOTE 9 - NOTES PAYABLE

Notes payable consisted of the following at December 31, 2005 and 2004:

	2005	2004
Notes payable to Equity Line Investor, no periodic interest, matures 70 to 131 days after issuance	$ -	$ 1,700,000
Note payable to a company, interest at 8.00%, matured August 2002, collateralized by 3,000,000 shares of the Company's common stock held in escrow	-	115,875
Mortgage payable to a bank, interest at 12.50%, monthly payments of $10,938 to $12,699 through November 2008, unpaid principal due in full December 2008, secured by building	1,050,000	-
Total Notes Payable	$ 1,050,000	$ 1,815,875
Less current maturities	(12,610)	(1,815,875)
Long-Term Portion of Notes Payable	$ 1,037,390	$ -

During the year ended December 31, 2004, the Company converted five notes payable and accrued interest of $551,819 into notes with Abacus (see Note 2). Accrued interest of $27,020 associated with these notes payable was not converted to the note payable with Abacus; therefore, a gain on forgiveness of debt was recorded for $27,020 for the year ended December 31, 2004.

In March 2004, the Company settled a note payable with a financial institution. The outstanding loan balance and accrued interest at the time of settlement was $189,663. The balance was settled for $90,000 in cash and 542,495 shares of common stock valued at $30,000. A gain on forgiveness of debt of $61,370 was recorded on this transaction.

In April 2004, the Company settled three notes payable with a financing company. The outstanding loan balances and accrued interest at the time of settlement was $192,043. The balance was settled for $75,000 in cash. A gain on forgiveness of debt of $117,043 was recorded on this transaction.

In November 2004, the Company settled a note payable with a corporation. The outstanding loan balance and accrued interest at the time of settlement was $75,000. The balance was settled for $50,000 in cash and 1,000,000 shares of common stock valued at $25,000.

In December 2004, the Company settled a note payable with a financial institution. The outstanding loan balance and accrued interest at the time of settlement was $36,902. The balance was settled for $10,000 in cash. A gain on forgiveness of debt of $26,902 was recorded on this transaction.

In December 2004, the Company settled a note payable with an individual. The outstanding loan balance and accrued interest at the time of settlement was $145,779. The balance was settled for $120,000 in cash. A gain on forgiveness of debt of $25,779 was recorded on this transaction.

Certain of the Company's notes payable contain various covenants and restrictions, including providing for the acceleration of principal payments in the event of a covenant violation or a material adverse change in the operations of the Company. During the year ended December 31, 2005 the Company was out of compliance on several notes payable, primarily due to a failure to make monthly payments. In instances where the Company was out of compliance, the amounts were shown as current. Additionally, all default provisions were accrued as part of the principal balance of the related notes payable.

Notes Payable to Equity Line Investor -- At December 31, 2004, the Company owed $1.7 million to Cornell Capital Partners, LP ("Cornell"), pursuant to an unsecured promissory note. The note was repayable over 193 days and was past due as of March 31, 2005. The note stated that if the Company did not repay the note when due, a default interest rate of 24% would apply to the unpaid balance. The Company recorded accrued interest of $105,074 on the note.

In January 2005, the Company entered into an additional promissory note with Cornell for $565,000. The Company received proceeds of $503,500, net of loan costs of $61,500. The terms of the note included a 9% premium or $50,850, resulting in a total note payable of $615,850. The premium was amortized to interest expense over the life of the loan. The terms of the loan stated that interest only payments would be made for the first six months. The Company would repay the principal, interest, and premium over the next six months. The loan was due January 2006. The Company amortized $11,057 of the premium as interest expense prior to settling the loan as discussed below.

All notes to Cornell were paid on May 27, 2005, with funds acquired from Highgate House Funds, Ltd. ("Highgate"), in connection with the issuance of a convertible debenture. (See Note 11) Payment of accrued interest was not required as part of the repayment. In connection with the repayment, the remaining premium of $39,793 was immediately amortized as interest expense. The gain from forgiveness of debt on both Cornell notes totaled $162,774.

In December 2005, the Company entered into a transaction for the issuance of an additional convertible debenture to Cornell for $1,500,000. (See Note 11.)

The total principal amount owed to Cornell Capital Partners, LP was $1,500,000 and $1,700,000 as of December 31, 2005, and 2004, respectively.

Mortgage Note Payable -- In conjunction with the acquisition of PFE, the Company assumed a mortgage note payable for $1,050,000. The note bears interest at 12.5% per annum. Interest only payments are required through January 2006. Starting in February 2006, principal and interest payments will be required based on a twenty-year amortization of the note. The entire balance of principal and unpaid interest will be due in December 2008.

The following is a schedule of future maturities on notes payable:

Year Ending December 31,	
2006	12,610
2007	14,280
2008	16,170
2009	1,006,940
Total	$ 1,050,000

NOTE 10 - LEASES

During 2005, the Company leased a satellite office in Los Angeles, CA. This office is used for sales and promotions. The Company entered into a two-year sublease agreement with an unrelated party on of October 24, 2005. Additionally, the Company has a lease for a facility in China that expires in 2006.

The following is a schedule of future minimum lease payments under the operating leases:

Year Ending December 31,	
2006	65,944
2007	44,878
Total	$ 110,822

The building lease provides for payment of property taxes, insurance, and maintenance costs by the Company. Rental expense for operating leases totaled $55,410 and $213,688 for the years ended December 31, 2005 and 2004, respectively.

NOTE 11 - CONVERTIBLE DEBENTURES

Highgate - On May 26, 2005, the Company entered into an agreement with Highgate to issue to Highgate a $3,750,000, 5% Secured Convertible Debenture (the "Debenture"). The Debenture is due December 2007 and is secured by all of the Company's property.

Accrued interest is payable at the time of maturity or conversion. The Company may, at its option, elect to pay accrued interest in cash or shares of the Company's common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either the date the interest payment is due or the date on which the interest payment is made. The balance of accrued interest owed at December 31, 2005 was $111,986.

At any time, Highgate may elect to convert principal amounts owing on the Debenture into shares of the Company's common stock at a conversion price equal to the lesser of $0.10 per share, or an amount equal to the lowest closing bid price of the Company's common stock for the twenty trading days immediately preceding the conversion date. The Company has the right to redeem a portion or the entire Debenture then outstanding by paying 105% of the principal amount redeemed plus accrued interest thereon.

Highgate's right to convert principal amounts into shares of the Company's common stock is limited as follows:

(i) Highgate may convert up to $250,000 worth of the principal amount plus accrued interest of the Debenture in any consecutive 30-day period when the market price of the Company's stock is $0.10 per share or less at the time of conversion;

(ii) Highgate may convert up to $500,000 worth of the principal amount plus accrued interest of the Debenture in any consecutive 30-day period when the price of the Company's stock is greater than $0.10 per share at the time of conversion; provided, however, that Highgate may convert in excess of the foregoing amounts if the Company and Highgate mutually agree; and

(iii) Upon the occurrence of an event of default, Highgate may, in its sole discretion, accelerate full repayment of all debentures outstanding and accrued interest thereon or may convert the Debentures and accrued interest thereon into shares of the Company's common stock.

Except in the event of default, Highgate may not convert the Debenture for a number of shares that would result in Highgate owning more than 4.99% of the Company's outstanding common stock.

As discussed in Note 8, the Company granted Highgate registration rights related to the issuance of the debenture.

The Company determined that the features of the Debenture fell under derivative accounting treatment. As of December 31, 2005 the carrying value of the Debenture was $996,252. The carrying value will be accreted each quarter over the life of the Debenture until the carrying value equals the face value of $3,750,000. The fair value of the derivative liability as of December 31, 2005 was $3,175,287.

In connection with the issuance of the Debenture, $2,265,000 of the proceeds were paid to Cornell to repay promissory notes. Fees of $256,433 were withheld from the proceeds, were capitalized, and are being amortized over the life of the note. As such, of the total Debenture of $3,750,000, the net proceeds to the

Company were $1,228,567. The proceeds were used for general corporate and working capital purposes, at the Company's discretion.

Cornell - On December 30, 2005, the Company entered into an agreement with

Cornell to sell to Cornell a $1,500,000, 5% Secured Convertible Debenture (the "Cornell Debenture"). The Cornell Debenture is due July 30, 2008 and has a security interest of all the Company's property, junior to the Highgate security interest.

Accrued interest is payable at the time of maturity or conversion. The Company may, at its option, elect to pay accrued interest in cash or shares of the Company's common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either the date the interest payment is due or the date on which the interest payment is made.

At any time, Cornell may elect to convert principal amounts owing on the Cornell Debenture into shares of the Company's common stock at a conversion price equal to an amount equal to the lowest closing bid price of the Company's common stock for the twenty trading days immediately preceding the conversion date. The Company has the right to redeem a portion or the entire Cornell Debenture then outstanding by paying 105% of the principal amount redeemed plus accrued interest thereon.

Cornell's right to convert principal amounts into shares of the Company's common stock is limited as follows:

(i) Cornell may convert up to $250,000 worth of the principal amount plus accrued interest of the Cornell Debenture in any consecutive 30-day period when the market price of the Company's stock is $0.10 per share or less at the time of conversion;

(ii) Cornell may convert up to $500,000 worth of the principal amount plus accrued interest of the Cornell Debenture in any consecutive 30-day period when the price of the Company's stock is greater than $0.10 per share at the time of conversion; provided, however, that Cornell may convert in excess of the foregoing amounts if the Company and Cornell mutually agree; and

(iii) Upon the occurrence of an event of default, Cornell Capital Partners, LP may, in its sole discretion, accelerate full repayment of the debenture outstanding and accrued interest thereon or may convert the Debenture and accrued interest thereon into shares of the Company's common stock.

Except in the event of default, Cornell may not convert the Cornell Debenture for a number of shares that would result in Cornell owning more than 4.99% of the Company's outstanding common stock.

The Cornell Debenture was issued with 10,000,000 warrants with an exercise price of $0.09 per share that vest immediately and have a three year life.

As discussed in Note 8, the Company granted Cornell registration rights related to the issuance of the Cornell Debenture and warrants.

The Company determined that the features on the Cornell Debenture and the associated warrants fell under derivative accounting treatment. As of December 31, 2005 the carrying value of the Cornell Debenture was $0. The carrying value will be accreted each quarter over the life of the Cornell Debenture until the carrying value equals the face value of $1,500,000. The fair value of the derivative liability as of December 31, 2005 was $1,735,016.

In connection with the issuance of the Cornell Debenture, fees of $130,000 were withheld from the proceeds, capitalized, and will be amortized over the life of the Cornell Debenture. As such, of the total Cornell Debenture of $1,500,000, the net proceeds to the Company were $1,370,000. The proceeds will be used for general corporate and working capital purposes, at the Company's discretion

NOTE 12 - INCOME TAXES

The Company has paid no federal or state income taxes. The significant components of the Company's deferred tax assets and liabilities at December 31, 2005 and 2004, were as follows:

	2005	2004
Deferred Income Tax Assets:		
Inventory reserve	$ 280,233	$ 266,026
Bad debt reserve	102,903	15,346
Vacation reserve	26,602	26,809
Research and development credits	27,285	27,285
Net operating loss carryforward	4,676,769	4,597,493
Depreciation	-	2,668
Intellectual property	101,095	115,581
Total Deferred Income Tax Assets	5,214,887	5,051,208
Valuation allowance	(5,213,178)	(5,051,208)
Deferred Income Tax Liability - depreciation	(1,709)	-
Net Deferred Income Tax Asset	$ -	$ -

The Company has sufficient long-term deferred income tax assets to offset the deferred income tax liability related to depreciation. The long-term deferred income tax assets relate to the net operating loss carryforward and the intellectual property.

The Company has sustained net operating losses in both periods presented. There were no deferred tax assets or income tax benefits recorded in the financial statements for net deductible temporary differences or net operating loss carryforwards because the likelihood of realization of the related tax benefits cannot be established. Accordingly, a valuation allowance has been recorded to reduce the net deferred tax asset to zero and consequently, there is no income tax provision or benefit presented for the years ended December 31, 2005 and 2004.

As of December 31, 2005, the Company had net operating loss carryforwards for tax reporting purposes of approximately $12,538,254. These net operating loss carryforwards, if unused, begin to expire in 2019. Utilization of approximately $1,193,685 of the total net operating loss is dependent on the future profitable operation of Racore Technology Corporation under the separate return limitation rules and limitations on the carryforward of net operating losses after a change

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in ownership. The realization of tax benefits relating to net operation loss carryforwards is limited due to the settlement related to amounts previously due to the IRS discussed in Note 8.

The following is a reconciliation of the amount of tax benefit that would result from applying the federal statutory rate to pretax loss with the benefit from income taxes for the years ended December 31, 2005 and 2004:

	2005	2004
Benefit at statuatory rate (34%)	$(179,421)	$(223,829)
Non-deductible expenses	21,399	38,099
Change in valuation allowance	161,970	207,457
State tax benefit, net of federal tax benefit	(17,416)	(21,727)
Return to provision	13,468	-
Net Benefit from Income Taxes	$ -	$ -

NOTE 13 - STOCKHOLDERS' EQUITY

Common Stock Issuances -- During the year ended December 31, 2005, the Company issued 51,250,000 shares of the Company's restricted common stock for payment of principal and accrued interest on the note to Abacus. (See Note 7.)

During the year ended December 31, 2005, the Company issued 10,000,000 shares of the Company's restricted common stock for payment of accrued rent and accrued interest of $411,402. Because the rent was owed to a related party, no gain or loss on forgiveness of debt was recognized.

During the year ended December 31, 2005, the Company issued 3,000,000 shares of the Company's restricted common stock as partial payment on a note payable for $92,969. (See Note 8.) As of the date of this report, the registration statement had not been declared effective.

On March 31, 2005, the Company acquired a 100% interest in PFE Properties, LLC for 20,000,000 shares of the Company's restricted common stock. (See Note 5)

During the year ended December 31, 2004, the Company issued 542,495 shares and 1,000,000 shares of common stock in 2004 with a fair value of $30,000 and $25,000, respectively, based on the per share fair value of the Company's common stock on the dates of issuance, as part of a settlement agreements for notes payable. (See Note 9)

During the year ended December 31, 2004, the Company settled a legal claim by issuing 1,000,000 shares of common which resulted in a settlement expense of $60,000, which was the fair value of the shares issued based on the per share fair value of the Company's common stock on the date of issuance.

During 2004, the Company issued 45,273,989 shares of the Company's restricted common stock to officers of the Company. The shares were valued at $543,288 based on the fair value of the Company's stock on the date of issuance. The shares were issued as settlement of accrued compensation of $431,770, accrued interest of $5,587, and compensation of $105,931.

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Equity Line of Credit Agreement - On November 5, 2002, the Company entered into an Equity Line of Credit Agreement (the "Equity Line Agreement") with Cornell. The Company subsequently terminated the Equity Line Agreement, and on April 8, 2003, the Company entered into an amended equity line agreement (the "Amended Equity Line Agreement") with Cornell. Under the Amended Equity Line Agreement, the Company had the right to draw up to $5,000,000 from Cornell against an equity line of credit (the "Equity Line"), and to put to Cornell shares of the Company's common stock in lieu of repayment of the draw. The number of shares to be issued was determined by dividing the amount of the draw by the lowest closing bid price of the Company's common stock over the five trading days after the advance notice was tendered. Cornell was required under the Amended Equity Line Agreement to tender the funds requested by the Company within two trading days after the five-trading-day period used to determine the market price. Upon the issuance of the Convertible Debenture, the Amended Equity Line Agreement was terminated.

Standby Equity Distribution Agreement - The Company entered into a Standby Equity Distribution Agreement dated May 21, 2004, with Cornell. Under the Agreement, the Company had the right, at its sole discretion, to draw up to $20 million on the standby equity facility (the "SEDA Facility") and put to Cornell shares of its common stock in lieu of repayment of the draws. The number of shares to be issued in connection with each draw was determined by dividing the amount of the draw by the lowest volume-weighted average price of the Company's common stock during the five consecutive trading days after the advance was sought. The maximum advance amount was $1,000,000 per advance, with a minimum of seven trading days between advances. Cornell was to retain 5% of each advance as a fee under the Agreement. The term of the Agreement was to run over a period of twenty-four months after a registration statement related to the Agreement was declared effective or until the full $20 million had been drawn, whichever came first. The Company had made no draws against the SEDA Facility and issued no shares in connection with the SEDA Facility.

With the issuance of the Convertible Debenture on May 27, 2005, the SEDA Facility and related agreements were terminated. (See Note 12.)

NOTE 14 - STOCK OPTIONS AND WARRANTS

Stock-Based Compensation - The Company accounts for stock options issued to directors, officers and employees under APB No. 25 and related interpretations. Under APB 25, compensation expense is recognized if an option's exercise price on the measurement date is below the fair value of the Company's common stock. For options that provide for cashless exercise or that have been modified, the measurement date is considered the date the options are exercised or expire. Those options are accounted for as variable options with compensation adjusted each period based on the difference between the market value of the common stock and the exercise price of the options at the end of the period. The Company accounts for options and warrants issued to non-employees, including the developers mentioned in Note 7, at their fair value in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

Stock Option Plan - During November 2003, the Company adopted the 2003 Stock Option Plan (the "2003 Plan") with 35,000,000 shares of common stock reserved for issuance there under. Also, during December 2004, the Company adopted the

2004 Stock Option Plan (the "2004 Plan") with 40,000,000 shares of common stock reserved for issuance there under. The Company's Board of Directors administers the plans and has discretion in determining the employees, directors, independent contractors and advisors who receive awards, the type of awards (stock, incentive stock options or non-qualified stock options) granted, and the term, vesting, and exercise prices.

Non-Employee Options - During the year ended December 31, 2005, the Company granted options to purchase 7,000,000 shares of common stock to counsel for the Company with an exercise price of $0.0001 per share. The options were five year options and vested on the date granted. Legal expense of $195,803 was recorded for the fair value of options issued. During 2005, 5,000,000 of these options and 1,500,000 previously issued options were exercised by counsel for proceeds of $650.

During 2004, the Company granted options to purchase 6,500,000 shares of common stock to attorneys for services at exercise prices of $0.0001 per share. The options were all five year options and vested on the dates granted. Legal expense of $209,952 was recorded for the fair value of options issued during 2004. 5,000,000 of these options were exercised in 2004 for cash proceeds of $500. An additional 500,000 of previously issued options were exercised in 2004 for cash proceeds of $50.

Employee Options - During the year ended December 31, 2005, the Company granted options to purchase 19,000,000 shares of common stock to directors and employees of the Company pursuant to the 2004 Plan. These options are five year options that vested on the date of grant. The related exercise prices ranged from $0.022 to $0.027 per share. These options had intrinsic value of $12,000 which was recognized as non-cash compensation expense. A total of 18,500,000 options were exercised during the year ended December 31, 2005, for $33,000 in cash, $135,000 in compensation, $256,500 in accrued compensation, and $23,000 as payment on a shareholder note payable. The $135,000 of compensation was recorded in conjunction with the cashless exercise of 3,000,000 of the options.

During 2004, the Company granted options to purchase 24,000,000 shares of common stock to directors and employees of the Company pursuant to the 2003 and 2004 Plans. These options are five year options that vested on the date of grant. The related exercise prices range from $0.01 to $0.03 per share. Non-cash compensation relating to the grant of these options was recognized for $125,000 during 2004, based upon the intrinsic value of options on the grant date. 14,250,000 of these options were exercised during 2004 for $111,500 of cash, $101,250 of compensation and $61,000 of accrued compensation. The $101,250 of compensation was recorded in conjunction with the cashless exercise of 4,500,000 of the options.

Developer Options - During the year ended December 31, 2005, the Company granted options to purchase 1,500,000 shares of common stock to developers as described in Note 8 at exercise prices of $0.06 per share. The options were all five-year options and vested on the dates granted. Two of the developers were employees and together were issued 1,000,000 of the options. The exercise price equaled the fair value of the common shares at the time these options were granted; therefore, the options had no intrinsic value. The fair value of these options of $42,052 was estimated using the Black-Scholes option pricing model with the following assumptions: risk free interest rate ranging of 4.00%, dividend yield of 0.0%, volatility of 302%, and expected average life of .5 years. None of these options were exercised during the year ended December 31, 2005.

The remaining 500,000 developer options were issued to a non-employee under the terms described above. Because the developer was a non-employee, cost of goods sold of $21,526 was recorded for the fair value of options issued during the year ended December 31, 2005. These options were valued using the Black-Scholes option pricing model with the following assumptions: risk free interest rate ranging of 4.00%, dividend yield of 0.0%, volatility of 302%, and expected average life of .5 years. None of these options were exercised during the year ended December 31, 2005.

A total of 12,750,000 employee options and 4,000,500 non-employee options were outstanding as of December 31, 2005.

A summary of the stock option activity for the years ended December 31, 2004 and 2005, is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2003	3,850,500	$ 0.02
Granted	30,500,000	$ 0.02
Exercised	(19,750,000)	$ 0.01
Cancelled	(350,000)	$ 0.14
Outstanding at December 31, 2004	14,250,500	$ 0.02
Granted	27,500,000	$ 0.02
Exercised	(25,000,000)	$ 0.02
Cancelled	-	$ -
Outstanding at December 31, 2005	16,750,500	$ 0.02
Excercisable at December 31, 2005	16,750,500	$ 0.02

The fair value of stock options was determined at the grant dates using the Black-Scholes option-pricing model with the following weighted-average assumptions for the year ended December 31, 2005 and 2004:

	2005	2004
Expected dividend yield	-	-
Risk free interest rate	4.13%	3.39%
Expected volatility	268%	300%
Expected life	.12 years	.10 years
Weighted average fair value per share	$ 0.02	$ 0.02

A summary of stock option and warrant grants with exercise prices less than, equal to or greater than the estimated market value on the date of grant during the years ended December 31, 2005 and 2004 is as follows:

	Options Granted	Weighted Average Exercise Price	Weighted Average Fair Value of Options
Year Ended - December 31, 2005			
Grants with exercise prices less than the estimated market value of the common stock	13,000,000	$ 0.01	$ 0.02
Grants with exercise prices equal to the estimated market value of the common stock	14,500,000	$ 0.03	$ 0.01
Grants with exercise prices greater than the estimated market value of the common stock	-	$ -	$ -
Year Ended - December 31, 2004			
Grants with exercise prices less than the estimated market value of the common stock	12,750,000	$ 0.01	$ 0.03
Grants with exercise prices equal to the estimated market value of the common stock	17,750,000	$ 0.02	$ 0.01
Grants with exercise prices greater than the estimated market value of the common stock	-	$ -	$ -

A summary of the stock options outstanding and exercisable at December 31, 2005 follows:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$0.0001	3,500,500	4.10	$0.0001	3,500,500	$0.0001
$0.0200 - $0.0300	11,750,000	3.82	$0.0251	11,750,000	$0.0251
$0.0600	1,500,000	0.02	$0.0600	1,500,000	$0.0600

Other Warrants - In connection with the Cornell convertible debenture the company issued 10,000,000 warrants to purchase shares of the Company's common stock. The warrants had an exercise price of $0.09 per share, vested immediately, and have a 3 year life. The registration rights associated with the warrants caused derivative accounting treatment of the debenture and the warrants. The warrants were measured at their fair value using the Black-Scholes pricing model with the following assumptions: risk free interest rate of 4.37%, dividend yield of 0.0%, volatility of 163.31%, and expected average life of 3 years. These warrants were recorded as part of the derivative liability on the balance sheet and will be re-measured at their fair value for every reporting period.

NOTE 15 -SEGMENT INFORMATION

Segment information has been prepared in accordance with SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information." The Company has three reportable segments: electronics assembly, Ethernet technology, and contract manufacturing. The electronics assembly segment manufactures and assembles circuit boards and electronic component cables. The Ethernet technology segment designs and manufactures Ethernet cards. The contract manufacturing segment manufactures, either directly or through foreign subcontractors, certain products under an exclusive manufacturing agreement. The accounting policies of the segments are consistent with those described in the summary of significant accounting policies. The Company evaluates performance of each segment based on earnings or loss from operations. Selected segment information is as follows:

CIRTRAN CORPORATION AND SUBSIDIARIES
NOTES CONSOLIDATED FINANCIAL STATEMENTS

	Electronics Assembly	Ethernet Technology	Contract Manufacturing	Total
December 31, 2005				
Sales to external customers	3,002,038	125,451	9,865,023	$ 12,992,512
Intersegment sales	49,015	-	-	49,015
Segment income (loss)	2,084,254)	(233,394)	1,789,940	(527,708)
Segment assets	5,609,386	183,231	5,109,280	10,901,897
Depreciation and amortization	223,755	1,843	99,357	324,955
December 31, 2004				
Sales to external customers	$ 3,354,057	$ 49,714	$ 5,458,944	$ 8,862,715
Intersegment sales	11,610	167	-	11,777
Segment loss	(375,864)	74,665	(357,123)	(658,322)
Segment assets	3,085,208	208,043	1,000,178	4,293,429
Depreciation and amortization	220,940	2,438	26,017	249,395

	December 31,	
Sales	2005	2004
Total sales for reportable segments	$ 13,041,527	$ 8,874,492
Elimination of intersegment sales	(49,015)	(11,777)
Consolidated net sales	$ 12,992,512	$ 8,862,715

Total Assets	December 31, 2005	2004
Total assets for reportable segments	$ 10,901,897	$ 4,293,429
Adjustment for intersegment amounts	-	-
Consolidated total assets	$ 10,901,897	$ 4,293,429

NOTE 16 - GEOGRAPHIC INFORMATION

All revenue-producing assets are located in the United States of America or China. Revenues are attributed to the geographic areas based on the location of the customers purchasing the products. The Company's net sales and assets by geographic area are as follows:

CIRTRAN CORPORATION AND SUBSIDIARIES
NOTES CONSOLIDATED FINANCIAL STATEMENTS

	Revenues		Revenue-producing assets	
	2005	2004	2005	2004
United States of America	$12,694,817	$ 8,850,775	$ 280,490	$ 454,610
China	-	-	663,420	386,183
Other	297,695	11,940	-	-
	$12,992,512	$ 8,862,715	$ 943,910	$ 840,793

NOTE 17 - SUBSEQUENT EVENTS

Accrued Payroll Tax Liabilities - In January 2006, the Utah State Tax Commission reduced the remaining accrued payroll taxes, penalties and interest due on prior period payroll taxes and were paid the amount of $98,316.

Settlement of Litigation - On January 26, 2006, a settlement was reached related to the leased facilities in Colorado. The Company settled the remaining claim for $200,000 cash. This amount was recorded in full at December 31, 2005 and is included in accrued liabilities.

On February 24, 2006 the Company entered into a settlement agreement with the investment firm discussed in Note 8. The Company issued 4,000,000 shares of restricted stock with a fair value of $0.044 per share. Warrants were also issued to purchase 7,000,000 shares of the Company's common stock with an exercise price of $0.05 cents per share and a life of 5 years. The value of the shares and warrants of $464,186 was accrued in 2005 as an accrued liability.

Convertible Debenture - In January 2006, Highgate converted $750,000 of its convertible debenture into 24,193,548 shares of the Company's common stock at a conversion rate of $0.031 per share, which was the lower of $0.10 or 100% of the lowest closing bid price of the Company's commons stock over the 20 trading days preceding the conversion.

Stock Options - During January 2006, an employee exercised options to purchase 1,000,000 shares of common stock with an exercise price of $0.027 per share. These options were exercised as payment of accrued compensation of $27,000.

On January 27, 2006, counsel for the Company exercised options to purchase 2,000,000 shares of common stock with an exercise price of $0.0001 per share.

During February 2006, an employee exercised options to purchase 1,000,000 shares of common stock with an exercise price of $0.027 per share. These options were exercised as payment of accrued compensation of $27,000.

During March 2006, a director exercised options to purchase 1,000,000 shares of common stock with an exercise price of $0.027 per share. These options were exercised as payment of accrued compensation of $27,000.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The following financial statements of CirTran Corporation and related notes thereto and auditors' report thereon were filed as part of the Company's Form 10-QSB, filed on:

CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	March 31, 2006	December 31, 2005
ASSETS		
Current Assets		
Cash and cash equivalents	$ 443,637	$ 1,427,865
Trade accounts receivable, net of allowance for doubtful accounts of $158,374 and $158,374, respectively	3,019,960	3,358,981
Inventory, Net of reserve of $751,296 and $751,296, respectively	2,203,537	2,271,604
Prepaid Deposits	-	142,188
Other	108,976	252,941
Total Current Assets	5,776,110	7,453,579
Property and Equipment, Net	2,778,692	2,686,737
Investment in Securities, at Cost	300,000	300,000
Other Assets, Net	691,417	361,581
Deposits	129,283	100,000
Total Assets	$ 9,675,502	$ 10,901,897
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable	$ 528,963	$ 1,239,519
Accrued liabilities	551,049	1,222,018
Deferred revenue	33,625	119,945
Derivative liability	3,136,160	4,910,303
Convertible Debenture	-	996,252
Current maturities of long-term notes payable	1,225,785	12,610
Notes payable to stockholders	-	95,806
Total Current Liabilities	5,475,582	8,596,453
Long-Term Notes Payable, Less Current Maturities	1,033,989	1,037,390

Commitments and Contingencies		
Stockholders' Equity (Deficit)		
Common stock, par value $0.001; authorized 750,000,000 shares; issued and outstanding shares: 616,562,117 and 583,368,569 at March 31, 2006 and December 31, 2005, respectively	616,558	583,364
Additional paid-in capital	22,154,684	20,012,000
Accumulated deficit	(19,605,311)	(19,327,310)
Total Stockholders' Equity (Deficit)	3,165,931	1,268,054
Total Liabilities and Stockholders' Equity (Deficit)	$ 9,675,502	$ 10,901,897

The accompanying notes are an integral part of these financial statements.

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CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

For the Three Months Ended March 31,	2006	2005
Net Sales	$ 1,737,824	$ 2,920,465
Cost of Sales	(990,370)	(1,949,773)
Gross Profit	747,454	970,692
Operating Expenses		
Selling, general and administrative expenses	837,520	959,891
Non-cash employee compensation expense	-	69,000
Total Operating Expenses	837,520	1,028,891
Loss From Operations	(90,066)	(58,199)
Other Income (Expense)		
Interest	(1,086,253)	(143,770)
Other, net	-	241
Gain on forgiveness of debt	4,670	-
Gain on derivative valuation	893,651	-
Total Other Expense, Net	(187,932)	(143,529)
Net Loss	$ (277,998)	$ (201,728)
Basic and diluted loss per common share	$ (0.00)	$ (0.00)

Basic and diluted weighted-average common shares outstanding	558,748,729	488,490,792

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

For the Three Months Ended March 31,	2006	2005
Cash flows from operating activities		
Net loss	$ (277,998)	$ (201,728)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	114,939	73,660
Accretion expense	965,512	-
Provision for doubtful accounts	-	417
Amortization of loan premium to interest expense	-	11,057
Non-cash compensation expense	-	69,000
Loan costs and fees in lieu of interest on notes payable	-	61,500
Options issued to attorneys and consultants for services	-	21,526
Gain on derivative valuation	(893,651)	
Accrued Interest Expense	61,586	-
Changes in assets and liabilities:		
Trade accounts receivable	366,021	(119,299)
Prepaid Deposits	142,188	-
Inventories	68,067	(148,087)
Prepaid expenses and other assets	(255,318)	(1,836)
Accounts payable	(710,556)	(108,800)
Accrued liabilities	(214,368)	(43,111)
Deferred revenue	(86,320)	-
Total adjustments	(441,900)	(183,973)
Net cash used in operating activities	(719,898)	(385,701)
Cash flows from investing activities		
Cash aquired with PFE acquisition	-	39,331
Purchase of property and equipment	(166,730)	(230,771)
Net cash used in investing activities	(166,730)	(191,440)

Cash flows from financing activities		
Proceeds from notes payable to stockholders	-	4,414
Payments on notes payable to stockholders	(95,806)	-
Proceeds from notes payable, net of cash paid for offering costs	-	503,500
Principal payments on notes payable	(1,994)	-
Proceeds from notes payable to related parties	-	95,586
Proceeds from exercise of options and warrants to purchase common stock	-	33,000
Exercise of options issued to attorneys and consultants for services	200	150
Net cash provided by financing activities	(97,600)	636,650
Net increase in cash and cash equivalents	(984,228)	59,509
Cash and cash equivalents at beginning of year	1,427,865	81,101
Cash and cash equivalents at end of period	$ 443,637	$ 140,610

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(CONTINUED)

For the Three Months Ended March 31,	2006	2005
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ 22,765	$ -
Noncash investing and financing activities		
Acquisition of PFE Properties, LLC for stock and assumption of note payable	$ -	$ 1,868,974
Common stock issued for settlement of note payable and accrued interest	-	2,148,913
Deposit applied to purchase of property and equipment	-	100,000
Common stock issued for accrued liabilities	464,187	411,402
Stock options exercised for settlement of accrued interest and accrued compensation	81,000	59,000
Stock options exercised for settlement of notes payable to stockholders	-	23,000
Common stock issued for partial conversion of convertible debenture and derivative liability	1,630,491	-

The accompanying notes are an integral part of these financial statements.

CIRTRAN CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Condensed Financial Statements -- The accompanying unaudited condensed consolidated financial statements include the accounts of CirTran Corporation and its subsidiaries (the "Company"). These financial statements are condensed and, therefore, do not include all disclosures normally required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the Company's annual financial statements included in the Company's Annual Report on Form 10-KSB. In particular, the Company's significant accounting principles were presented as Note 1 to the consolidated financial statements in that Annual Report. In the opinion of management, all adjustments necessary for a fair presentation have been included in the accompanying condensed consolidated financial statements and consist of only normal recurring adjustments. The results of operations presented in the accompanying condensed consolidated financial statements for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2006.

Principles of Consolidation -- The consolidated financial statements include the accounts of CirTran Corporation, and it's wholly owned subsidiaries, Racore Technology Corporation, CirTran-Asia Inc, CirTran Products, Inc., Diverse Media Group Corporation and PFE Properties, LLC. All significant intercompany transactions have been eliminated in consolidation.

Stock-Based Compensation -- Effective January 1, 2006, the Company adopted the provisions of Statement of Accounting Standards No. 123R, Share Based Payment ("FAS 123R") for its one stock-based compensation plan. The Company previously accounted for this plan under the recognition and measurement principles of Accounting Standards No. 25, Accounting for Stock Issued to Employees, ("APB 25") and related interpretations and disclosure requirements established by SFAS No. 123, Accounting for Stock-Based Compensation ("SFAS 123") as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure.

Under APB 25, no compensation expense was recorded in earnings for the Company's stock-based options granted under its compensation plans. The pro forma effects on net income and earnings per share for the options and awards granted under the plans were instead disclosed in a note to the consolidated financial statements. Under SFAS 123R, all stock-based compensation is measured at the grant date, based on the fair value of the option or award, and is recognized as an expense in earnings over the requisite service period, which is typically through the date the options vest.

The Company adopted SFAS 123R using the modified prospective method. Under this method, for all stock-based options and awards, granted prior to January 1, 2006 that remain outstanding as of that date, compensation cost is recognized for the unvested portion over the remaining requisite service period, using the grant-date fair value measured under the original provisions of SFAS 123 for pro forma and disclosure purposes. No such options were outstanding as of January 1, 2006.

The Company utilized the Black-Scholes model for calculating the fair value pro forma disclosures under SFAS 123 and will continue to use this model, which is an acceptable valuation approach under SFAS 123R. The following table summarizes

the Black-Scholes option-pricing model assumptions used to compute the weighted-average fair value of stock options granted during the periods below:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Expected dividend yield	N/A*	-
Risk free interest rate	N/A*	3.76%
Expected volatility	N/A*	282%
Expected life	N/A*	$ 0.16
Weighted average fair value per share	N/A*	$ 0.02

* Not applicable as there were no options granted during the period

No options were granted for the three months ended March 31, 2006 and all previously issued options were fully vested prior to January 1, 2006. Therefore, there were no compensation costs relating to stock-based compensation for the three months ended March 31, 2006, including the effects from adoption of SFAS 123R, which would have previously been presented in a pro forma disclosure, as discussed above.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair-value recognition provisions of SFAS 123 to all of its stock-based compensation awards for periods prior to adoption of SFAS 123R:

Three Months Ended March 31,	2005
Net loss, as reported	$(201,728)

Add: Stock-based employee compensation expense included in net loss	69,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(138,248)
Pro forma net loss	$(270,976)
Basic and diluted loss per common share as reported	$ (0.00)
Basic and diluted loss per common share pro forma	$ (0.00)

Patents -- Legal fees and other direct costs incurred in obtaining patents in the United States and other countries are capitalized. Patents costs are amortized over the estimated useful life of the patent. During the year ended December 31, 2005, the Company capitalized $35,799 in patent related legal costs. Amortization expense was $1,279 during the three months ended March 31, 2006.

The realization of patents and other long-lived assets is evaluated periodically when events or circumstances indicate a possible inability to recover the carrying amount. An impairment loss is recognized for the excess of the carrying amount over the fair value of the asset or the group of assets. Fair value is determined based on expected discounted net future cash flows. The analysis necessarily involves significant management judgment to evaluate the capacity of an asset to perform within projections. As required, an evaluation of impairment was made on the patents as of March 31, 2006. No indicators of impairment were noted.

NOTE 2 - REALIZATION OF ASSETS

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company had net loss of $277,998 for the three months ended March 31, 2006, compared to a net loss of $527,708 for the year ended December 31, 2005. As of March 31, 2006, and December 31, 2005, the Company had an accumulated deficit of $19,605,311 and $19,327,310, respectively, and a total stockholders' equity of $3,165,931 and $1,268,054, respectively. The Company also had a working capital (deficit) of $300,528 and $(1,142,874) as of March 31, 2006, and December 31, 2005, respectively. In addition, the Company used, rather than provided, cash in its operations in the amounts of $719,698 and $1,751,744 for the three months ended March 31, 2006, and the year ended December 31, 2005, respectively. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

In view of the matters described in the preceding paragraphs, recoverability of a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheets is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain or replace present financing, to acquire additional capital from investors, and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

NOTE 3 - RELATED PARTY TRANSACTIONS

Notes Payable to Stockholders -- During December 2005 a stockholder loaned the Company $95,806 which was recorded as a notes payable to stockholders. The proceeds of this loan were used to fund on going operations of the Company. In January 2006, the Company made a payment to the stockholder which repaid the entire balance ($95,806) of the loan.

NOTE 4 - COMMITMENTS AND CONTINGENCIES

Settlement of Litigation -- During January 2002, the Company settled a lawsuit that had alleged a breach of facilities sublease agreement involving facilities located in Colorado. The Company's liability in this action was originally estimated to range up to $2.5 million. The Company had filed a counter suit in the same court for an amount exceeding $500,000 for missing equipment. Effective January 18, 2002, the Company entered into a settlement agreement which required the Company to pay the plaintiff the sum of $250,000. Of this amount, $25,000 was paid upon execution of the settlement, and the balance, together with interest at 8% per annum, was payable by July 18, 2002. As security for payment of the balance, the Company executed and delivered to the plaintiff a Confession of Judgment and also issued 3,000,000 shares of common stock, which were held in escrow and were treated as treasury stock recorded at no cost. The fair value of the 3,000,000 shares was less than the carrying amount of the note payable. Because 75 percent of the balance had not been paid by May 18, 2002, the Company was required to prepare and file with the Securities & Exchange Commission, at its own expense, a registration statement with respect to the escrowed shares.

As of December 31, 2005, the Company was in default of its obligations under the settlement agreement and the total payment due thereunder had not been made. A registration statement with respect to the escrowed shares was not filed and the Company did not replace the escrowed shares with registered, free-trading shares as per the terms of the agreement. The plaintiff filed a Confession of Judgment and proceeded with execution thereon. The shares in escrow were released and issued as partial settlement of $92,969 on the note payable outstanding.

In connection with a separate sublease agreement of these facilities, the Company received a settlement from the sublessee during May 2002, in the amount of $152,500, which was recorded as other income. The Company did not receive cash from this settlement, but certain obligations of the Company were paid directly. $109,125 of the principal balance of the note related to the settlement mentioned above was paid. Also, $7,000 was paid to the Company's legal counsel as a retainer for future services. The remaining $36,375 was paid to the above mentioned plaintiff as a settlement of rent expense.

During September 2002, the plaintiff filed a claim that the $109,125 portion of the payment was to be applied as additional rent expense rather than a principal payment on the note payable. The Company estimated that the probability of the $109,125 being considered additional rent expense was remote and disputed the claim.

On January 26, 2006, a settlement was reached related to the leased facilities in Colorado. The Company settled the remaining claim for $200,000 cash.

During 2003 and 2004, an investment firm filed suits in the U.S. District Court for the District of Utah seeking payment of a commission consisting of common stock valued at 1,750,000 for allegedly introducing the Company to the Equity Line Investor (See Note 10). The case was previously dismissed in a New York court.

On February 24, 2006, the Company entered into a settlement agreement with the investment firm. The Company issued 4,000,000 shares of restricted stock with a fair value of $0.044 per share. Warrants were also issued to purchase 7,000,000 shares of the Company's common stock with an exercise price of $0.05 cents per share and a life of 5 years. The warrants were valued using the Black-Scholes pricing model at $288,186. Total consideration for the settlement was valued at $464,186.

Litigation - Various vendors have notified the Company that they believe they have claims against the Company totaling $18,810. None of these vendors have filed lawsuits in relation to these claims. The Company has accrued for these claims, and they are included in accounts payable.

In addition, various vendors have notified the Company that they believe they have claims against the Company totaling $164,802. The Company has determined the probability of realizing any loss on these claims is remote. The Company has made no accrual for these claims and is currently in the process of negotiating the dismissal of these claims with the various vendors.

Registration Rights - In May 2005, in connection with the Company's issuance of a convertible debenture (discussed below), the Company granted to the debenture holder registration rights, pursuant to which the Company agreed to file, within 120 days of the closing of the purchase of the debenture, a registration statement to register the resale of shares of the Company's common stock issuable upon conversion of the debenture. The company also agreed to use its best efforts to have the registration statement declared effective within 270 days after filing the registration statement. The Company agreed to register the resale of up to 100,000,000 shares, and to keep such registration statement effective until all of the shares issuable upon conversion of the debenture have been sold. The Company filed the registration statement on September 23, 2005. As of March 31, 2006, the registration statement had not been declared effective.

In December 2005, in connection with the Company's issuance of a convertible debenture (discussed below), the Company granted to the debenture holder registration rights, pursuant to which the Company agreed to file, within 120 days of the closing of the purchase of the debenture, a registration statement

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to register the resale of shares of the Company's common stock issuable upon conversion of the debenture. The company also agreed to use its best efforts to have the registration statement declared effective within 270 days after filing the registration statement. The Company agreed to register the resale of up to 32,608,696 shares and 10,000,000 warrants, and to keep such registration statement effective until all of the shares issuable upon conversion of the debenture have been sold.

In connection with the settlement agreement with the investment firm discussed above in this Note, the Company agreed to register the resale by the investment firm of shares issued or issuable to it in connection with the settlement.

Accrued Payroll Tax Liabilities -- The Utah State Tax Commission entered into an agreement to allow the Company to pay the tax liability owing to the State of Utah in equal monthly installments of $4,000. Through December 2005, the Company had made the required payments.

In January 2006, the Utah State Tax Commission reduced the remaining accrued payroll taxes, penalties and interest due on prior period payroll taxes to the amount of $98,316. The balance was paid in full.

Manufacturing Agreement -- On June 10, 2004, the Company entered into an exclusive manufacturing agreement with certain Developers. Under the terms of the agreement, the Company, through its wholly-owned subsidiary CirTran-Asia, has the exclusive right to manufacture certain products developed by the Developers or any of their affiliates. The Developers will continue to provide marketing and consulting services related to the products under the agreement. Should the Developers terminate the agreement early, they must pay the Company $150,000. Revenue is recognized when products are shipped. Title passes to the customer or independent sales representative at the time of shipment.

In connection with this agreement the Company agreed to issue options to purchase 1,500,000 shares common stock to the Developers upon the sale, shipment and payment for 200,000 units of a fitness product. In addition, the Company agreed to issue options to purchase 300,000 shares of common stock to the Developers for each multiple of 100,000 units of the fitness product sold in excess of the initial 200,000 units within twenty-four months of the agreement (June 2004). The options will be exercisable at $0.06 per share, vest on the grant date and expire one year after issuance. As of March 31, 2006, the Company had sold, shipped and received payment for, 257,577 units of the fitness product. In January 2005, the Company issued 1,500,000 options under the terms of the agreement. During the three months ended March 31, 2006 the options expired.

In connection with the above manufacturing agreement, the Company agreed to issue various options to purchase shares of common stock to the Developers upon the sale, shipment, and payment of certain quantities of the additional products. In addition, the Company agreed to issue additional options to purchase common stock to the developers for each multiple of units sold in excess of the initial units within the first twenty-four months of the agreements. The schedule of units and potential options that will be issued follows:

Product	Initial Units	Options for Initial Units Sold	Each Multiple of Units above Initial Units	Options for Each Multiple of Units
1	500,000	500,000	200,000	200,000
2	25,000	500,000	15,000	100,000
3	100,000	500,000	50,000	100,000
4	300,000	1,000,000	100,000	200,000
5	200,000	250,000	100,000	100,000
6	200,000	500,000	100,000	100,000

As of March 31, 2006, the Company had not sold, shipped and received payment for enough units to require the issuance of options related to the additional products under these agreements. Because the Developers must provide future services for the options to vest, the options are treated as unissued for accounting purposes. The cost of these options will be recognized when the options are earned.

NOTE 5 - MORTGAGE NOTE PAYABLE

In conjunction with the acquisition of PFE, the Company assumed a mortgage note payable for $1,050,000, which is secured by the land and the building that was acquired as part of the PFE acquisition. The note bears interest at 12.5% per annum and is collateralized by the land and building. Interest only payments were made through January 2006. Starting in February 2006, principal and interest payments were required based on a twenty-year amortization of the note. The entire balance of principal and unpaid interest will be due in December 2008.

NOTE 6 - CONVERTIBLE DEBENTURES

Highgate - On May 26, 2005, the Company entered into an agreement with Highgate to issue to Highgate a $3,750,000, 5% Secured Convertible Debenture (the "Debenture"). The Debenture is due December 2007 and is secured by all of the Company's property.

Accrued interest is payable at the time of maturity or conversion. The Company may, at its option, elect to pay accrued interest in cash or shares of the Company's common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either the date the interest payment is due or the date on which the interest payment is made. The balance of accrued interest owed at March 31, 2006, and December 31, 2005, was $152,349 and $111,986, respectively.

At any time, Highgate may elect to convert principal amounts owing on the Debenture into shares of the Company's common stock at a conversion price equal to the lesser of $0.10 per share, or an amount equal to the lowest closing bid price of the Company's common stock for the twenty trading days immediately preceding the conversion date. The Company has the right to redeem a portion or the entire Debenture then outstanding by paying 105% of the principal amount redeemed plus accrued interest thereon.

Highgate's right to convert principal amounts into shares of the Company's common stock is limited as follows:

(i) Highgate may convert up to $250,000 worth of the principal amount plus accrued interest of the Debenture in any consecutive 30-day period when the market price of the

Company's stock is $0.10 per share or less at the time of conversion;

(ii) Highgate may convert up to $500,000 worth of the principal amount plus accrued interest of the Debenture in any consecutive 30-day period when the price of the Company's stock is greater than $0.10 per share at the time of conversion; provided, however, that Highgate may convert in excess of the foregoing amounts if the Company and Highgate mutually agree; and

(iii) Upon the occurrence of an event of default, Highgate may, in its sole discretion, accelerate full repayment of all debentures outstanding and accrued interest thereon or may convert the Debentures and accrued interest thereon into shares of the Company's common stock.

Except in the event of default, Highgate may not convert the Debenture for a number of shares that would result in Highgate owning more than 4.99% of the Company's outstanding common stock.

In connection with the issuance of the Highgate Debenture, the Company granted Highgate registration rights related to the issuance of the debenture. (See Note 4.)

The Company determined that the features of the Debenture fell under derivative accounting treatment. As of March 31, 2006 the carrying value of the Debenture was $1,068,604. The carrying value will be accreted each quarter over the life of the Debenture until the carrying value equals the unconverted face value of $3,000,000 (see below). The fair value of the derivative liability as of March 31, 2006 was $1,767,254.

In connection with the issuance of the Debenture, $2,265,000 of the proceeds were paid to Cornell to repay promissory notes. Fees of $256,433 were withheld from the proceeds, were capitalized, and are being amortized over the life of the note. As such, of the total Debenture of $3,750,000, the net proceeds to the Company were $1,228,567. The proceeds were used for general corporate and working capital purposes, at the Company's discretion.

In January 2006, Highgate converted $750,000 of its convertible debenture into 24,193,548 shares of the Company's common stock at a conversion rate of $0.031 per share, which was the lower of $0.10 or 100% of the lowest closing bid price of the Company's commons stock over the 20 trading days preceding the conversion.

Cornell - On December 30, 2005, the Company entered into an agreement with Cornell Capital Partners, L.P. ("Cornell") to issue to Cornell a $1,500,000, 5% Secured Convertible Debenture (the "Cornell Debenture"). The Cornell Debenture is due July 30, 2008, and is secured by all the Company's property, junior to the Highgate security interest.

Accrued interest is payable at the time of maturity or conversion. The Company may, at its option, elect to pay accrued interest in cash or shares of the Company's common stock. If paid in stock, the conversion price shall be the closing bid price of the common stock on either the date the interest payment is due or the date on which the interest payment is made. The balance of accrued interest owed at March 31, 2006 and December 31, 2005 was $18,082 and zero, respectively.

At any time, Cornell may elect to convert principal amounts owing on the Cornell Debenture into shares of the Company's common stock at a conversion price equal to an amount equal to the lowest closing bid price of the Company's common stock for the twenty trading days immediately preceding the conversion date. The Company has the right to redeem a portion or the entire Cornell Debenture then

outstanding by paying 105% of the principal amount redeemed plus accrued interest thereon.

Cornell's right to convert principal amounts into shares of the Company's common stock is limited as follows:

(i) Cornell may convert up to $250,000 worth of the principal amount plus accrued interest of the Cornell Debenture in any consecutive 30-day period when the market price of the Company's stock is $0.10 per share or less at the time of conversion;

(ii) Cornell may convert up to $500,000 worth of the principal amount plus accrued interest of the Cornell Debenture in any consecutive 30-day period when the price of the Company's stock is greater than $0.10 per share at the time of conversion; provided, however, that Cornell may convert in excess of the foregoing amounts if the Company and Cornell mutually agree; and

(iii) Upon the occurrence of an event of default, Cornell Capital Partners, LP may, in its sole discretion, accelerate full repayment of the debenture outstanding and accrued interest thereon or may convert the Debenture and accrued interest thereon into shares of the Company's common stock.

Except in the event of default, Cornell may not convert the Cornell Debenture for a number of shares that would result in Cornell owning more than 4.99% of the Company's outstanding common stock.

The Cornell Debenture was issued with 10,000,000 warrants with an exercise price of $0.09 per share that vest immediately and have a three year life.

In connection with the issuance of the Cornell Debenture, the Company granted Cornell registration rights related to the issuance of the Cornell Debenture and warrants. (See Note 4.)

The Company determined that the features on the Cornell Debenture and the associated warrants fell under derivative accounting treatment. As of March 31, 2006 the carrying value of the Cornell Debenture was $143,160. The carrying value will be accreted each quarter over the life of the Cornell Debenture until the carrying value equals the face value of $1,500,000. The fair value of the derivative liability as of March 31, 2006 was $1,368,906.

In connection with the issuance of the Cornell Debenture, fees of $130,000 were withheld from the proceeds, capitalized, and will be amortized over the life of the Cornell Debenture. As such, of the total Cornell Debenture of $1,500,000, the net proceeds to the Company were $1,370,000. The proceeds will be used for general corporate and working capital purposes, at the Company's discretion.

As of March 31, 2006, Cornell had not converted any of the Cornell Debenture into shares of the Company's common stock.

NOTE 7 - STOCKHOLDERS' EQUITY

Common Stock Issuances -- During the three months ended March 31, 2006, the Company issued 4,000,000 shares of common stock as a settlement of litigation with an investment firm. (See Note 4.)

During the three months ended March 31, 2006, the Company issued to Highgate 24,193,548 shares of restricted common stock in connection with a conversion by Highgate of $750,000 principal amount of the convertible debenture. (See Note 6.)

NOTE 8 - STOCK OPTIONS AND WARRANTS

Non-Employee Options - During the three months ended March 31, 2006, 2,000,000 of previously issued options were exercised by counsel for proceeds of $200.

Employee Options - During the three month period ended March 31, 2006, 3,000,000 options were exercised for accrued compensation and employee advances of $54,000 and $27,000 respectively.

Developer Options - During 2005, the Company granted options to purchase 1,500,000 shares of common stock to developers at exercise prices of $0.06 per share. The options were all one-year options and vested on the dates granted. Two of the developers were employees and together were issued 1,000,000 of the options. The exercise price equaled the fair value of the common shares at the time these options were granted; therefore, the options had no intrinsic value. The fair value of these options of $42,052 was estimated using the Black-Scholes option pricing model with the following assumptions: risk free interest rate ranging of 4.00%, dividend yield of 0.0%, volatility of 302%, and expected average life of .5 years. These options expired during the three months ended March 31, 2006.

The remaining 500,000 developer options were issued to a non-employee under the terms described above. Because the developer was a non-employee, cost of goods sold of $21,526 was recorded for the fair value of options issued during the year ended December 31, 2005. These options were valued using the Black-Scholes option pricing model with the following assumptions: risk free interest rate ranging of 4.00%, dividend yield of 0.0%, volatility of 302%, and expected average life of .5 years. None of these options were exercised during 2005. These options expired during the three months ended March 31, 2006.

A summary of the stock option activity for the three months ended March 31, 2006, is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2005	16,750,500	$ 0.02
Granted	-	$ -
Exercised	(5,000,000)	$ 0.02
Cancelled	(1,500,000)	$ 0.06
Outstanding at March 31, 2006	10,250,500	$ 0.03
Excercisable at March 31, 2006	10,250,500	$ 0.03

NOTE 9 -SEGMENT INFORMATION

Segment information has been prepared in accordance with SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information." The Company has three reportable segments: electronics assembly, Ethernet technology, and contract manufacturing. The electronics assembly segment manufactures and assembles circuit boards and electronic component cables. The Ethernet technology segment designs and manufactures Ethernet cards. The contract manufacturing segment manufactures, either directly or through foreign subcontractors, certain products under an exclusive manufacturing agreement. The accounting policies of the segments are consistent with those described in the summary of significant accounting policies. The Company evaluates performance of

each segment based on earnings or loss from operations. Selected segment information is as follows:

	Electronics Assembly	Ethernet Technology	Contract Manufacturing	Total
March 31, 2006				
Sales to external customers	$ 774,359	$ 22,226	$ 941,239	$ 1,737,824
Intersegment sales	-	-	-	-
Segment income (loss)	(30,057)	(58,108)	(189,833)	(277,998)
Segment assets	4,529,176	192,756	4,953,570	9,675,502
Depreciation and amortization	82,912	210	31,817	114,939
March 31, 2005				
Sales to external customers	$ 773,013	$ 22,608	$ 2,124,844	$ 2,920,465
Intersegment sales	-	-	-	-
Segment loss	(372,197)	(66,739)	237,208	(201,728)
Segment assets	4,591,074	216,838	1,800,585	6,608,497
Depreciation and amortization	50,399	594	22,667	73,660

	March 31,	
Sales	2006	2005
Total sales for reportable segments	$1,737,824	$2,920,465
Elimination of intersegment sales	-	-
Consolidated net sales	$1,737,824	$2,920,465

	March 31,	
Total Assets	2006	2005
Total assets for reportable segments	$9,675,502	$6,608,497
Adjustment for intersegment amounts	-	-
Consolidated total assets	$9,675,502	$6,608,497

NOTE 10 - SUBSEQUENT EVENTS

Stock Options - During April 2006, counsel for the Company exercised options to purchase 1,500,000 shares of common stock with an exercise price of $0.0001 per share.

During May 2006, an employee was granted options to purchase 1,500,000 shares of the Company's common stock. These options were five year options that vested immediately and had an exercise price of $0.03 per share. The options were immediately exercised in lieu of amounts owed in connection with the PFE Acquisition.

During May 2006, an employee exercised options to purchase 1,000,000 shares of common stock with an exercise price of $0.027 per share. These options were exercised as payment of accrued bonus expense of $27,000.

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Dealer Prospectus Delivery Obligation. Until November 8, 2006, all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

CirTran Corporation

100,000,000
SHARES

COMMON STOCK

PROSPECTUS

August 11, 2006

Research and product development	(38,994)	(2.0)	(104,881)	(3.0)	(298,199)	(46,034)	(3.9)
Sales and marketing	(110,071)	(5.6)	(434,191)	(12.3)	(1,154,155)	(178,171)	(15.1)
General and administrative	(69,679)	(3.6)	(166,988)	(4.7)	(385,442)	(59,502)	(5.0)
Other operating income	1,689	0.1	6,902	0.2	12,175	1,879	0.1
Loss from operations	(97,033)	(5.0)	(473,020)	(13.4)	(1,455,036)	(224,620)	(19.1)
Other income/(expenses):							
Interest income	16,163	0.8	31,284	0.9	76,516	11,812	1.0
Foreign exchange gains/(losses)/, net	1,286	0.1	(5,334)	(0.2)	(83,118)	(12,831)	(1.1)
Other loss, net	(48)	(0.0)	(788)	(0.0)	(1,336)	(205)	(0.0)
Loss before income tax expense	(79,632)	(4.1)	(447,858)	(12.7)	(1,462,974)	(225,844)	(19.2)
Income tax benefit	—	—	—	—	589	91	0.0
Net loss	(79,632)	(4.1)%	(447,858)	(12.7)%	(1,462,385)	(225,753)	(19.2)%

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Revenues. Total revenues increased by 116.1% from RMB3,554.7 million in 2014 to RMB7,680.8 million (US$1,185.7 million) in 2015. This increase was primarily due to an increase in our revenues from both organized tours and self-guided tours.

- *Revenues from organized tours.* Revenues from organized tours, substantially all of which are recognized on a gross basis, increased by 114.4% from RMB3,432.8 million in 2014 to RMB7,358.9 million (US$1,136.0 million) in 2015, primarily due to the growth in the number of trips of our organized tours. This was a result of the rapid growth in demand for travel to certain international destinations, such as Europe, Southeast Asia, Japan, and North America, and for domestic tours. During the same period, the number of trips of our organized tours (excluding local tours) increased by 129.4% from 711,847 to 1,632,955 and the number of trips of our local tours increased by 58.4% from 1,074,335 to 1,701,821.

- *Revenues from self-guided tours.* Revenues from self-guided tours, which are recognized on a net basis, increased by 108.5% from RMB93.1 million in 2014 to RMB194.2 million (US$30.0 million) in 2015. The increase in revenues from self-guided tours generally reflected the growth in travel to domestic destinations, certain islands and Japan. The number of trips for our self-guided tours increased by 181.6% from 395,652 in 2014 to 1,114,277 in 2015.

- *Other revenues.* Other revenues increased by 344.2% from RMB28.8 million in the 2014 to RMB127.7 million (US$19.7 million) in 2015, primarily due to a rise in service fees received from insurance companies, revenues from tourist attraction tickets and other travel-related products, which are recognized on a net basis.

Net Revenues. Net revenues increased by 116.3% from RMB3,534.9 million in 2014 to RMB7,645.3 million (US$1,180.2 million) in 2015, as a result of our increased total revenues, partially offset by the resulting increase in business and related taxes over the same periods.

Cost of Revenues. Cost of revenues increased by 119.9% from RMB3,308.8 million in 2014 to RMB7,274.7 million (US$1,123.0 million) in 2015, primarily due to the increase in the cost to suppliers of our organized tours. Cost to suppliers of our organized tours increased mainly as a result of the increase in the sales of our organized tours (excluding local tours) from 711,847 trips in 2014 to 1,632,955 trips in 2015 and the sales of our local tours from 1,074,335 trips in 2014 to 1,701,821 trips in 2015. As a percentage of our net revenues, our cost of revenues was 93.6% in 2014 compared to 95.2% in 2015.

Operating Expenses. Operating expenses increased by 161.1% from RMB699.2 million in 2014 to RMB1,825.6 million (US281.8 million) in 2015, due to increases in sales and marketing expenses, research and product development expenses and general and administrative expenses, partially offset by the increase in our other operating income.

- *Research and product development.* Research and product development expenses increased by 184.3% from RMB104.9 million in 2014 to RMB298.2 million (US$46.0 million) in 2015, primarily due to investments for the implementation of additional product categories and initiatives, the increase in direct procurement related personnel at regional service centers, improvement of online technology, and the rise in technology and product development personnel related expenses.

- *Sales and marketing.* Sales and marketing expenses increased by 165.8% from RMB434.2 million in 2014 to RMB1,154.2 million (US$178.2 million) in 2015. The increase was primarily attributable to branding and advertising campaigns, advertisements for our mobile business development, and amortization of acquired intangible assets from our investment in resources on JD.com, Inc. in 2015.

- *General and administrative.* General and administrative expenses increased by 130.8% from RMB167.0 million in 2014 to RMB385.4 million (US$59.5 million) in 2015, primarily due to an increase in the headcount of our administrative personnel as a result of our business expansion, such as regional service center expansion and product category expansion, and an increase in the professional service fees associated with being a public company.

- *Other operating income.* Other operating income increased from RMB6.9 million in 2014 to RMB12.2 million (US$1.9 million) in 2015.

Net Loss. As a result of the foregoing, net loss increased from RMB447.9 million in 2014 to RMB1,462.4 million (US$225.8 million) in 2015.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

Revenues. Total revenues increased by 81.1% from RMB1,962.5 million in 2013 to RMB3,554.7 million in 2014. This increase was primarily due to an increase in our revenues from both organized tours and self-guided tours.

- *Revenues from organized tours*. Revenues from organized tours, substantially all of which are recognized on a gross basis, increased by 81.4% from RMB1,892.8 million in 2013 to RMB3,432.8 million in 2014, primarily due to the growth in the number of trips of our organized tours. This was a result of the rapid growth in demand for travel to certain international destinations, such as Europe, North America, South Korea and Japan, and for domestic tours. During the same period, the number of trips of our organized tours (excluding local tours) increased by 93.9% from 367,104 to 711,847 and the number of trips of our local tours increased by 56.4% from 687,121 to 1,074,335.

- *Revenues from self-guided tours*. Revenues from self-guided tours, which are recognized on a net basis, increased by 90.4% from RMB48.9 million in 2013 to RMB93.1 million in 2014. The increase in revenues from self-guided tours generally reflected an increase in the number of trips for self-guided tours due to the growth in domestic travel, demand for cruise line products and travel to certain popular international destinations such as Maldives. The number of trips for our self-guided tours increased by 78.7% from 221,412 in 2013 to 395,652 in 2014.

- *Other revenues*. Other revenues increased by 38.6% from RMB20.7 million in the 2013 to RMB28.8 million in 2014, primarily due to the increase in service fees we received from insurance companies that sell travel insurance products through our online platform, commissions from sales of tickets for tourist attractions and the advertising fees we received from tourism boards and bureaus.

Net Revenues. Net revenues increased by 81.3% from RMB1,949.7 million in 2013 to RMB3,534.9 million in 2014, as a result of our increased total revenues, partially offset by the resulting increase in business and related taxes over the same periods.

Cost of Revenues. Cost of revenues increased by 80.8% from RMB1,829.7 million in 2013 to RMB3,308.8 million in 2014, primarily due to the increase in the cost to suppliers of our organized tours. Cost to suppliers of our organized tours increased mainly as a result of the increase in the sales of our organized tours (excluding local tours) from 367,104 trips in 2013 to 711,847 trips in 2014 and the sales of our local tours from 687,121 trips in 2013 to 1,074,335 trips in 2014. As a percentage of our net revenues, our cost of revenues was 93.8% in 2013 compared to 93.6% in 2014.

Operating Expenses. Operating expenses increased by 222.1% from RMB217.1 million in 2013 to RMB699.2 million in 2014, due to increases in sales and marketing expenses, research and product development expenses and general and administrative expenses, partially offset by the increase in our other operating income.

- *Research and product development*. Research and product development expenses increased by 169.0% from RMB39.0 million in 2013 to RMB104.9 million in 2014, primarily attributable to investments in new product offerings and mobile related initiatives, and the rise in technology expenses and personnel expenses for product development.

- *Sales and marketing*. Sales and marketing expenses increased by 294.5% from RMB110.1 million in 2013 to RMB434.2 million in 2014. The increase was primarily attributable to an increase in marketing and promotional expenses, primarily brand-promotion campaigns and advertisements.

- *General and administrative*. General and administrative expenses increased by 139.7% from RMB69.7 million in 2013 to RMB167.0 million in 2014, primarily attributable to the increases in the headcount of, and higher average compensation paid to, our general and administrative personnel as a result of our business expansion and an increase in the professional service fees associated with being a public company.

- *Other operating income*. Other operating income increased from RMB1.7 million in 2013 to RMB6.9 million in 2014.

Net Loss. As a result of the foregoing, net loss increased from RMB79.6 million in 2013 to RMB447.9 million in 2014.

Inflation

Since our inception, inflation in China has not had a material adverse impact on our results of operations. According to the National Bureau of Statistics of China, the year-over-year percent changes in the consumer price index for December 2013, 2014 and 2015 were increases of 2.5%, 1.5% and 1.6%, respectively. Although we have not been materially affected by inflation in the past, we may be materially affected if China experiences higher rates of inflation in the future. For example, certain operating costs and expenses, such as employee compensation and office operating expenses may increase as a result of higher inflation. Additionally, because a substantial portion of our assets consist of cash and cash equivalents and short-term investments, high inflation could significantly reduce the value and purchasing power of these assets. We are not able to hedge our exposure to higher inflation in China.

Foreign Currency

The average exchange rate between U.S. dollar and Renminbi has declined from RMB8.2264 per U.S. dollar in July 2005 to RMB6.4778 per U.S. dollar as of December 31, 2015. As of December 31, 2015, we recorded RMB188.1 million (US$29.0 million) of net foreign currency translation gain in accumulated other comprehensive income as a component of shareholders' equity. We have not hedged exposures to exchange fluctuations using any hedging instruments. See also "Item 3.D. Key Information—Risk Factors—Fluctuations in exchange rates could have a material adverse effect on our results of operations and the value of your investment" and "Item 11. Quantitative and Qualitative Disclosures about Market Risk—Foreign Exchange Risk."

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with U.S. GAAP. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities, revenues and expenses, as well as related disclosure of contingent assets and liabilities. To the extent that there are material differences between these estimates and actual results, our financial condition or operating results and margins would be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss further below.

Business combination

U.S. GAAP requires that all business combinations not involving entities or businesses under common control be accounted for under the purchase method. We have adopted ASC 805 “Business Combinations”, and the cost of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred and equity instruments issued. The transaction costs directly attributable to the acquisition are expensed as incurred. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any noncontrolling interests. The excess of the (i) the total of cost of acquisition, fair value of the noncontrolling interests and acquisition date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of operations and comprehensive income.

The determination and allocation of fair values to the identifiable assets acquired and liabilities assumed is based on various assumptions and valuation methodologies requiring considerable management judgment. The most significant variables in these valuations are discount rates, the number of years on which to base the cash flow projections, as well as the assumptions and estimates used to forecast the future cash inflows and outflows. Management determines discount rates to be used based on the risk inherent in the related activity's current business model and industry comparisons. Terminal values are based on the expected life of products and forecasted life cycle and forecasted cash flows over that period. Although management believes that the assumptions applied in the determination are reasonable based on information available at the date of acquisition, actual results may differ from the forecasted amounts and the difference could be material.

A noncontrolling interest is recognized to reflect the portion of a subsidiary's equity which is not attributable, directly or indirectly, to the Company. Consolidated net income on the consolidated statements of operations and comprehensive income includes the net income (loss) attributable to noncontrolling interests when applicable. The cumulative results of operations attributable to noncontrolling interests are also recorded as noncontrolling interests in our consolidated balance sheets. Cash flows related to transactions with noncontrolling interests are presented under financing activities in the consolidated statements of cash flows when applicable.

Intangible assets

Intangible assets purchased are recognized and measured at cost upon acquisition and intangible assets arising from acquisitions of subsidiaries are recognized and measured at fair value upon acquisition. Our intangible assets are amortized on a straight-line basis over their estimated useful lives, ranging from 3 to 20 years. The estimated life of intangible assets subject to amortization is reassessed if circumstances occur that indicate the life has changed. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. No impairment of intangible assets was recognized for the years ended December 31, 2013, 2014 and 2015.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable assets and liabilities acquired in business combinations. Goodwill is not amortized, but tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

We adopted Accounting Standards Update ("ASU") 2011-08, Intangibles—Goodwill and Other (Topic 350). This accounting standard gives us an option to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, goodwill is then tested following a two-step process. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying amount of a reporting unit's goodwill. The fair value of each reporting unit is determined by us using the expected present value of future cash flows. The key assumptions used in the calculation include the long-term growth rates of revenue and gross margin, working-capital requirements and discount rates. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination, with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Our management performs its annual goodwill impairment test on October 1.

No impairment loss was recognized for the year ended December 31, 2015.

Revenue Recognition

We generate revenues primarily from selling packaged tours and travel-related services. Our main product and service offerings include (i) organized tours, (ii) self-guided tours and (iii) other travel-related services. Organized tours offer pre-arranged itineraries, transportation, accommodations, entertainment, meals and tour guide services and customers pay one lump-sum fee in exchange for such a package. Self-guided tours consist of a combination of flights and hotel bookings or cruise trips, which are often offered to customers at a more favorable price as compared to customers purchasing these travel-related products and services on a stand-alone basis. Other travel-related services primarily include sales of tourist attraction tickets, visa processing services and advertising services that we provide to domestic and foreign tourism boards and bureaus.

Revenues are recognized in accordance with ASC 605, “Revenue Recognition,” when the following criteria are met: persuasive evidence of an arrangement exists, the sales price is fixed or determinable, delivery has occurred or service has been provided and collectability is reasonably assured.

Organized tours

Substantially all of our revenues from organized tours are recognized on gross basis, which represent amounts charged to and received from customers, as we are the primary obligor in the arrangement and bear the risks and rewards, including the customers’ acceptance of products and services delivered. While we do not generally assume the inventory risk of purchasing travel services before customers place an order, we assess the facts and circumstances and conclude that we are the principal in organized tour arrangements. Factors that support our conclusion mainly include the following:

- We are the primary obligor in the arrangement as we are responsible for the ultimate customer acceptance for all products and services rendered. Such commitment is also made in the contracts we enter into with our customers. We are the party retained by and paid by our customers. In situations of customer disputes, where the customer files a complaint or demands a refund, we assume risks and responsibilities for the delivery of organized tours and we, rather than the travel suppliers, are responsible for (and solely authorized to grant) refunding the customers their payments.

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We independently determine the prices charged to customers for organized tours, as well as the prices paid to travel suppliers and subcontractors.

- We conduct a rigorous process in qualifying our travel suppliers and selecting travel products and services at our discretion before selling these products to our customers, and participate in the design of organized tours.

Revenues from organized tours are recognized when customers return from the tour as delivery is only considered completed upon conclusion of the entire organized tour.

Self-guided tours

Revenues from self-guided tours are recognized on a net basis, representing the difference between the amount the customer pays us, and the amount we pay our travel suppliers. We generally do not assume inventory risk and have limited involvement in determining the product or service specifications in the self-guided tour arrangements. Customers purchase self-guided tours based on the desired products specified, and we provide limited additional services to customers. Suppliers are responsible for all aspects of providing the air transportation and hotel accommodation. Therefore, we are an agent for the travel suppliers in the self-guided tour transactions and revenues from self-guided tours are reported on net basis. Revenues from self-guided tours are recognized when the tours end, as commissions are not earned until this time according to the contractual arrangements entered into with travel suppliers.

Other revenues

Our other revenues primarily comprise revenues generated from (i) service fees received from insurance companies, (ii) other travel-related services, such as sales of tourist attraction tickets and visa processing services, which are recognized on a net basis, (iii) fees for advertising services that we provide primarily to domestic and foreign tourism boards and bureaus, (iv) commission fees for hotel reservation and air-ticketing, and (v) service fees for financial services. Revenue is recognized when the services are rendered or when the tickets are issued.

We do not recognize revenue if customer refunds are warranted due to customer satisfaction issues or other reasons, which is generally known at the end of each tour when revenues are recognized. In the event of tour cancellation by customers, the liability associated with prepayments received from customers remains on our consolidated balance sheets until refunds are issued.

We commenced our financial services in 2015. Certain domestic financial assets exchanges, or the Exchanges, and trust companies offered the yield enhancement products through our online platform and we charged these companies for the commission fees which were recorded as other revenue upon the delivery of service. For the year ended December 31, 2015, the commission revenue was immaterial. In addition, we purchased the yield enhancement products with maturities ranging from three months to two years from the Exchanges and trust companies and split all of the products into new yield enhancement products with lower yield rate and shorter maturities within one year, which were offered to the individual investors through our online platform. The interest revenue was recorded as other revenue and the relevant interest cost was recorded as cost of revenue.

Customer incentives

We have a customer loyalty program that offers customers coupons, travel vouchers, membership points or cash rewards. We account for these customer incentives in accordance with ASC 605-50, *"Customer Payments and Incentives."* For coupons and travel vouchers offered where prior purchase is not required, we account for them as a reduction of revenues when revenues are recognized. We also assess coupons and vouchers offered to customers as part of a current purchase that give customers a right but not an obligation to make future purchases, and concluded that the discounts offered are insignificant; as such, no deferral of revenues are considered necessary.

For membership points earned by customers which provide travel awards upon point redemption, we use the incremental cost method to estimate our future obligation to our customers, and record the incremental costs as sales and marketing expenses in the consolidated statements of comprehensive loss. Unredeemed membership points are recorded in other current liabilities in the consolidated balance sheets. Cash rewards earned by customers are recorded as a reduction to revenues, with corresponding unclaimed amount recorded in other current liabilities. We estimate liabilities under the customer loyalty program based on accumulated membership points and cash rewards, and the estimate of probability of redemption in accordance with the historical redemption pattern. The actual expenditure may differ from the estimated liability recorded. Prior to April 2015, we recorded estimated liabilities for all points earned by customers as we did not have sufficient historical information to determine point forfeitures or breakage. We, with accumulated knowledge on membership points and cash rewards redemption and expiration, began to apply historical redemption rates in estimating the costs of points earned from May 2015 onwards.

Research and Product Development

Research and product development expenses include salaries and other compensation-related expenses for our research and product development personnel, as well as office rental, depreciation and other related expenses for our research and product development function. We recognize software development costs in accordance with ASC 350-40 "*Software—internal use software.*" We expense all costs that are incurred in connection with the planning and implementation phases of development, and costs that are associated with repair or maintenance of the existing websites or software for internal use. Certain costs associated with developing internal use software are capitalized when such costs are incurred within the application development stage of software development.

Income Taxes

Current income taxes are provided on the basis of net income for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes, in accordance with the regulations of the relevant tax jurisdictions. Deferred income taxes are provided using the liability method. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. The effect on deferred taxes of a change in tax rates is recognized in the statement of comprehensive loss in the period of change. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of the deferred tax assets will not be realized.

The guidance prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Guidance also provides for derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. We recognize interest and penalties, if any, under accrued expenses and other current liabilities on our balance sheet and under other expenses in our statement of comprehensive loss. As of December 31, 2014 and 2015, we did not have any significant unrecognized uncertain tax positions or any interest or penalties associated with tax positions.

In order to assess uncertain tax positions, we apply a more likely than not threshold and a two-step approach for the tax position measurement and financial statement recognition. Under the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement.

Share-based Compensation

We account for share options granted to employees in accordance with ASC 718, *"Stock Compensation."* The 2014 Share Incentive Plan, or the 2014 Plan, allows the plan administrator to grant options, restricted shares and restricted share units. The 2008 Plan allows the plan administrator to grant options and restricted shares to our employees, directors, and consultants. The plan administrator under both plans is our board of directors or a committee appointed and determined by the board. The board may also authorize one or more of our officers to grant awards under the plan. In accordance with the guidance, we determine whether a stock-based award should be classified and accounted for as a liability award or equity award. Under the 2008 Plan and the 2014 Plan, we only granted options to employees and directors, and such stock-based compensation is considered to be equity classified awards, and is recognized in the financial statements based on their grant date fair values which are calculated using the binomial option pricing model. Share-based compensation expense is recorded net of an estimated forfeiture rate at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Share-based compensation expense is recorded net of estimated forfeitures such that expenses are recorded only for those share-based awards that are expected to ultimately vest.

Under the 2008 Plan and the 2014 Plan, options granted to employees vest upon satisfaction of a service condition, which is generally satisfied over four years. Additionally, the 2008 Plan includes an exercisability clause where employees can only exercise vested options upon the occurrence of the following events: (i) after our ordinary shares become listed securities, (ii) in connection with or after a triggering event (defined as a sale, transfer, or disposition of all or substantially all of our assets, or a merger, consolidation, or other business combination transaction), or (iii) if the optionee obtains all necessary governmental approvals and consents required. Options for which the service condition has been satisfied are forfeited should employment terminate three months prior to the occurrence of an exercisable event, which substantially creates a performance condition. Therefore, since the adoption of the 2008 Plan through the date of the completion of our initial public offering, we did not recognize any stock-based compensation expense for options granted, because an exercisable event as described above did not occur. The satisfaction of the performance condition became probable upon completion of our initial public offering, and we recorded a significant cumulative expense for share-based awards granted for which the service condition has been satisfied as of that date. Accordingly, we recognized a significant share-based compensation expense of RMB39.2 million in 2014. In 2015, we recognized a share-based compensation expense of RMB65.1 million (US$10.1 million). The estimates we used to determine the fair value of these options in computing our share-based compensation expense are determined on the respective grant dates, and will not change when the underlying shares begin trading because our options are equity classified awards.

The following table sets forth the options granted under the 2008 Plan and the 2014 Plan in 2013, 2014 and 2015:

		Exercise Price		Fair Value of Option as of the Grant Date		Fair Value of the Underlying Ordinary Shares as of the Grant Date		Intrinsic Value as of the Grant Date		
	Number of Options Granted	US$	**RMB(2)**	US$	**RMB(2)**	US$	**RMB(2)**	US$	**RMB(2)**	Type of Valuation
January 7, 2013	2,177,133	0.90	5.45	0.44	2.66	0.91	5.51	0.01	0.06	Retrospective
March 23, 2013	5,000	1.14	6.90	0.44	2.66	0.91	5.51	N/A	N/A	Retrospective
April 18, 2013	45,000	1.14	6.90	0.44	2.66	0.91	5.51	N/A	N/A	Retrospective
June 3, 2013	20,000	1.14	6.90	0.44	2.66	0.91	5.51	N/A	N/A	Retrospective
June 28, 2013	20,000	1.14	6.90	0.44	2.66	0.91	5.51	N/A	N/A	Retrospective
July 1, 2013	20,000	1.14	6.90	0.44	2.66	0.91	5.51	N/A	N/A	Retrospective
August 1, 2013	3,809,985	0.0001	0.001	1.20	7.26	1.20	7.26	1.20	7.26	Retrospective
August 15, 2013	378,192	1.79	10.84	0.44	2.66	1.20	7.26	N/A	N/A	Retrospective
October 30, 2013(1)	500,000	1.14	6.90	1.07	6.48	1.82	11.02	0.68	4.12	Contemporaneous
October 30, 2013(1)	190,000	1.14	6.90	0.98	5.93	1.82	11.02	0.68	4.12	Contemporaneous
November 30, 2013(1)	10,000	2.00	12.11	0.93	5.63	1.98	11.99	N/A	N/A	Contemporaneous
November 30, 2013(1)	270,000	2.00	12.11	0.79	4.78	1.98	11.99	N/A	N/A	Contemporaneous
April 1, 2014(1)(3)	150,000	5.00	31.02	1.23	7.64	3.33	20.66	N/A	N/A	Contemporaneous
April 1, 2014(1)(3)	426,000	5.00	31.02	0.93	5.78	3.33	20.66	N/A	N/A	Contemporaneous
June 13, 2014	2,700,000	3.00	18.61	3.73	23.14	5.61	34.79	2.61	16.19	Contemporaneous
August 15, 2014(1)	800,000	3.00	18.61	4.89	30.34	6.98	43.31	3.98	24.69	Contemporaneous
August 15, 2014(1)	1,575,000	3.00	18.61	4.60	28.54	6.98	43.31	3.98	24.69	Contemporaneous
December 8, 2014(1)(4)	60,000	3.59	22.27	2.04	12.66	3.59	22.27	—	—	Contemporaneous
December 8, 2014(1)(4)	766,000	3.59	22.27	1.58	9.80	3.59	22.27	—	—	Contemporaneous
March 6. 2015(1)(4)	2,428,200	4.21	27.27	2.39	15.48	4.21	27.27	—	—	Contemporaneous
March 6. 2015(1)(4)	2,027,800	4.21	27.27	2.14	13.86	4.21	27.27	—	—	Contemporaneous
August 20, 2015(1) (4)	7,743,000	5.02	32.54	2.46	15.94	4.54	29.43	N/A	N/A	Contemporaneous
August 20, 2015(1) (4)	1,350,000	5.02	32.54	2.25	14.58	4.54	29.43	N/A	N/A	Contemporaneous
November 25, 2015 (4)	820,000	5.17	33.47	2.74	17.75	5.26	34.07	0.09	0.58	Contemporaneous

(1) Options granted to officers and non-officer employees result in different fair value on the same grant date.

(2) The translations from U.S. dollars to Renminbi were made at a rate of RMB6.0537 to US$1.00, the exchange rate in effect as of December 31, 2013 for option granted before December 31, 2013, a rate of RMB6.2046 to US$1.00,

the exchange rate in effect as of December 31, 2014 for the options granted before December 31, 2014, and a rate of RMB6.4778 to US$1.00, the exchange rate in effect as of December 31, 2015 for the options granted after January 1, 2015, solely for the convenience of the readers.

(3) We modified the exercise price from $5.00 to $3.00 on May 15, 2014.

(4) We modified these exercise prices to US$3.09 on March 4, 2016.

Significant Factors, Assumptions, and Methodologies Used in Determining Fair Value of Options

We estimated the fair value of share options using the binomial option-pricing model with the assistance from an independent valuation firm before the completion of our initial public offering on May 9, 2014. As part of our valuation process for share-based awards granted in 2012, 2013 and April 2014, we have also taken into consideration the transaction value of independent third parties' private equity investments in us that are closest to the respective valuation dates. Our management is ultimately responsible for all assumptions and valuation methodologies used in such determination. The fair value of each option grant is estimated on the date of grant with the following assumptions:

- *Expected volatility*. We estimated expected volatility based on the annualized standard deviation of the daily return embedded in historical share prices of comparable companies with a time horizon close to the expected expiry of the term.

- *Risk-free interest rate (per annum)*. We estimated risk-free interest rate based on the yield to maturity of US Treasury Bonds with a maturity similar to the expected expiry of the term.

- *Exercise multiple*. The exercise multiple is estimated as the ratio of fair value of underlying shares over the exercise price at the time the option is exercised, based on a consideration of empirical studies on the actual exercise behavior of employees.

- *Expected dividend yield*. We have never declared or paid any cash dividends on our capital stock, and we do not anticipate any dividend payments on our ordinary shares in the foreseeable future.

- *Expected term (in years)*. Expected term is the contract life of the option.

- *Expected forfeiture rate (post-vesting)*. Estimated based on historical employee turnover rate after each option grant.

Changes in the estimates used to determine the fair value of awards

After the completion of our initial public offering, in addition to the significant estimates and assumptions disclosed above, we take the following factors into consideration, which affect the estimates we use to determine the fair value of awards on their respective grant dates:

- *Expected volatility*. We determine if there is sufficient history for us to calculate volatility using trading prices of our own ADSs. Additionally, we may update the list of comparable companies from time to time.

- *Risk-free interest rate (per annum)*. We update this estimate each time a new stock award is granted.

- *Exercise multiple*. The exercise multiple is estimated based on a consideration of empirical studies on the actual exercise behavior of employees of comparable companies as we currently do not have a sufficiently long history of employee exercise patterns. Based on our employees' exercise behavior and pattern, we continue to update this estimate when stock awards are granted.

- *Expected dividend yield*. This estimate remained unchanged since our initial public offering and is unlikely to change in the foreseeable future, as we do not anticipate any dividend payments on our ordinary shares in the foreseeable future.

- *Expected term (in years)*. This estimate did not change upon completion of our initial public offering.

- *Expected forfeiture rate (post-vesting)*. We update this estimate each time a new stock award is granted based on the turnover rate of our employees.

- *Fair value of our ordinary shares*. The fair value of our ordinary shares on the grant date is determined based on the trading price of our ADSs on such date, as opposed to applying the income approach valuation method.

Significant Factors, Assumptions, and Methodologies Used in Determining Fair Value of Ordinary Shares before the completion of our initial public offering on May 9, 2014

As part of our valuation of share-based awards granted before the completion of our initial public offering, determining the fair value of our ordinary shares required us to make complex and subjective judgments, assumptions and estimates, which involved inherent uncertainty. Had our management used different assumptions and estimates, the resulting fair value of our ordinary shares and the resulting share-based compensation expenses could have been different.

In determining the grant date fair value of our ordinary shares for purposes of recording share-based compensation in connection with employee stock options for share-based awards granted before the completion of our initial public offering, we, with the assistance of independent appraisers, performed retrospective valuations instead of contemporaneous valuations because, at the time of the valuation dates, our financial and limited human resources were principally focused on business development efforts. This approach is consistent with the guidance prescribed by the AICPA Audit and Accounting Practice Aid, Valuation of Privately-Held-Company Equity Securities Issued as Compensation, or the Practice Aid. Specifically, the “Level B” recommendation in paragraph 16 of the Practice Aid sets forth the preferred types of valuation that should be used.

For all share-based awards granted before the completion of our initial public offering, we, with the assistance of an independent valuation firm, evaluated the use of three generally accepted valuation approaches: market, cost and income approaches to estimate our enterprise value. We and our appraisers considered the market and cost approaches as inappropriate for valuing our ordinary shares because no exactly comparable market transaction could be found for the market valuation approach and the cost approach does not directly incorporate information about the economic benefits contributed by our business operations. Consequently, we and our appraisers relied solely on the income approach in determining the fair value of our ordinary shares. This method eliminates the discrepancy in the time value of money by using a discount rate to reflect all business risks including intrinsic and extrinsic uncertainties in relation to our company.

The income approach involves applying discounted cash flow analysis based on our projected cash flow using management’s best estimate as of the valuation dates. Estimating future cash flow requires us to analyze projected revenue growth, gross margins, operating expense levels, effective tax rates, capital expenditures, working capital requirements, and discount rates. Our projected revenues were based on expected annual growth rates derived from a combination of our historical experience and the general trend in online leisure travel market. The revenue and cost assumptions we used are consistent with our long-term business plan and market conditions in the online leisure travel market. We also have to make complex and subjective judgments regarding our unique business risks, our limited operating history, and future prospects at the time of grant. Other assumptions we used in deriving the fair value of our equity include:

- no material changes will occur in the applicable future periods in the existing political, legal, fiscal or economic conditions in China;
- no material changes will occur in the current taxation law in China and the applicable tax rates will remain consistent;
- we have the ability to retain competent management and key personnel to support our ongoing operations; and
- industry trends and market conditions for the online leisure travel market will not deviate significantly from current forecasts.

The option-pricing method was used to allocate equity value of our company to preferred and ordinary shares, taking into account the guidance prescribed by the Practice Aid. This method involves making estimates of the anticipated timing of a potential liquidity event, such as a sale of our company or an initial public offering, and estimates of the volatility of our equity securities. The anticipated timing is based on the plans of our board and management.

The other major assumptions used in calculating the fair value of ordinary shares include:

- *Weighted average cost of capital, or WACC*. Our cash flows were discounted to present value using discount rates that reflect the risks the management perceived as being associated with achieving the forecasts and are based on the estimate of our weighted average cost of capital, or WACC, on the grant date. The WACCs were determined considering the risk-free rate, industry-average correlated relative volatility coefficient, or beta, equity risk premium, country risk premium, size of our company, scale of our business and our ability in achieving forecast projections. WACCs of 25%, 23%, 22% and 22%, were used for dates as of January 7, 2013, August 1, 2013, October 30, 2013 and November 30, 2013, respectively.

- *Comparable companies*. In deriving the WACCs, which are used as the discount rates under the income approach, six to eight publicly traded companies in the U.S. (varied by valuation time points), two publicly traded companies in Australia, and one publicly traded company in China online travel industry were selected for reference as our guideline companies.

- *Discount for lack of marketability, or DLOM*. At the time of above grants, we were a closely-held company and there was no public market for our equity securities. To determine the discount for lack of marketability, we and the independent appraisers used the Finnerty's average-strike put option model. Pursuant to that model, we used the cost of a put option, which can be used to hedge the price change before a privately held share can be sold, as the basis to determine the discount for lack of marketability. A put option was used because it incorporates certain company-specific factors, including timing of the expected initial public offering and the volatility of the share price of the guideline companies engaged in the same industry. Based on the analysis, DLOM of 16%, 13%, 11% and 11% were used for the valuation of our ordinary shares as of January 7, 2013, August 1, 2013, October 30, 2013 and November 30, 2013, respectively.

Significant Factors Contributing to the Difference in Fair Value Determined

The determined fair value of our ordinary shares increased from US$0.91 (RMB5.51) per share as of December 16, 2012 to US$1.20 (RMB7.26) per share as of August 1, 2013. We believe the increase in the fair value of our ordinary shares was primarily attributable to the following factors:

- continued adoption and increased penetration of online leisure travel and the consistent strong growth seen in the overall industry;

- improvement of our financial and operating performance in 2013 which was primarily attributable to increased economies of scale, greater bargaining power with travel suppliers, and hence improved gross margin in 2013; and

- management's adjustment of our financial forecasts to reflect the anticipated higher revenue growth rate and long-term profitability in the future due to the abovementioned developments.

The determined fair value of our ordinary shares increased from US$1.20 (RMB7.26) per share as of August 1, 2013 to US$1.82 (RMB11.02) per share as of October 30, 2013 and further to US$1.98 (RMB11.99) per share as of November 30, 2013. We believe the increase in the fair value of our ordinary shares was primarily attributable to the following factors:

- the improvement of our financial and operating performance in 2013, which was primarily attributable to increased economies of scale, including greater pricing power with travel suppliers;

- the issuance of Series D convertible preferred shares in August 2013, which provided us with additional capital for our business expansion;

- management’s adjustment of our financial forecast to reflect the anticipated higher revenue growth rate and better financial performance in the future due to the abovementioned developments; and

- the commencement of our initial public offering preparation process in November 2013 and the completion of our initial public offering in 2014, resulting in a decrease in the expected time period leading to a liquidity event. As we progressed towards our initial public offering, the lead time to an expected liquidity event decreased, resulting in a decrease in the DLOM.

The determined fair value of our ordinary shares increased from US$1.98 (RMB11.99) per share as of November 30, 2013 to US$3.33 (RMB20.18) per share, the mid-point of the estimated price range identified on the front cover of our preliminary prospectus for our initial public offering dated April 28, 2014. We believe the increase in the fair value of our ordinary shares was primarily attributable to the following factors:

- the improvement of our financial and operating performance in the first quarter of 2014, which was primarily attributable to increased economies of scale, including greater bargaining power with travel suppliers and increased customer base;

- the short-term negative impact resulted from the promulgation of the Tourism Law in October 2013 has been fading, and we saw a steady and sustainable increase in the number of customers purchasing the more expensive organized tours in the first quarter of 2014, which resulted in higher average gross booking per trip; and we confidentially submitted the registration statement relating to our initial public offering to the SEC in the first quarter of 2014 and completed our initial public offering in May 2014, resulting in a decrease in the expected time period leading to a liquidity event. As we progressed towards our initial public offering, the lead time to an expected liquidity event decreased, resulting in a decrease in the DLOM.

Recent Accounting Pronouncements

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern” (“ASU 2014-15”)., which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date of issuance of the entity’s financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is “substantial doubt about the entity’s ability to continue as a going concern.” ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter; early adoption is permitted. We are in the process of evaluating the impact of adopting this guidance.

In January 2015, the FASB issued ASU No. 2015-01, “Income Statement—Extraordinary and Unusual Items” (“ASU 2015-01”) to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under ASU 2015-01, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. ASU 2015-01 is effective for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. This guidance will not have material impact on our financial position, results of operations or cash flows.

In February 2015, the FASB issued ASU No. 2015-02, “Consolidation (Topic 810): Amendments to the Consolidation Analysis” (“ASU 2015-02”). ASU 2015-02 focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. ASU 2015-02 simplifies consolidation accounting by reducing the number of consolidation models from four to two. In addition, the new standard simplifies the FASB Accounting Standards Codification and improves current guidance by: (i) placing more emphasis on risk of loss when determining a controlling financial interest; (ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a VIE; and (iii) changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. ASU 2015-02 is effective for annual and interim periods beginning after December 15, 2015, and early adoption is permitted, including adoption in an interim period. We are in the process of evaluating the impact of adopting this guidance.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2015-14”): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. Therefore, the effective date of ASU No, 2014-09 for public business entities is for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. We are in the process of evaluating the impact of adopting this guidance.

In September 2015, the FASB issued ASU No. 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments” (“ASU 2015-16”). This ASU requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Prior to the issuance of ASU 2015-16, entities were required to retrospectively apply adjustments made to provisional amounts recognized in a business combination. ASU 2015-16 is effective for annual and interim periods beginning after December 15, 2015, and early adoption is permitted. We have early adopted ASU 2015-16 in 2015.

In November 2015, the FASB issued ASU No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes”(“ASU 2015-17”), which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheet. ASU 2015-17 is effective for annual and interim periods beginning after December 15, 2016 and early adoption is permitted. We early adopted the new standard on a retrospective basis as of December 31, 2015. The early adoption has no impact on the consolidated financial statements as there was a fully valuation allowance on the deferred tax assets.

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments - Overall (Subtopic 825-10): “Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”) which amends the guidance in U.S.

GAAP on the classification and measurement of financial instruments. Although the ASU retains many current requirements, it significantly revises an entity's accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. ASU 2016-01 also amends certain disclosure requirements associated with the fair value of financial instruments. ASU 2016-01 is effective for annual and interim periods beginning after December 15, 2017. We are in the process of evaluating the impact of adopting this guidance.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)"("ASU 2016-02"), which requires lessees to recognize assets and liabilities for all leases with lease terms of more than 12 months on the balance sheet. Under the new guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted on a modified retrospective basis. We are in the process of evaluating the impact of adopting this guidance.

B. Liquidity and Capital Resources

Our primary sources of liquidity have been proceeds from operating activities, private issuances of ordinary and preferred shares, and our initial public offering.

Prior to the completion of our initial public offering in May 2014, we financed our operations primarily through cash generated from our operating activities, private issuances and sales of preferred shares. In May 2014, we completed our initial public offering in which we issued and sold 8,580,000 ADSs representing 25,740,000 Class A ordinary shares. Concurrently with our initial public offering, we issued and sold 5,000,000, 5,000,000 and 1,666,666 Class A ordinary shares to each of DCM Hybrid RMB Fund, L.P., Ctrip Investment Holding Ltd. and Qihoo 360 Technology Co. Ltd., respectively. As a result of our initial public offering and such concurrent private placements, we raised an aggregate of approximately US$106.3 million (RMB659.5 million) in proceeds, net of underwriting commissions.

In December 2014 we entered into a share subscription agreement with Unicorn Riches Limited, JD.com E-commerce (Investment) Hong Kong Corporation Limited, Ctrip Investment Holding Ltd. and the respective personal holding companies of Tuniu's chief executive officer and chief operating officer, pursuant to which we sold a total of 36,812,868 newly issued class A ordinary shares. As a result of this sale, we raised an aggregate of approximately US$148.0 million (RMB918.3 million) in proceeds.

In May 2015, we entered into share subscription agreements with each of Fabulous Jade Global Limited, a subsidiary of JD.com, Inc., Unicorn Riches Limited, a special purpose vehicle of Hony Capital, DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P., both affiliates of DCM V, L.P., Ctrip Investment Holding Ltd., a subsidiary of Ctrip.com International, Ltd., Esta Investments Pte Ltd, an affiliate of Temasek Holdings and Sequoia Capital 2010 CV Holdco, Ltd, an affiliate of Sequoia Capital, pursuant to which we sold a total of 93,750,000 newly issued Class A ordinary shares. As a result of this sale, we raised an aggregate of approximately US$400.0 million in proceeds and JD.com, Inc.'s business resources.

In November 2015, we entered into a strategic partnership with HNA Tourism, as part of which an affiliate of HNA Tourism purchased 90,909,091 newly issued Class A ordinary shares from us for an aggregate of approximately US$500 million in January 2016.

Generally, our customers pay us upon contract confirmation, which is usually more than one month before the departure dates, and we pay our travel suppliers at a later date, such as at the end of each month. The timing difference between when the cash is collected from our customers and when payments are made to our travel suppliers increases our operating cash inflow and provides us with a source of liquidity to fund our settlement of outstanding accounts payable to travel suppliers and our prepayment to our travel suppliers to secure organized tours and self-guided tours during peak seasons.

In connection with the increase in the sales of our travel products and services, advances from customer increased from RMB396.7 million as of December 31, 2013 to RMB638.8 million as of December 31, 2014 and further to RMB1,223.3 million (US$188.8 million) as of December 31, 2015. In addition, primarily due to timing differences between when cash is collected from our customers and when payments are made to our travel suppliers and the expansion of our business, accounts payable increased from RMB289.0 million as of December 31, 2013 to RMB382.7 million as of December 31, 2014 and further to RMB767.3 million (US$118.5 million) as of December 31, 2015. Furthermore, primarily due to the increase in our prepayment to travel suppliers as a result of our business expansion, prepayments and other current assets increased from RMB286.6 million as of December 31, 2013 to RMB575.3 million as of December 31, 2014 and further to RMB1,699.5 million (US$262.4 million) as of December 31, 2015. Moreover, due to investments in branding and advertising campaigns, advertisements for our mobile business development, expansion of our VIP customer service center and amortization of acquired intangible asset in 2015, our sales and marketing expenses increased from RMB110.1 million in 2013, to RMB434.2 million in 2014 and further to RMB1,154.2 million (US$178.2 million) in 2015. As a result, our net cash provided by operating activities was RMB116.7 million in 2013 and our net cash used in operating activities was RMB271.1 million and RMB514.7 million (US$79.5 million) in 2014 and 2015, respectively.

Our principal uses of cash for the years ended December 31, 2013, 2014 and 2015 were for operating activities, primarily marketing and brand promotion expenses, salaries and other compensation expenses as well as office rental and professional service fees. Our cash and cash equivalents consist of cash on hand and cash in bank, including demand bank deposits. Our short-term investments comprise financial products issued by banks or other financial institutions. As of December 31, 2013, 2014 and 2015, we had RMB755.7 million, RMB1,970.3 million and RMB3,666.6 million (US$566.0 million) in cash and cash equivalents, restricted cash and short-term investments, respectively. We did not have any short-term or long-term bank borrowings outstanding as of December 31, 2015.

In November 2014, we entered into framework cooperation agreements with four PRC-based banks under which the banks intend to make available loan facilities up to an aggregate of RMB4.0 billion with terms ranging from two to five years to us or our suppliers. The actual borrowings under the framework agreements are subject to execution of definitive agreements and final approvals by the respective banks. In the definitive financing agreements executed among banks, our suppliers and us pursuant to the framework agreements, we did not provide guarantee for our suppliers' borrowings nor bear the banks' credit risks.

We believe that our current cash and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs, including our cash needs for at least the next 12 months. We may require additional cash due to unanticipated business conditions or other future developments. If our existing cash is insufficient to meet our requirements, we may seek to sell additional equity securities, debt securities or secure debt funding from financial institutions.

The following table sets forth a summary of our cash flows for the periods presented:

	For the Year Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$
	(in thousands, except percentages)			
Net cash provided by/(used in) operating activities	116,736	(271,102)	(514,735)	(79,462)
Net cash used in investing activities	(304,218)	(227,923)	(1,915,168)	(295,651)
Net cash provided by financing activities	306,360	1,540,397	3,005,838	464,022
Effect of exchange rate changes on cash and cash equivalents	1,287	(3,053)	67,560	10,429
Net increase in cash and cash equivalents	120,165	1,038,319	643,495	99,338
Cash and cash equivalents at beginning of the period	299,238	419,403	1,457,722	225,034
Cash and cash equivalents at the end of the period	419,403	1,457,722	2,101,217	324,372

Operating Activities

Our net cash used in operating activities was RMB514.7 million (US$79.5 million) in 2015, primarily attributable to cash inflows from sales of our travel products and services of RMB12,468.0 million (US$1,924.7 million) and cash inflows from other operating activities such as deposits, interest income and government subsidies of RMB715.2 million (US$110.4 million), that were offset by cash outflows due to payments to our travel suppliers of RMB11,948.4 million (US$1,844.5 million), payments relating to other operating activities, which include payments for marketing and promotional activities, office rental and utilities and professional services, of RMB1,022.4 million (US$157.8 million), payments to employees and for employees' benefits of RMB691.0 million (US$106.7 million) and payments of taxes and levies of RMB36.1 million (US$5.6 million).

Our net cash used in operating activities was RMB271.1 million in 2014, primarily attributable to cash inflows from sales of our travel products and services of RMB5,289.1 million and cash inflows from interest income and government subsidies of RMB35.1 million, that were offset by cash outflows due to payments to our travel suppliers of RMB4,796.3 million, payments relating to other operating activities, which include payments for marketing and promotional activities, office rental and utilities and professional services, of RMB524.3 million, payments to employees and for employees' benefits of RMB257.4 million and payments of taxes and levies of RMB17.2 million.

Our net cash provided by operating activities was RMB116.7 million in 2013, primarily attributable to cash inflows from sales of our travel products and services of RMB3,199.2 million and cash inflows from interest income and government subsidies of RMB13.0 million, partially offset by cash outflows due to payments to our travel suppliers of RMB2,842.0 million , payments relating to other operating activities, which include payments for marketing and promotional activities, office rental and utilities and professional services, of RMB130.6 million, payments to employees and for employees' benefits of RMB110.8 million and payments of taxes and levies of RMB12.1 million.

Investing Activities

Our net cash used in investing activities was RMB1,915.2 million (US$295.7 million) in 2015, primarily attributable to the purchase of short-term investments of RMB1,139.7 million (US$175.9 million), the purchase of financial products of RMB718.6 million (US$110.9 million), the business acquisition of RMB60.1 million (US$9.3 million), the purchase of property and equipment and intangible assets of RMB155.5 million (US$24.0 million) and the increase in our balance of restricted cash of RMB294.4 million (US$45.4 million), partially offset by the proceeds from the maturity of short-term investments of RMB442.1 million (US$68.3 million) and the proceeds from maturity of financial products of RMB10.8 million (US$1.7 million).

Our net cash used in investing activities was RMB227.9 million in 2014, primarily attributable to the purchase of short-term investments of RMB547.6 million, the purchase of property and equipment and intangible assets of RMB50.6 million and the increase in our balance of restricted cash of RMB34.8 million, offset by the proceeds from the disposal of short-term investments of RMB405.0 million.

Our net cash used in investing activities was RMB304.2 million in 2013, primarily attributable to the purchase of short-term investments of RMB451.8 million and the purchase of property and equipment and intangible assets of RMB4.8 million, offset by the proceeds from the disposal of short-term investments of RMB154.8 million.

Financing Activities

Our net cash provided by financing activities in 2015 was RMB3,005.8 million (US$464.0 million) net proceeds from our private placement (net of issuance cost of RMB2,430.2 million (US$375.2 million)), funds of RMB579.5million (US$89.4 million) collected from the purchases of financial products by individual investors on our website, RMB12.6 million (US$1.9 million) proceeds from employees exercising stock options, partially offset by repayment of short-term borrowing of RMB15.0 million (US$2.3 million) and the acquisition of the remaining non-controlling interest of a subsidiary of RMB1.5 million (US$0.2 million).

Our net cash provided by financing activities in 2014 was RMB1,540.4 million, attributable to the net proceeds of our initial public offering and the concurrent private placements as well as the private placement in December 2014.

Our net cash provided by financing activities in 2013 was RMB306.4 million, attributable to the net proceeds from issuance of Series D preferred shares.

Capital Expenditures

Cash outflow in connection with capital expenditures amounted to RMB4.8 million, RMB50.6 million and RMB155.5 million (US$24.0 million) in 2013, 2014 and 2015, respectively. Our capital expenditures were primarily used to purchase equipment and intangible assets for our business. As of December 31, 2015, capital commitments relating to leasehold improvement and installation of equipment were approximately RMB0.2 million (US$29,625).

Holding Company Structure

We are a holding company with no material operations of our own. We conduct our operations primarily through our wholly owned subsidiaries and consolidated affiliated entities in China. As a result, our ability to pay dividends to our shareholders depends upon dividends paid by our PRC subsidiaries. If our PRC subsidiaries or any newly formed PRC subsidiaries incur debt on their own behalf in the future, the instruments governing their debt may restrict their ability to pay dividends to us. In addition, our PRC subsidiaries are permitted to pay dividends to us only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. Under PRC law, each of our subsidiaries and our consolidated affiliated entities in China is required to set aside at least 10% of its after-tax profits each year, if any, to fund certain statutory reserve funds until such reserve funds reach 50% of its registered capital. In addition, each of our subsidiaries and consolidated affiliated entities in China may allocate a portion of its after-tax profits based on PRC accounting standards to staff welfare and bonus funds at its discretion. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends. As our PRC subsidiaries and consolidated affiliated entities have incurred losses, they have not started to contribute to the staff welfare and bonus funds. Our PRC subsidiaries have never paid dividends and will not be able to pay dividends until they generate accumulated profits and meet the requirements for statutory reserve funds.

C. Research and Development

We have built our technology infrastructure with high levels of performance, reliability, scalability and security. We rely on internally developed proprietary technologies and licensed technologies to manage and improve our website, mobile platform and management systems. We have a team of over 1,000 engineers dedicated to research and development in the areas of website operations, mobile platform, search engine, data analytics and supply chain management system.

Research and product development expenses primarily comprise salaries and other compensation expenses for our research and product development personnel as well as office rental, depreciation and other expenses related to our research and product development function. Research and product development expenses also include expenses that are incurred in connection with the planning and implementation phases of development and costs that are associated with the maintenance of our online platform or software for internal use. In 2013, 2014 and 2015 our research and product development expenses accounted for 2.0%, 3.0% and 3.9% of our net revenues, respectively. During the same period, our research and product development expenses increased in order to support our business expansion, primarily attributable to investments for the implementation of additional product categories such as Internet finance, accommodation reservation and transportation ticketing, the increase in direct procurement-related personnel at regional service centers, improvement of online technology, and the rise in technology and product development personnel-related expenses. We expect research and product development expenses to increase in absolute amounts as the results of our continual research and product development efforts and the increase in share-based compensation expenses.

D. Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the year ended December 31, 2015 that are reasonably likely to have a material and adverse effect on our net revenues, income, profitability, liquidity or capital resources, or that would cause the disclosed financial information to be not necessarily indicative of future results of operations or financial conditions.

E. Off-Balance Sheet Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any off-balance sheet derivative instruments. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

F. Contractual Obligations

The following table sets forth our contractual obligations by specified categories as of December 31, 2015.

	Payment Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(In RMB thousands)				
Operating Lease Obligations[(1)]	215,032	53,393	80,029	53,102	28,508
Purchase Obligations[(2)]	192	192	—	—	—
Total	215,224	53,585	80,029	53,102	28,508

(1) Operating lease obligations represent our obligations for the leased premises of our headquarters and regional service centers.

(2) Purchase obligations consist primarily of contractual commitments in connection with leasehold improvements and the installation of equipment for our headquarters and regional service centers.

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Other than the contractual obligations set forth above, we do not have any contractual obligations that are long-term debt obligations, capital (finance) lease obligations, purchase obligations or other long-term liabilities reflected on our balance sheet.

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

The following table sets forth information regarding our executive officers and directors as of the date of this annual report:

Directors and Executive Officers	**Age**	**Position/Title**
Dunde Yu	35	Co-founder, chairman and chief executive officer
Haifeng Yan	34	Co-founder, director, president and chief operating officer
Tie Li	39	Director
Jie Zhu	35	Director
Haoyu Shen	45	Director
Cindy Chen	40	Director
Frank Lin	51	Director
Steve Yue Ji	43	Director
James Jianzhang Liang	46	Director
Onward Choi	45	Director
Jack Xu	48	Director
Conor Chia-hung Yang	53	Chief financial officer
Zhengrong Tang	46	Chief technology officer
Enjie Wu	44	Vice president of human resources center

Mr. Dunde Yu is our co-founder and has served as chairman of our board of directors and chief executive officer since our inception. Prior to founding our company, Mr. Yu was the chief technology officer of *ci123.com* in 2006, where he helped *ci123.com* become a leading Chinese childcare website. From 2004 to 2006, Mr. Yu served as the technical director of *Bokee.com*. Mr. Yu received a bachelor’s degree in mathematics from Southeast University in China in 2003.

Mr. Haifeng Yan is our co-founder, president and chief operation officer and has served as our director since our inception. Prior to founding our company, Mr. Yan was one of the founding members and the chief operating officer of *ci123.com*, from 2005 to 2006, where he was responsible for daily operations and helped *ci123.com* become a leading Chinese childcare website. Mr. Yan served as an analyst of iTech Holdings Limited in 2004.

Mr. Tie Li has served as our director since February 2016. Mr. Li currently serves as vice chairman and chief executive officer of HNA Tourism Group. Mr. Li joined HNA Group in 2002 and has headed various business divisions of HNA Group since then, serving as financial director, president and vice chairman of HNA Aviation Group and chief investment officer of HNA Tourism Group, before being promoted to vice chairman and chief executive officer in November 2015. Mr. Li has extensive experience in the fields of investment, finance and legal matters in connection with the travel and tourism industry. Mr. Li holds a bachelor's degree from Anhui University.

Mr. Jie Zhu has served as our director since February 2016. Mr. Zhu currently serves as a member of the board of directors and chief innovation officer of HNA Tourism Group. After joining HNA Group in 2011, Mr. Zhu headed the investment and securities business divisions of HNA Tourism Group and its subsidiary Beijing Tourism Investment Fund. Mr. Zhu holds an MBA from Glendon-York University.

Mr. Haoyu Shen has served as our director since May 2015. Mr. Shen currently serves as the chief executive officer of JD Mall, the B2C business group of JD.com, Inc. Prior to assuming his current role in April 2014, Mr. Shen served as the chief operating officer of JD.com, Inc. from August 2011 to April 2014, and was in charge of JD.com, Inc.'s entire supply chain management and customer service functions. Prior to joining JD.com, Inc., Mr. Shen worked at Baidu, Inc., the leading Chinese language internet search provider, where he served as a senior vice president from January 2010 to July 2011 and the vice president of business operations from July 2007 to July 2010. Mr. Shen holds a bachelor's degree in international finance from Renmin University of China in Beijing and an MBA degree from the University of Iowa. Mr. Shen is a CFA charter holder.

Ms. Cindy Chen has served as our director since May 2015. Ms. Chen is a managing director at Hony Capital specializing in the Internet, high-end manufacturing and new energy sectors. Ms. Chen has a deep understanding of the commercial environment and enterprise management in China. Prior to assuming her role at Hony Capital, Ms. Chen held key finance roles with the Lenovo Group. Ms. Chen holds a bachelor's degree in economics from Beijing Institute of Petrochemical Technology and an EMBA degree from China Europe International Business School.

Mr. Frank Lin has served as our director since December 2009. Mr. Lin is a general partner of DCM, a technology venture capital firm. Prior to joining DCM in 2006, Mr. Lin was chief operating officer of Sina Corporation, a Nasdaq-listed company. Mr. Lin co-founded *sina.com's* precursor company, SinaNet, in 1995 and later guided the company through its listing on Nasdaq. Prior to founding SinaNet, Mr. Lin was a consultant at Ernst & Young Management Consulting Group. Mr. Lin had also held various marketing, engineering and managerial positions at Octel Communication Inc. and NYNEX. Mr. Lin currently serves on the board of directors of numerous companies invested by DCM, including Vipshop Holdings Limited, a NYSE-listed company, and 58.com Inc., a NYSE-listed company. Mr. Lin received a bachelor's degree in engineering from Dartmouth College and a master's degree in business administration from Stanford University.

Mr. Steve Yue Ji has served as our director since March 2011. Mr. Ji is a partner of Sequoia Capital China. Prior to joining Sequoia Capital in 2005, Mr. Ji worked at Walden International, Vertex Management and CIV Venture Capital, where he contributed to investments in numerous wireless, Internet and semiconductor companies in China. Prior to that, Mr. Ji worked for Seagate Technology China, a Nasdaq-listed company, among the first group of its employees in 1995. Mr. Ji has been an independent director of Country Style Cooking Restaurant Chain Co., Ltd., a NYSE-listed company, since 2010. Mr. Ji received a master's degree in business administration from China Europe International Business School in 1999 and a bachelor's degree in engineering from Nanjing University of Aeronautics and Astronautics in Nanjing, China in 1995.

Mr. James Jianzhang Liang has served as our director since July 2014. Mr. Liang is the chairman and Chief Executive Officer of Ctrip.com International, Ltd., a leading travel service provider for hotel accommodation reservation, transportation ticketing, packaged tours and corporate travel management in China. Prior to co-founding Ctrip in 1999, Mr. Liang held a number of technical and managerial positions at Oracle Corporation from 1991 to 1999 in the U.S. and China, including head of the ERP Consulting Division of Oracle China from 1997 to 1999. Mr. Liang currently serves on the boards of Home Inns, 51job.com and eHi Car Services Limited. Mr. Liang received a Ph.D. in Economics from Stanford University in 2011 and a Master's in Computer Science from the Georgia Institute of Technology.

Mr. Onward Choi has served as our independent director since May 2014. Mr. Choi has been the acting chief financial officer of NetEase Inc., or NetEase, a Nasdaq-listed company, since July 2007. He previously served as NetEase's financial controller from January 2005 to June 2007 and as its corporate finance director from November 2003 to December 2004. Prior to joining NetEase, Mr. Choi worked in the Beijing office of Ernst & Young, the Hong Kong Trade Development Council and the Hong Kong office of KPMG for over ten years. Mr. Choi currently serves as the chairman of the audit committee and an independent non-executive director of Beijing Jingkelong Company Limited and China ITS (Holdings) Co., Ltd., both of which are listed on the Hong Kong Stock Exchange. Mr. Choi is a member of the Institute of Chartered Accountants in England and Wales, a fellow member of the Association of Chartered Certified Accountants, a fellow member of the CPA Australia, a fellow member of the Hong Kong Institute of Certified Public Accountants and a registered practicing certified public accountant in Hong Kong. Mr. Choi received a bachelor's degree in accountancy with honors from the Hong Kong Polytechnic University.

Mr. Jack Xu has served as Tuniu's independent director since May 2014. Mr. Xu is the managing partner at Seven Seas Venture Partners. Mr. Xu served as President and Chief Technology Officer of Sina Corporation, a Nasdaq-listed company, from January 2013 to February 2015. Prior to joining Sina Corporation, Mr. Xu worked at Cisco as the Corporate Vice President of the Communications and Collaboration business unit. Previously, Mr. Xu served as Vice President of Engineering and Research at eBay from October 2002 to April 2008 and Chief Technology Officer at NetEase from May 2000 to July 2002. He led Excite's search engine development in 1996, while pursuing a Ph.D. at the University of California at Berkeley. Mr. Xu received a bachelor's degree and a master's degree in information management from Sun Yat-Sen University in China.

Mr. Conor Chia-hung Yang has served as our chief financial officer since January 2013. Prior to joining us, Mr. Yang was the chief financial officer of E-Commerce China Dangdang Inc., a NYSE-listed company, from March 2010 to July 2012 and the chief financial officer of AirMedia Group Inc., a Nasdaq-listed company, from March 2007 to March 2010. Mr. Yang was the chief executive officer of RockMobile Corporation from 2004 to February 2007. From 1999 to 2004, Mr. Yang served as the chief financial officer of the Asia Pacific region for CellStar Asia Corporation. Mr. Yang was an executive director of Goldman Sachs (Asia) L.L.C. from 1997 to 1999. Prior to that, Mr. Yang was a vice president of Lehman Brothers Asia Limited from 1994 to 1996 and an associate at Morgan Stanley Asia Limited from 1992 to 1994. Mr. Yang currently serves as an independent director and chairman of the audit committee of AirMedia Group Inc., and an independent director of Leyou Technologies Holdings Limited. Mr. Yang received a master's degree of business administration from University of California, Los Angeles in 1992.

Mr. Zhengrong Tang has served as our chief technology officer since August 2013. Prior to joining us, Mr. Tang was the chief technology officer of China Gtel from 2012 to 2013, where he was responsible for the products, operations and technology of *guahao.com*. From 2004 to 2012, Mr. Tang served as a senior director of Alibaba Group's *alibaba.com*, *taobao.com* and *alipay.com* and the chief technology officer of Alibaba Japan, where he was responsible for the architecture migration of *taobao.com*, the establishment of *alipay.com*, and the development of Alibaba's international website. Between 2003 and 2004, Mr. Tang was the chief research architect of CTB/McGraw-Hill. From 1995 to 2003, Mr. Tang served as an architect at Neoforma, senior engineer at Comergent Technologies and technology manager at Perot Systems. Mr. Tang received a master's degree in computer science from University of Pittsburgh in 1995, a bachelor's degree in computer science from State University of New York at Albany in 1993.

Mr. Enjie Wu has served as our vice president of human resources center since January 2010. Prior to joining us, Mr. Wu was the human resources general manager of Hisap Corporation from 2005 to 2010. From 2003 to 2005, Mr. Wu was the general manager of Jianghai Group. From 2001 to 2002, Mr. Wu served as the director of human resources of Beijing Yenova Decoration Co., Ltd. From 1993 to 2001, he was the human resource officer of Zindart Manufacturing Limited. Mr. Wu received a bachelor's degree in economics and management from Sun Yat-Sen University in China in 1993.

B. Compensation

For the fiscal year ended December 31, 2015, we paid an aggregate of approximately RMB5.9 million (US$0.9 million) in cash to our executive officers and RMB0.7 million (US$0.1 million) to our non-executive directors and officers. For share incentive grants to our directors and executive officers and the vesting conditions of such share incentive grants, see "—Share Incentive Plans."

Share Incentive Plans

2008 Incentive Compensation Plan

We adopted an incentive compensation plan, or the 2008 Plan, in 2008. The purposes of the 2008 Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to employees and consultants, and to promote the success of our business by offering these individuals an opportunity to acquire a proprietary interest in our company. In 2012, we increased the maximum aggregate number of shares which may be issued under the 2008 Plan from 11,500,000 to 18,375,140. As of March 31, 2016, options to purchase 10,766,805 ordinary shares were outstanding, and there were 399,152 ordinary shares available for future issuance upon the exercise of future grants under the 2008 Plan.

The following paragraphs summarize the terms of the 2008 Plan.

Types of Awards. The 2008 Plan permits the awards of options and restricted shares.

Plan Administration. Our board of directors or a committee appointed by our board will administer the 2008 Plan. The committee or the full board of directors, as applicable, will determine the participants to receive awards, the type and number of awards to be granted to each participant, and the terms and conditions of each award grant, among other things. Our board of directors may authorize one or more officers of us to grant awards under the 2008 Plan, subject to parameters specified by the board of directors.

Award Agreement. Awards granted under the 2008 Plan are evidenced by an award agreement that sets forth terms, conditions and limitations for each award, which may include the term of the award, the provisions applicable in the event that the grantee's employment or service terminates, and our authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind the award, among other things. Pursuant to the form award agreement under the 2008 Plan, 1/4 of the ordinary shares underlying the option shall vest on the first anniversary of the date of grant, and 1/48 of the remaining ordinary shares underlying the option shall vest on a monthly basis in the following three years. However, the option may be exercised, to the extent vested, only (a) in connection with or after certain triggering events if the option is assumed by a company whose shares are listed on a securities exchange, or (b) unless otherwise allowed by the plan administrator in its sole discretion, if the option holder obtains all the necessary governmental approvals and consents required for the issuance of such shares.

Eligibility. We may grant awards to our employees and consultants of our company. However, we may grant options that are intended to qualify as incentive options only to our employees.

Vesting Schedule. In general, the plan administrator determines the vesting schedule, which is specified in the relevant award agreement.

Exercise of Options. The plan administrator determines the exercise price for each award, which is stated in the award agreement. The vested portion of option will expire if not exercised prior to the time as the plan administrator determines at the time of its grant. However, the maximum exercisable term is the tenth anniversary after the date of a grant.

Transfer Restrictions. Options may not be transferred in any manner by the recipient other than by will or by the laws of descent or distribution, except as otherwise provided by the plan administrator.

Termination of the 2008 Plan. Unless terminated earlier, the 2008 Plan will terminate automatically in 2018. Our board of directors has the authority to amend or terminate the plan subject to shareholder approval if required by applicable law.

2014 Share Incentive Plan

We adopted the 2014 Share Incentive Plan, or the 2014 Plan, in 2014. The maximum aggregate number of shares which may be issued pursuant to all awards under the 2014 Plan is initially 5,500,000 ordinary shares as of the date of its approval. The number of shares reserved for future issuances under the 2014 Plan will be increased automatically if and whenever the ordinary shares reserved under the 2014 Plan account for less than 1% of the total then-issued and outstanding ordinary shares on an as-converted basis. The ordinary shares reserved under the 2014 Plan immediately after each such increase shall equal to 5% of the then-issued and outstanding ordinary shares on an as-converted basis. As of March 31, 2016, there were options to purchase 18,805,521 ordinary shares and 113,772 restricted shares outstanding under the 2014 Plan.

The following paragraphs summarize the terms of the 2014 Plan.

Types of Awards. The 2014 Plan permits the awards of options, restricted shares and restricted share units.

Plan Administration. Our board of directors or a committee designated by our board administers the 2014 Plan. The committee or the full board of directors, as applicable, determines the participants to receive awards, the type and number of awards to be granted to each participant, and the terms and conditions of each award grant.

Award Agreement. Awards granted under the 2014 Plan are evidenced by an award agreement that sets forth terms, conditions and limitations for each award, which may include the term of the award, the provisions applicable in the event of the grantee's employment or service terminates, and our authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind the award.

Eligibility. We may grant awards to our employees, directors and consultants of our company. However, we may grant options that are intended to qualify as incentive share options only to our employees and employees of our parent companies and subsidiaries.

Acceleration of Awards upon Change in Control. If a change in control of our company occurs, the plan administrator may, in its sole discretion, provide for (i) all awards outstanding to terminate at a specific time in the future and give each participant the right to exercise the vested portion of such awards during a specific period of time, or (ii) the purchase of any award for an amount of cash equal to the amount that could have been attained upon the exercise of such award, or (iii) the replacement of such award with other rights or property selected by the plan administrator in its sole discretion, or (iv) payment of award in cash based on the value of ordinary shares on the date of the change-in-control transaction plus reasonable interest.

Vesting Schedule. In general, the plan administrator determines the vesting schedule, which is specified in the relevant award agreement.

Exercise of Options. The plan administrator determines the exercise price for each award, which is stated in the award agreement. The vested portion of option will expire if not exercised prior to the time as the plan administrator determines at the time of its grant. However, the maximum exercisable term is the tenth anniversary after the date of a grant.

Transfer Restrictions. Awards may not be transferred in any manner by the recipient other than by will or the laws of descent and distribution, except as otherwise provided by the plan administrator.

Termination of the 2014 Plan. Unless terminated earlier, the 2014 Plan will terminate automatically in 2024. Our board of directors has the authority to amend or terminate the plan subject to shareholder approval or home country practice.

The following table summarizes, as of March 31, 2016, the outstanding options and restricted shares granted to our directors and executive officers under the 2008 Plan and 2014 Plan.

Name	Ordinary Shares Underlying Options Awarded/ Restricted Shares	Exercise Price (US$/ Share)	**(RMB/ Share)**[2]	Date of Grant	Vesting Schedule	Date of Expiration
Dunde Yu	630,814	0.100	0.65	November 5, 2009	4 years[1]	November 4, 2019
	1,100,000	0.226	1.463	March 11, 2011	4 years[1]	March 10, 2017
	1,269,995	0.0001	0.0006	August 1, 2013	4 years[1]	July 31, 2019
	900,000	3.000	19.43	June 13, 2014	4 years[1]	June 12, 2024
	760,000	3.090	20.02	March 6, 2015	4 years[1]	March 5, 2025
	1,981,000	3.090	20.02	August 20, 2015	4 years[1]	August 19, 2025
Haifeng Yan	340,000	0.100	0.65	November 5, 2009	4 years[1]	November 4, 2019
	1,100,000	0.226	1.463	March 11, 2011	4 years[1]	March 10, 2017
	1,269,995	0.0001	0.0006	August 1, 2013	4 years[1]	July 31, 2019
	900,000	3.000	19.43	June 13,2014	4 years[1]	June 12, 2024
	660,000	3.090	20.02	March 6, 2015	4 years[1]	March 5, 2025
	1,981,000	3.090	20.02	August 20, 2015	4 years[1]	August 19, 2025
Conor Chia-hung Yang	*	0.900	5.83	January 7, 2013	4 years[1]	January 6, 2019
	*	0.0001	0.0006	August 1, 2013	4 years[1]	July 31, 2019
	*	3.000	19.43	June 13,2014	4 years[1]	June 12, 2024
	*	3.090	20.02	March 6, 2015	4 years[1]	March 5, 2025
	*	3.090	20.02	August 20, 2015	4 years[1]	August 19, 2025
Zhengrong Tang	*	1.135	7.35	October 30, 2013	4 years[1]	October 29, 2019
	*	3.090	20.02	March 6, 2015	4 years[1]	March 5, 2025
	*	3.090	20.02	August 20, 2015	4 years[1]	August 19, 2025
Enjie Wu	*	0.226	1.46	March 11, 2011	4 years[1]	March 10, 2017
	*	1.135	7.353	March 19, 2012	4 years[1]	March 18, 2018
	*	1.790	11.60	August 15, 2013	4 years[1]	August 14, 2019
	*	3.000	19.43	August 15, 2014	4 years[1]	August 14, 2024
	*	3.090	20.02	March 6, 2015	4 years[1]	March 5, 2025
	*	3.090	20.02	August 20, 2015	4 years[1]	August 19, 2025
Jack Xu	*†	N/A		May 9, 2014	4 years[1]	May 8, 2024
Onward Choi	*†	N/A		May 9, 2014	4 years[1]	May 8, 2024
Directors and officers as a group	20,168,859	—	—	—	—	—

* Shares underlying vested options less than 1% of our total outstanding shares.

† Denotes restricted share award; all other awards in this table are option awards.

(1) Pursuant to the relevant award agreement, 1/4 of the ordinary shares underlying the option or restricted shares shall vest on the first anniversary of the date of grant, and 1/48 of the remaining ordinary shares underlying the option or restricted shares shall vest on a monthly basis in the following three years. However, the option or restricted shares may be exercised, to the extent vested, only (a) in connection with or after certain triggering events if the option is assumed by a company whose shares are listed on a securities exchange, or (b) unless otherwise allowed by the plan administrator in its sole discretion, if the option holder or holder of restricted shares obtains all the necessary governmental approvals and consents required for the issuance of such shares.

(2) The prices in Renminbi were translated using the rate of US$1.00 = RMB6.4778, the exchange rate in effect as of December 31, 2015, solely for the convenience of the readers.

C. Board Practices

Board of Directors

Our board of directors currently consists of eleven directors. A director is not required to hold any shares in our company. A director may vote with respect to any contract, proposed contract, or arrangement in which he or she is interested provided (a) such director has declared the nature of his or her interest, whether material or not, at the earliest meeting of the board at which it is practicable to do so, either specifically or by way of a general notice, (b) such director has not been disqualified by the chairman of the relevant board meeting, and (c) if such contract or arrangement is a transaction with a related party, such transaction has been approved by the audit committee in accordance with the NASDAQ rules. The directors may exercise all the powers of the company to borrow money, mortgage its business, property and uncalled capital, and issue debentures or other securities whenever money is borrowed or as security for any obligation of the company or of any third party.

Committees of the Board of Directors

We have three committees of the board of directors: the audit committee, the compensation committee and the nominating and corporate governance committee under the board of directors. We have adopted a charter for each of the three committees. Each committee’s members and functions are described below.

Audit Committee. Our audit committee consists of Mr. Onward Choi, Mr. Jack Xu and Ms. Cindy Chen and is chaired by Mr. Choi. Each of Mr. Choi, Mr. Xu and Ms. Chen satisfies the “independence” requirements of Rule 5605(a)(2) of the NASDAQ Stock Market Rules and meet the independence standards under Rule 10A-3 under the Securities Exchange Act of 1934, as amended. Our board of directors has determined that each of Mr. Choi and Mr. Xu qualifies as an “audit committee financial expert” within the meaning of Item 407(d) of Regulation S-K under the Securities Act of 1933, as amended. The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

- selecting the independent registered public accounting firm and pre-approving all auditing and non-auditing services permitted to be performed by the independent registered public accounting firm;

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- reviewing with the independent registered public accounting firm any audit problems or difficulties and management's response;

- reviewing and approving all proposed related party transactions, as defined in Item 404 of Regulation S-K under the Securities Act;

- discussing the annual audited financial statements with management and the independent registered public accounting firm;

- reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of material control deficiencies;

- reviewing and reassessing annually the adequacy of our audit committee charter;

- meeting separately and periodically with management and the independent registered public accounting firm; and

- monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

Compensation Committee. Our compensation committee consists of Mr. Onward Choi, Mr. Haoyu Shen and Mr. Jack Xu, and is chaired by Mr. Choi. Each of Mr. Choi, Mr. Shen and Mr. Xu, satisfies the "independence" requirements of Rule 5605(a)(2) of the NASDAQ Stock Market Rules. The compensation committee assists the board in reviewing and approving the compensation structure, including all forms of compensation, relating to our directors and executive officers. Our chief executive officer may not be present at any committee meeting during which his compensation is deliberated upon. The compensation committee is responsible for, among other things:

- reviewing and approving, or recommending to the board for its approval, the compensation for our chief executive officer and other executive officers;

- reviewing and recommending to the board for determination with respect to the compensation of our non-employee directors;

- reviewing periodically and approving any incentive compensation or equity plans, programs or similar arrangements; and

- selecting compensation consultant, legal counsel or other adviser only after taking into consideration all factors relevant to that person's independence from management.

Nominating and Corporate Governance Committee. Our nominating and corporate governance committee consists of Mr. Jack Xu, Mr. Onward Choi and Mr. Frank Lin, and is chaired by Mr. Xu. Each of Mr. Xu, Mr. Choi and Mr. Lin satisfies the "independence" requirements of Rule 5605(a)(2) of the NASDAQ Stock Market Rules. The nominating and corporate governance committee assists the board in selecting individuals qualified to become our directors and in determining the composition of the board and its committees. The nominating and corporate governance committee is responsible for, among other things:

- recommending nominees to the board for election or re-election to the board, or for appointment to fill any vacancy on the board;

- reviewing annually with the board the current composition of the board with regards to characteristics such as independence, age, skills, experience and availability of service to us;

- selecting and recommending to the board the names of directors to serve as members of the audit committee and the compensation committee, as well as of the nominating and corporate governance committee itself;

- developing and reviewing the corporate governance principles adopted by the board and advising the board with respect to significant developments in the law and practice of corporate governance and our compliance with such laws and practices; and
- evaluating the performance and effectiveness of the board as a whole.

Terms of Directors and Executive Officers

All directors hold office until they are removed by ordinary resolution of the shareholders or become disqualified from being a director in accordance with the terms of our articles of association. In addition, the service agreements between us, our subsidiaries, if applicable, and the directors do not provide benefits upon termination of their service. Director nominations by the board of directors are subject to the approval of our corporate governance and nominating committee. Our shareholders may remove any director by ordinary resolution and may in like manner appoint another person in his stead. A valid ordinary resolution requires a majority of the votes cast at a shareholder meeting that is duly constituted and meets the quorum requirement. Officers are elected by and serve at the discretion of the board of directors. For the periods of service of our directors as of December 31, 2015, see “—A. Directors and Senior Management.”

Duties of Directors

Under Cayman Islands law, our directors have a duty of loyalty to act honestly in good faith with a view to our best interests. Our directors also have a duty to exercise the skill they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association. A shareholder may have the right to seek damages in our name if a duty owed by our directors is breached. You should refer to “Item 10.B. Additional Information—Memorandum and Articles of Association—Differences in Corporate Law—Directors’ Fiduciary Duties.”

D. Employees

We had a total of 1,415, 2,799, and 7,028 employees as of December 31, 2013, 2014 and 2015, respectively. The following table sets forth the numbers of our employees, categorized by function, as of December 31, 2015:

Function	Number of Employees

Management and administration	1,023
Tour advisor	1,426
Call center	376
Sales and marketing	581
Research and product development	2,297
Regional service centers	1,305
Tour guides	20
Total	7,028

We enter into standard employment agreements with all our employees. We also enter into confidentiality agreements with certain directors and executive officers that impose confidentiality obligations until the relevant information becomes public or is no longer considered confidential by us. In addition to salaries and benefits, we provide stock-based compensation and performance-based bonuses for our employees and commission-based compensation for our sales personnel.

As required by regulations in China, we participate in various employee social security plans that are organized by municipal and provincial governments, including pension insurance, medical insurance, unemployment insurance, maternity insurance, job-related injury insurance and a housing provident fund. We are required by PRC laws to make contributions to employee social security plans at specified percentages of the salaries, bonuses and certain allowances of our employees.

Our success depends on our ability to attract, retain and motivate qualified personnel. We believe that we maintain a good working relationship with our employees, and we have not experienced any significant labor disputes.

E. Share Ownership

The following table sets forth information with respect to the beneficial ownership of our shares as of March 31, 2016 by:

- each of our current directors and executive officers; and
- each person known to us to own beneficially more than 5% of our shares.

See "—B. Compensation—Share Incentive Plans" for more details on options and restricted shares granted to our directors and executive officers.

The calculations in the table below are based on (i) 378,089,251 ordinary shares outstanding as of March 31, 2016, including 17,373,500 Class B ordinary shares outstanding and 360,715,751 Class A ordinary shares outstanding (excluding 1,642,293 Class A ordinary shares, represented by 547,431 American depositary shares, issued and reserved for the future exercise of options or the vesting of other awards under the 2008 Plan and the 2014 Plan).

Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we have included shares that the person has the right to acquire within 60 days, including through the exercise of any option, warrant, or other right or the conversion of any other security. These shares, however, are not included in the computation of the percentage ownership of any other person.

	Class A Ordinary Shares	Class B Ordinary Shares	**Total Ordinary Shares**	**%**†	**Voting Power**††
Directors and Executive Officers:*					
Dunde Yu(1)	7,360,952	10,423,503	17,784,455	4.7	20.8
Haifeng Yan(2)	7,040,975	6,949,997	13,990,972	3.7	14.2
Tie Li(3)	90,909,091	—	90,909,091	24.0	17.0
Jie Zhu(4)	90,909,091	—	90,909,091	24.0	17.0
Haoyu Shen(5)	78,061,780	—	78,061,780	20.7	14.6
Cindy Chen(6)	27,436,780	—	27,436,780	7.3	5.1

Frank Lin[7]	34,829,512	—	34,829,512	9.2	6.5
Steve Yue Ji[8]	16,198,364	—	16,198,364	4.3	3.0
James Jianzhang Liang[9]	12,481,034	—	12,481,034	3.3	2.3
Onward Choi[10]	**	—	**	**	**
Jack Xu[11]	**	—	**	**	**
Conor Chia-hung Yang	**	—	**	**	**
Zhengrong Tang	**	—	**	**	**
Enjie Wu	**	—	**	**	**
All directors and executive officers as a group	276,916,533	17,373,500	294,290,033	76.1	83.0
Principal Shareholders:					
BHR Winwood Investment Management Limited[12]	90,909,091	—	90,909,091	24.0	17.0
Affiliates of JD.com, Inc.[13]	78,061,780	—	78,061,780	20.7	14.6
DCM V, L.P. and Affiliates[14]	34,829,512	—	34,829,512	9.2	6.5
Unicorn Riches Limited[15]	27,436,780	—	27,436,780	7.3	5.1
Dragon Rabbit Capital Limited[16]	4,104,137	10,423,503	14,527,640	3.8	20.3
Verne Capital Limited[17]	4,104,137	6,949,997	11,054,134	2.9	13.7

* Except for Tie Li, Jie Zhu, Haoyu Shen, Cindy Chen, Frank Lin, Steve Yue Ji, James Jianzhang Liang, Onward Choi and Jack Xu, the business address of our directors and executive officers is Tuniu Building, No. 699-32, Xuanwudadao, Xuanwu District, Nanjing, Jiangsu Province 210042, PRC.

** Shares underlying vested options of less than 1% of our total outstanding shares on an as-converted basis.

† For each person and group included in this column, percentage ownership is calculated by dividing the number of ordinary shares beneficially owned by such person or group by the sum of the total number of ordinary shares outstanding as of March 31, 2016, which is 378,089,251 ordinary shares outstanding, including 17,373,500 Class B ordinary shares outstanding and 360,715,751 Class A ordinary shares (excluding 1,642,293 Class A ordinary shares, represented by 547,431 American depositary shares, issued and reserved for the future exercise of options or the vesting of other awards under the 2008 Plan and the 2014 Plan), plus the number of ordinary shares such person or group has the right to acquire, including upon exercise of options and vesting of restricted shares and restricted share units, within 60 days after March 31, 2016.

†† For each person and group included in this column, percentage ownership percentage of total voting power represents voting power based on both Class A and Class B ordinary shares held by such person or group, and the ordinary shares such person or group has the right to acquire upon exercise of the stock options or warrants within 60 days after March 31, 2016, with respect to all outstanding shares of our Class A and Class B ordinary shares as a single class. Each holder of Class A ordinary shares is entitled to one vote per Class A ordinary share. Each holder of our Class B ordinary shares is entitled to ten votes per Class B ordinary share. Our Class B ordinary shares are convertible at any time by the holder into Class A ordinary shares on a share-for-share basis.

(1) Represents (i) 3,256,815 Class A ordinary shares underlying the options or restricted shares that have become fully vested as of March 31, 2016 or will become fully vested within 60 days after March 31, 2016, and (ii) 4,104,137 Class A ordinary shares and 10,423,503 Class B ordinary shares held by Dragon Rabbit Capital Limited, a British

Virgin Islands company. Dragon Rabbit Capital Limited is wholly owned by Longtu Holdings Limited, a British Virgin Islands company which is wholly owned by a trust, of which Mr. Yu's family is the beneficiary.

(2) Represents (i) 2,936,838 Class A ordinary shares underlying the options or restricted shares that have become fully vested as of March 31, 2016 or will become fully vested within 60 days after March 31, 2016, and (ii) 4,104,137 Class A ordinary shares and 6,949,997 Class B ordinary shares held by Verne Capital Limited, a British Virgin Islands company. Verne Capital Limited is wholly owned by Magic Worldwide Limited, a British Virgin Islands company which is wholly owned by a trust, of which Mr. Yan's family is the beneficiary.

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(3) Represents 90,909,091 Class A ordinary shares held by BHR Winwood Investment Management Limited. The business address of Mr. Li is 20F, Tower A, Hainan Airlines Plaza, B-2, East 3rd Ring North Road, Chaoyang District, Beijing, PRC.

(4) Represents 90,909,091 Class A ordinary shares held by BHR Winwood Investment Management Limited. The business address of Mr. Zhu is 20F, Tower A, Hainan Airlines Plaza, B-2, East 3rd Ring North Road, Chaoyang District, Beijing, PRC.

(5) Represents (i) 65,625,000 Class A ordinary shares held by Fabulous Jade Global Limited and (ii) 12,436,780 Class A ordinary shares held by JD.com E-Commerce (Investment) Hong Kong Corporation Limited. The business address of Mr. Shen is 15F, Building C, No. 18 Kechuang 11 Street, BDA, Beijing, PRC

(6) Represents 27,436,780 Class A ordinary shares held by Unicorn Riches Limited. The business address of Ms. Chen is 6F, South Tower C, Raycom Info Tech Park, No. 2 Kexueyuan Nanlu, Haidian District, Beijing, 100190, PRC.

(7) Represents (i) 22,881,096 Class A ordinary shares held by DCM V, L.P., (ii) 558,324 Class A ordinary shares held by DCM Affiliates Fund V, L.P., (iii) 7,640,092 Class A ordinary shares held by DCM Hybrid RMB Fund, L.P., (iv) 3,541,670 Class A ordinary shares held by DCM Ventures China Turbo Fund, L.P., and (v) 208,330 Class A ordinary shares held by DCM Ventures China Turbo Affiliates Fund, L.P. The business address of Mr. Lin is Unit 1, Level 10, Tower W2, Oriental Plaza, Dong Cheng District, Beijing, PRC.

(8) Represents 16,198,364 Class A ordinary shares held by Sequoia Capital 2010 CV Holdco, Ltd. The business address of Mr. Ji is 2805, Plaza 66 Tower 2, 1366 Nanjing West Road, Shanghai, PRC.

(9) Represents 12,481,034 Class A ordinary shares held by Ctrip Investment Holding Ltd. The business address of Mr. Liang is Building 16, Sky SOHO, No. 968 Jinzhong Road, Shanghai, PRC.

(10) The business address of Mr. Choi is Building No. 7, West Zone, Zhongguancun Software Park (Phase II), No. 10 Xibeiwang East Road, Haidian District, Beijing 100193, PRC.

(11) The business address of Mr. Xu is 3000 Sand Hill Road, Building 4, Suite 100; Menlo Park, CA 94025.

(12) BHR Winwood Investment Management Limited is a company incorporated in Hong Kong and wholly owned by an affiliated fund of HNA Tourism. The business address of BHR Winwood Investment Management Limited is Unit 3101, 31/F, tower 2, China Central Place, 79 Jianguo Road, Chaoyang District, Beijing 100025, PRC.

(13)

Represents (i) 65,625,000 Class A ordinary shares held by Fabulous Jade Global Limited, and (ii) 12,436,780 Class A ordinary shares held by JD.com E-commerce (Investment) Hong Kong Corporation Limited. The business address of Fabulous Jade Global Limited is P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands. Fabulous Jade is a wholly-owned subsidiary of JD.com Investment Limited, which in turn is a wholly-owned subsidiary of JD.com, Inc., a NASDAQ listed company. The business address of JD.com E-Commerce (Investment) Hong Kong Corporation Limited is Suite 1203, 12th Floor, Ruttonjee House, 11 Duddell Street Central, Hong Kong. JD.com E-Commerce (Investment) Hong Kong Corporation Limited is a wholly-owned subsidiary of JD.com E-Commerce (Technology) Hong Kong Corporation Limited, which in turn is a wholly-owned subsidiary of JD.com, Inc. We refer to Fabulous Jade Global Limited and JD.com E-Commerce (Investment) Hong Kong Corporation Limited as "Affiliates of JD.com, Inc."

(14) Represents (i) 22,881,096 Class A ordinary shares held by DCM V, L.P., (ii) 558,324 Class A ordinary shares held by DCM Affiliates Fund V, L.P., (iii) 7,640,092 Class A ordinary shares held by DCM Hybrid RMB Fund, L.P., (iv) 3,541,670 Class A ordinary shares held by DCM Ventures China Turbo Fund, L.P., and (v) 208,330 Class A ordinary shares held by DCM Ventures China Turbo Affiliates Fund, L.P. The general partner of DCM V, L.P. and DCM Affiliates Fund V, L.P. is DCM Investment Management V, L.P., whose general partner is DCM International V, Ltd. DCM International V, Ltd., through DCM Investment Management V, L.P., has the sole voting and investment power over these shares, and such voting and investment power is exercised by K. David Chao, Thomas Blaisdell and Peter W. Moran, the directors of DCM International V, Ltd. The general partner of DCM Hybrid RMB Fund, L.P. is DCM Hybrid RMB Fund Investment Management, L.P., whose general partner is DCM Hybrid RMB Fund International Ltd. DCM Hybrid RMB Fund International Ltd., through DCM Hybrid RMB Fund Investment Management, L.P., has the sole voting and investment power over these shares, and such voting and investment power is exercised by K. David Chao, Thomas Blaisdell, Jason Krikorian, and Peter W. Moran, the directors of DCM Hybrid RMB Fund International Ltd. The general partner of DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P. is DCM Turbo Fund Investment Management, L.P., whose general partner is DCM Turbo Fund International, Ltd. DCM Turbo Fund International, Ltd., through DCM Turbo Fund Investment Management, L.P., has the sole voting and investment power over these shares, and such voting and investment power is exercised by K. David Chao and Jason Krikorian, the directors of DCM Turbo Fund International, Ltd. The business address of DCM V, L.P., DCM Affiliates Fund V, L.P., DCM Hybrid RMB Fund, L.P., DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P. is 2420 Sand Hill Road, Suite 200, Menlo Park, CA 94025, the United States.

(15) The business address of Unicorn Riches Limited is c/o Hony Capital Limited, Suite 2701, One Exchange Square, Central, Hong Kong. Unicorn Riches Limited is a wholly-owned subsidiary of Hony Capital Fund V, L.P. Hony Capital Fund V. L.P.'s general partner is Hony Capital Fund V GP, L.P. Hony Capital Fund V GP, L.P.'s general partner is Hony Capital Fund V GP Limited. John Huan Zhao and Legend Holdings Corporation, have 80% and 20%, respectively, equity ownership of Hony Capital Fund V GP Limited.

(16) Dragon Rabbit Capital Limited is wholly owned by Longtu Holdings Limited is a British Virgin Islands company which is wholly owned by a trust, of which Mr. Yu's family is the beneficiary. The business address of Dragon Rabbit Capital Limited is Quastisky Building, P.O. Box 4389, Road Town, Tortola, British Virgin Islands.

(17) Verne Capital Limited is a British Virgin Islands company. Verne Capital Limited is wholly owned by Magic Worldwide Limited, a British Virgin Islands company which is wholly owned by a trust, of which Mr. Yan's family is the beneficiary. The business address of Verne Capital Limited is Quastisky Building, P.O. Box 4389, Road Town, Tortola, British Virgin Islands.

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To our knowledge, as of March 31, 2016, 119,780,334 of our outstanding ordinary shares are held by five record holders in the United States. The total number of shares held by the five record holders in the United States represents 31.7% of our total outstanding shares. This includes 92,590,914 ordinary shares (excluding 1,656,003 Class A ordinary shares, represented by 552,001 American depositary shares, issued and reserved for the future exercise of options or the vesting of other awards under the 2008 Plan and the 2014 Plan) held of record by JPMorgan Chase Bank, N.A., the depositary of our ADS program. The number of beneficial owners of our ADSs in the United States is likely to be much larger than the number of record holders of our ordinary shares in the United States. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company.

Item 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

Please refer to "Item 6.E Directors, Senior Management and Employees—Share Ownership."

B. Related Party Transactions

Contractual Arrangements

For a description of the contractual arrangements among Beijing Tuniu, Nanjing Tuniu and the shareholders of Nanjing Tuniu, see "Item 4.C. Information on the Company—Organizational Structure." See also "Item 3.D. Key Information—Risk Factors—Risks Related to Our Corporate Structure."

Private Placements, Repurchase and Redesignation

See "Item 5.B. Operating and Financial Review and Prospects—Liquidity and Capital Resources."

Relationship with Ctrip

Ctrip Investment Holding Ltd. ("Ctrip") has one director in common with our company. Ctrip purchased 5,000,000 Class A ordinary shares in a private placement concurrent with our initial public offering, an additional 3,731,034 Class A ordinary shares for a total of US$15,000,000 through a private placement transaction in December 2014 as well as an additional 3,750,000 Class A ordinary shares for a total of US$20,000,000 through a private placement transaction in May 2015. We conduct transactions in the ordinary course of business with Ctrip on the terms of arm-length transactions. We sell our packaged-tours through Ctrip's online platform and the commission fees for Ctrip's service were immaterial. In addition, Ctrip sells the hotel rooms and air tickets products through our online platform and commission fees we earned were RMB0.7 million and RMB3.5 million (US$0.5 million) for the years ended December 31, 2014 and 2015, respectively.

Relationship with JD.com, Inc.

On May 8, 2015, we issued 65,625,000 Class A ordinary shares to Fabulous Jade Global Limited, a subsidiary of JD.com, Inc., for a consideration of RMB1,528.2 million (US$250 million) in cash and RMB660.2 million in the business resource contributed by JD.com, Inc., which included the exclusive right to operate the leisure travel channel for both JD.com, Inc.'s website and mobile application, preferred partnership with JD.com, Inc. for hotel and air ticket reservation service, its internet traffic support and marketing support for the leisure travel channel for a period of five years starting from August 2015.

Relationship with HNA Tourism Group

In November 2015, we entered into a strategic partnership with HNA Tourism through a share subscription agreement, pursuant to which (i) HNA Tourism invested US$500 million in our company in January 2016 through the acquisition of 90,909,091 newly issued Class A ordinary shares of our company by one of its affiliates, and (ii) HNA Tourism agreed to provide us with access to its premium airlines and hotels resources at a preferential rate, in compliance with applicable fair competition market rules, and we undertook to acquire no less than US$100 million products and services sourced from HNA Tourism over the next two years. The transaction contemplated by the share subscription agreement was completed on in January 2016. In connection with the strategic partnership with HNA Tourism, we entered into an investor rights agreement with HNA Tourism in November 2015, which was subsequently amended in December 2015 and February 2016, to govern certain rights and obligations of us and HNA Tourism.

Employment Agreements and Indemnification Agreements

See “Item 6.B. Directors, Senior Management and Employees—Compensation.”

Share Incentive Plans

See “Item 6.B. Directors, Senior Management and Employees—Compensation.”

C. Interests of Experts and Counsel

Not applicable.

Item 8. Financial Information

A. Consolidated Statements and Other Financial Information

See “Item 18. Financial Statements.”

Legal Proceedings

From time to time, we may be involved in legal proceedings in the ordinary course of our business. We are not currently a party to any material legal or administrative proceedings.

Dividend Policy

Our board of directors has discretion as to whether to distribute dividends, subject to applicable laws. Even if our board of directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that our board of directors may deem relevant. If we pay any dividends, we will pay our ADS holders to the same extent as holders of our ordinary shares, subject to the terms of the deposit agreement, including the fees and expenses payable thereunder. See "Item 12.D. Description of Securities Other than Equity Securities—American Depositary Shares." Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

We have not previously declared or paid cash dividends and we have no plan to declare or pay any dividends in the near future on our shares or ADSs. We currently intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business.

We are a holding company incorporated in the Cayman Islands. We rely principally on dividends from our PRC subsidiaries for our cash requirements, including any payment of dividends to our shareholders. PRC regulations may restrict the ability of our PRC subsidiaries to pay dividends to us. See "Item 4.B. Information on the Company—Business Overview—PRC Regulation—Regulations on Dividend Distribution" and "Item 12.D. Description of Securities Other than Equity Securities— American Depositary Shares." Cash dividends on our common shares, if any, will be paid in U.S. dollars.

B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

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Item 9. The Offer and Listing

A. Offering and Listing Details

Our ADSs, each representing three of our Class A ordinary shares, have been listed on NASDAQ since May 9, 2014. Our ADSs trade under the symbol “TOUR.” The following table provides the high and low closing trading prices for our ADSs on NASDAQ since the date of our initial public offering:

	Trading Price Per ADS in US$	
	High	Low
Annual Highs and Lows		
2014 (since May 9, 2014)	24.00	10.07
2015	20.74	11.40
Quarterly Highs and Lows		
Second Quarter 2014 (since May 9, 2014)	18.67	10.07
Third Quarter 2014	24.00	16.52
Fourth Quarter 2014	19.79	10.77
First Quarter 2015	15.58	12.04
Second Quarter 2015	20.74	12.59
Third Quarter 2015	17.62	11.40
Fourth Quarter 2015	16.91	11.75
First Quarter 2016	16.00	8.99
Monthly Highs and Lows		
October 2015	15.43	11.75
November 2015	15.78	14.05
December 2015	16.91	15.40
January 2016	16.00	12.28
February 2016	12.64	10.56
March 2016	11.13	8.99
April 2016 (through April 22, 2016)	12.10	10.40

B. Plan of Distribution

Not applicable.

C. Markets

Our ADSs have been listed on NASDAQ since May 9, 2014 under the symbol “TOUR.”

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

Item 10. Additional Information

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We are a Cayman Islands company and our affairs are governed by our memorandum and articles of association and the Companies Law (2013 Revision) of the Cayman Islands, which we refer to as the Companies Law below. The following are summaries of material provisions of our fifth amended and restated memorandum and articles of association that became effective immediately prior to the completion of our initial public offering in May 2014, insofar as they relate to the material terms of our ordinary shares.

Registered Office and Objects

Our registered office in the Cayman Islands is located at International Corporation Services Ltd., P.O. Box 472, 2nd Floor, Harbour Place, 103 South Church Street, George Town, Grand Cayman KY1-1106, Cayman Islands, or at such other place as our board of directors may from time to time decide. The objects for which our company is established are unrestricted and we have full power and authority to carry out any object not prohibited by the Companies Law, as amended from time to time, or any other law of the Cayman Islands.

Board of Directors

See "Item 6.C. Directors, Senior Management and Employees—Board Practices."

Ordinary Shares

General. Our authorized share capital is US$100,000 divided into 1,000,000,000 shares, with a par value of US$0.0001 each, which will be divided into 780,000,000 Class A ordinary shares with a par value of US$0.0001 each, 120,000,000 Class B ordinary shares with a par value of US$0.0001 each, and 100,000,000 shares of a par value of US$0.0001 each of such class or classes (however designated) as our board of directors may determine. Holders of Class A ordinary shares and Class B ordinary shares have the same rights except for voting and conversion rights. All of our outstanding ordinary shares are fully paid and non-assessable. Certificates representing the ordinary shares are issued in registered form. Our shareholders who are non-residents of the Cayman Islands may freely hold and transfer their ordinary shares.

Dividends. The holders of our ordinary shares are entitled to such dividends as may be declared by our board of directors. Our current articles of association provide that dividends may be declared and paid out of our profits, realized or unrealized, or from any reserve set aside from profits which our board of directors determine is no longer needed. Dividends may also be declared and paid out of share premium account or any other fund or account which can be authorized for this purpose in accordance with the Companies Law. Holders of Class A ordinary shares and Class B ordinary shares are entitled to the same amount of dividends, if declared.

Voting Rights. In respect of all matters subject to a shareholders' vote, each Class A ordinary share is entitled to one vote, and each Class B ordinary share is entitled to ten votes, voting together as one class. Voting at any meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by the chairman of such meeting or any shareholder present in person or by proxy. Each holder of our ordinary shares are entitled to vote such ordinary shares as are registered in his or her name on our register of members.

A quorum required for a meeting of shareholders consists of at least two shareholders who hold at least one third in nominal value of our share capital in issue at the meeting present in person or by proxy or, if a corporation or other non-natural person, by its duly authorized representative. Shareholders' meetings may be held annually. Each general meeting, other than an annual general meeting, shall be an extraordinary general meeting. Extraordinary general meetings may be called by a majority of our board of directors or our chairman or upon a requisition of shareholders holding at the date of deposit of the requisition not less than one-third of the aggregate voting power of our company. Advance notice of at least 14 calendar days is required for the convening of our annual general meeting and other general meetings. All holders of ordinary shares are permitted to attend general and extraordinary meetings.

An ordinary resolution to be passed at a meeting by the shareholders requires the affirmative vote of a simple majority of the votes attaching to the ordinary shares cast at a meeting, while a special resolution requires the affirmative vote of no less than two-thirds of the votes cast attaching to the outstanding ordinary shares at a meeting. A special resolution is required for important matters such as a change of name or making changes to our current memorandum and articles of association.

Conversion. Each Class B ordinary share can be convertible into one Class A ordinary share at any time by the holder. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances. Upon any transfer of Class B ordinary shares by a holder to any person or entity which is not an affiliate of such holder, such Class B ordinary shares will be automatically and immediately converted into the equivalent number of Class A ordinary shares.

Transfer of Ordinary Shares. Subject to the restrictions set out below, any of our shareholders may transfer all or any of his or her ordinary shares by an instrument of transfer in the usual or common form or any other form approved by our board of directors.

Our board of directors may, in its absolute discretion, decline to register any transfer of any ordinary share which is not fully paid up or on which we have a lien. Our board of directors may also decline to register any transfer of any ordinary share unless:

- the instrument of transfer is lodged with us, accompanied by the certificate for the ordinary shares to which it relates and such other evidence as our board of directors may reasonably require to show the right of the transferor to make the transfer;
- the instrument of transfer is in respect of only one class of ordinary shares;
- the instrument of transfer is properly stamped, if required;
- in the case of a transfer to joint holders, the number of joint holders to whom the ordinary share is to be transferred does not exceed four;
- the shares transferred are free of any lien in favor of the Company; and
- a fee of such maximum sum as the NASDAQ Global Market may determine to be payable or such lesser sum as our directors may from time to time require is paid to us in respect thereof.

If our directors refuse to register a transfer they shall, within three months after the date on which the instrument of transfer was lodged, send to each of the transferor and the transferee notice of such refusal.

The registration of transfers may, after compliance with any notice required of the NASDAQ Global Market, be suspended and the register closed at such times and for such periods as our board of directors may from time to time determine, provided, however, that the registration of transfers shall not be suspended nor the register closed for more than 30 calendar days in a year.

Liquidation. On a return of capital on winding up or otherwise (other than on conversion, redemption or purchase of ordinary shares), assets available for distribution among the holders of ordinary shares shall be distributed among the holders of the ordinary shares on a pro rata basis. If our assets available for distribution are insufficient to repay all of the paid-up capital, the assets will be distributed so that the losses are borne by our shareholders proportionately. Any distribution of assets or capital to a holder of a Class A ordinary share and a holder of a Class B ordinary share will be the same in any liquidation event.

Calls on Ordinary Shares and Forfeiture of Ordinary Shares. Our board of directors may from time to time make calls upon shareholders for any amounts unpaid on their ordinary shares in a notice served to such shareholders at least 14 calendar days prior to the specified time of payment. The ordinary shares that have been called upon and remain unpaid are subject to forfeiture.

Redemption of Ordinary Shares. The Companies Law and our current articles of association permit us to purchase our own shares. In accordance with our current articles of association and provided the necessary shareholders or board approval have been obtained, we may issue shares on terms that are subject to redemption, at our option or at the option of the holders of these shares, on such terms and in such manner, including out of capital, as may be determined by our board of directors.

Variations of Rights of Shares. All or any of the special rights attached to any class of shares may, subject to the provisions of the Companies Law, be materially adversely varied with the written consent of the holders of three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a general meeting of the holders of the shares of that class. The rights conferred upon the holders of the shares of any class issued shall not, unless otherwise expressly provided by the terms of issue of the shares of that class, be deemed to be materially adversely varied by the creation or issue of further shares ranking *pari passu* with such existing class of shares, or by the creation or issue of shares with preferred or other rights including, without limitation, the creation of shares with enhanced or weighted voting rights.

Inspection of Books and Records. Holders of our ordinary shares have no general right under Cayman Islands law to inspect or obtain copies of our list of shareholders or our corporate records. However, we will provide our shareholders with annual audited financial statements. See “—H. Documents on Display.”

Issuance of Additional Shares. Our current memorandum of association authorizes our board of directors to issue additional ordinary shares from time to time as our board of directors shall determine, to the extent of available authorized but unissued shares.

Our current memorandum of association also authorizes our board of directors to establish from time to time one or more series of preferred shares and to determine, with respect to any series of preferred shares, the terms and rights of that series, including:

- the designation of the series;
- the number of shares of the series;
- the dividend rights, dividend rates, conversion rights, voting rights; and
- the rights and terms of redemption and liquidation preferences.

Our board of directors may issue preferred shares without action by our shareholders to the extent authorized but unissued. Issuance of these shares may dilute the voting power of holders of ordinary shares.

Anti-Takeover Provisions. Some provisions of our current memorandum and articles of association may discourage, delay or prevent a change of control of our company or management that shareholders may consider favorable, including provisions that authorize our board of directors to issue preferred shares in one or more series and to designate the price, rights, preferences, privileges and restrictions of such preferred shares without any further vote or action by our shareholders.

Exempted Company. We are an exempted company with limited liability under the Companies Law. The Companies Law distinguishes between ordinary resident companies and exempted companies. Any company that is registered in the Cayman Islands but conducts business mainly outside of the Cayman Islands may apply to be registered as an exempted company. The requirements for an exempted company are essentially the same as for an ordinary company except that an exempted company:

- does not have to file an annual return of its shareholders with the Registrar of Companies;
- is not required to open its register of members for inspection;
- does not have to hold an annual general meeting;
- may issue negotiable or bearer shares or shares with no par value;
- may obtain an undertaking against the imposition of any future taxation (such undertakings are usually given for 20 years in the first instance);
- may register by way of continuation in another jurisdiction and be deregistered in the Cayman Islands;

- may register as a limited duration company; and
- may register as a segregated portfolio company.

"Limited liability" means that the liability of each shareholder is limited to the amount unpaid by the shareholder on the shares of the company.

Register of Members. Under the Companies Law, we must keep a register of members and there should be entered therein:

- the names and addresses of our members, a statement of the shares held by each member, and of the amount paid or agreed to be considered as paid, on the shares of each member;
- the date on which the name of any person was entered on the register as a member; and
- the date on which any person ceased to be a member.

Under Cayman Islands law, the register of members of our company is prima facie evidence of the matters set out therein (i.e. the register of members will raise a presumption of fact on the matters referred to above unless rebutted) and a member registered in the register of members is deemed as a matter of Cayman Islands law to have legal title to the shares as set against its name in the register of members.

If the name of any person is incorrectly entered in or omitted from our register of members, or if there is any default or unnecessary delay in entering on the register the fact of any person having ceased to be a member of our company, the person or member aggrieved (or any member of our company or our company itself) may apply to the Grand Court of the Cayman Islands for an order that the register be rectified, and the Court may either refuse such application or it may, if satisfied of the justice of the case, make an order for the rectification of the register.

Differences in Corporate Law

The Companies Law is modeled after that of English law but does not follow many recent English law statutory enactments. In addition, the Companies Law differs from laws applicable to United States corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of the Companies Law applicable to us and the laws applicable to companies incorporated in the State of Delaware.

Mergers and Similar Arrangements. A merger of two or more constituent companies under Cayman Islands law requires a plan of merger or consolidation to be approved by the directors of each constituent company and authorization by (a) a special resolution of the shareholders and (b) such other authorization, if any, as may be specified in such constituent company's articles of association.

A merger between a Cayman parent company and its Cayman subsidiary or subsidiaries does not require authorization by a resolution of shareholders of that Cayman subsidiary if a copy of the plan of merger is given to every member of that Cayman subsidiary to be merged unless that member agrees otherwise. For this purpose a subsidiary is a company of which at least ninety percent (90%) of the issued shares entitled to vote are owned by the parent company.

The consent of each holder of a fixed or floating security interest over a constituent company is required unless this requirement is waived by a court in the Cayman Islands.

Save in certain circumstances, a dissentient shareholder of a Cayman constituent company is entitled to payment of the fair value of his shares upon dissenting to a merger or consolidation. The exercise of appraisal rights will preclude the exercise of any other rights save for the right to seek relief on the grounds that the merger or consolidation is void or unlawful.

In addition, there are statutory provisions that facilitate the reconstruction and amalgamation of companies, provided that the arrangement is approved by a majority in number of each class of shareholders and creditors with whom the arrangement is to be made, and who must in addition represent three-fourths in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting, or meetings, convened for that purpose. The convening of the meetings and subsequently the arrangement must be sanctioned by the Grand Court of the Cayman Islands. While a dissenting shareholder has the right to express to the court the view that the transaction ought not to be approved, the court can be expected to approve the arrangement if it determines that:

- the statutory provisions as to the required majority vote have been met;
- the shareholders have been fairly represented at the meeting in question and the statutory majority are acting bona fide without coercion of the minority to promote interests adverse to those of the class;
- the arrangement is such that may be reasonably approved by an intelligent and honest man of that class acting in respect of his interest; and
- the arrangement is not one that would more properly be sanctioned under some other provision of the Companies Law.

When a takeover offer is made and accepted by holders of 90.0% of the shares within four months, the offeror may, within a two-month period commencing on the expiration of such four month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed in the case of an offer which has been so approved unless there is evidence of fraud, bad faith or collusion.

If an arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of Delaware corporations, providing rights to receive payment in cash for the judicially determined value of the shares.

Shareholders' Suits. In principle, we will normally be the proper plaintiff and as a general rule a derivative action may not be brought by a minority shareholder. However, based on English authorities, which would in all likelihood be of persuasive authority in the Cayman Islands, there are exceptions to the foregoing principle, including when:

- a company acts or proposes to act illegally or ultra vires;

- the act complained of, although not ultra vires, could only be effected duly if authorized by more than a simple majority vote that has not been obtained; and

- those who control the company are perpetrating a "fraud on the minority."

Indemnification of Directors and Executive Officers and Limitation of Liability. Cayman Islands law does not limit the extent to which a company's memorandum and articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. Our current memorandum and articles of association permit indemnification of officers and directors for losses, damages, costs and expenses incurred in their capacities as such unless such losses or damages arise from dishonesty, willful default, or fraud of such directors or officers. This standard of conduct is generally the same as permitted under the Delaware General Corporation Law for a Delaware corporation. In addition, we have entered into indemnification agreements with our directors and executive officers that provide such persons with additional indemnification beyond that provided in our current memorandum and articles of association.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers or persons controlling us under the foregoing provisions, we have been informed that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

Directors' Fiduciary Duties. Under Delaware corporate law, a director of a Delaware corporation has a fiduciary duty to the corporation and its shareholders. This duty has two components: the duty of care and the duty of loyalty. The duty of care requires that a director act in good faith, with the care that an ordinarily prudent person would exercise under similar circumstances. Under this duty, a director must inform himself of, and disclose to shareholders, all material information reasonably available regarding a significant transaction. The duty of loyalty requires that a director acts in a manner he reasonably believes to be in the best interests of the corporation. He must not use his corporate position for personal gain or advantage. This duty prohibits self-dealing by a director and mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally. In general, actions of a director are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. However, this presumption may be rebutted by evidence of a breach of one of the fiduciary duties. Should such evidence be presented concerning a transaction by a director, the director must prove the procedural fairness of the transaction, and that the transaction was of fair value to the corporation.

As a matter of Cayman Islands law, a director of a Cayman Islands company is in the position of a fiduciary with respect to the company and therefore it is considered that he or she owes the following duties to the company—a duty to act bona fide in the best interests of the company, a duty not to make a profit based on his or her position as director (unless the company permits him or her to do so) and a duty not to put himself or herself in a position where the interests of the company conflict with his or her personal interest or his or her duty to a third party. A director of a Cayman Islands company owes to the company a duty to act with skill and care. It was previously considered that a director need not exhibit in the performance of his or her duties a greater degree of skill than may reasonably be expected from a person of his or her knowledge and experience. However, English and Commonwealth courts have moved towards an objective standard with regard to the required skill and care and these authorities are likely to be followed in the Cayman Islands.

Shareholder Action by Written Consent. Under the Delaware General Corporation Law, a corporation may eliminate the right of shareholders to act by written consent by amendment to its certificate of incorporation. Cayman Islands law and our current articles of association provide that shareholders may approve corporate matters by way of a unanimous written resolution signed by or on behalf of each shareholder who would have been entitled to vote on such matter at a general meeting without a meeting being held.

Shareholder Proposals. Under the Delaware General Corporation Law, a shareholder has the right to put any proposal before the annual meeting of shareholders, provided it complies with the notice provisions in the governing documents. A special meeting may be called by the board of directors or any other person authorized to do so in the governing documents, but shareholders may be precluded from calling special meetings.

Cayman Islands law does not provide shareholders any right to put proposals before a meeting or requisition a general meeting. However, these rights may be provided in articles of association. Our current articles of association allow our shareholders holding not less than one-third of all voting power of our share capital in issue to requisition a shareholder's meeting. Other than this right to requisition a shareholders' meeting, our current articles of association do not provide our shareholders other right to put proposal before a meeting. As an exempted Cayman Islands company, we are not obliged by law to call shareholders' annual general meetings.

Cumulative Voting. Under the Delaware General Corporation Law, cumulative voting for elections of directors is not permitted unless the corporation's certificate of incorporation specifically provides for it. Cumulative voting potentially facilitates the representation of minority shareholders on a board of directors since it permits the minority shareholder to cast all the votes to which the shareholder is entitled on a single director, which increases the shareholder's voting power with respect to electing such director. There are no prohibitions in relation to cumulative voting under the laws of the Cayman Islands but our current articles of association do not provide for cumulative voting. As a result, our shareholders are not afforded any less protections or rights on this issue than shareholders of a Delaware corporation.

Removal of Directors. Under the Delaware General Corporation Law, a director of a corporation with a classified board may be removed only for cause with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. Under our current articles of association, directors may be removed with or without cause, by an ordinary resolution of our shareholders.

Transactions with Interested Shareholders. The Delaware General Corporation Law contains a business combination statute applicable to Delaware corporations whereby, unless the corporation has specifically elected not to be governed by such statute by amendment to its certificate of incorporation, it is prohibited from engaging in certain business combinations with an “interested shareholder” for three years following the date that such person becomes an interested shareholder. An interested shareholder generally is a person or a group who or which owns or owned 15% or more of the target’s outstanding voting share within the past three years. This has the effect of limiting the ability of a potential acquirer to make a two-tiered bid for the target in which all shareholders would not be treated equally. The statute does not apply if, among other things, prior to the date on which such shareholder becomes an interested shareholder, the board of directors approves either the business combination or the transaction which resulted in the person becoming an interested shareholder. This encourages any potential acquirer of a Delaware corporation to negotiate the terms of any acquisition transaction with the target’s board of directors.

Cayman Islands law has no comparable statute. As a result, we cannot avail ourselves of the types of protections afforded by the Delaware business combination statute. However, although Cayman Islands law does not regulate transactions between a company and its significant shareholders, it does provide that such transactions must be entered into bona fide in the best interests of the company and not with the effect of constituting a fraud on the minority shareholders.

Dissolution; Winding up. Under the Delaware General Corporation Law, unless the board of directors approves the proposal to dissolve, dissolution must be approved by shareholders holding 100% of the total voting power of the corporation. Only if the dissolution is initiated by the board of directors may it be approved by a simple majority of the corporation’s outstanding shares. Delaware law allows a Delaware corporation to include in its certificate of incorporation a supermajority voting requirement in connection with dissolutions initiated by the board. Under Cayman Islands law, a company may be wound up by either an order of the courts of the Cayman Islands or by a special resolution of its members or, if the company is unable to pay its debts as they fall due, by an ordinary resolution of its members. The court has authority to order winding up in a number of specified circumstances including where it is, in the opinion of the court, just and equitable to do so. Under the Companies Law and our current articles of association, our company may be dissolved, liquidated or wound up by a special resolution of our shareholders.

Variation of Rights of Shares. Under the Delaware General Corporation Law, a corporation may vary the rights of a class of shares with the approval of a majority of the outstanding shares of such class, unless the certificate of incorporation provides otherwise. Under Cayman Islands law and our current articles of association, if our share capital is divided into more than one class of shares, we may vary the rights attached to any class with the written consent of the holders of three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a general meeting of the holders of the shares of that class.

Amendment of Governing Documents. Under the Delaware General Corporation Law, a corporation’s governing documents may be amended with the approval of a majority of the outstanding shares entitled to vote, unless the certificate of incorporation provides otherwise. As permitted by Cayman Islands law, our current memorandum and articles of association may only be amended with a special resolution of our shareholders.

Rights of Non-resident or Foreign Shareholders. There are no limitations imposed by our post-offering amended and restated memorandum and articles of association on the rights of non-resident or foreign shareholders to hold or exercise voting rights on our shares. In addition, there are no provisions in our current memorandum and articles of association governing the ownership threshold above which shareholder ownership must be disclosed.

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in "Item 4. Information on the Company" or elsewhere in this annual report on Form 20-F.

D. Exchange Controls

See "Item 4.B. Information on the Company—Business Overview—PRC Regulation—Regulations on Foreign Currency Exchange."

E. Taxation

Cayman Islands Taxation

Travers Thorp Alberga, our Cayman Islands counsel, has advised us that the Cayman Islands currently levies no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. There are no other taxes levied by the Government of the Cayman Islands that are likely to be material to holders of ADSs or ordinary shares. The Cayman Islands is not party to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

People's Republic of China Taxation

Under the EIT Law, an enterprise established outside the PRC with a "de facto management body" within the PRC is considered a PRC resident enterprise for PRC enterprise income tax purposes and is generally subject to a uniform 25% enterprise income tax rate on its worldwide income as well as tax reporting obligations. Under the Implementation Rules, a "de facto management body" is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and properties of an enterprise. In addition, SAT Circular 82 issued in April 2009 specifies that certain offshore-incorporated enterprises controlled by PRC enterprises or PRC enterprise groups will be classified as PRC resident enterprises if all of the following conditions are met: (a) senior management personnel and core management departments in charge of the daily operations of the enterprises have their presence mainly in the PRC; (b) their financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (c) major assets, accounting books and company seals of the enterprises, and minutes and files of their board's and shareholders' meetings are located or kept in the PRC; and (d) half or more of the enterprises' directors or senior management personnel with voting rights habitually reside in the PRC. Further to SAT Circular 82, the SAT issued SAT Bulletin 45, which took effect in September 2011, to provide more guidance on the implementation of SAT Circular 82. SAT Bulletin 45 provides for procedures and administration details of determination on PRC resident enterprise status and administration on post-determination matters. If the PRC tax authorities determine that Tuniu Corporation is a PRC resident enterprise for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. For example, Tuniu Corporation may be subject to enterprise income tax at a rate of 25% with respect to its worldwide taxable income. Also, a 10% withholding tax would be imposed on dividends we pay to our non-PRC enterprise shareholders and with respect to gains derived by our non-PRC enterprise shareholders from transferring our shares or ADSs and potentially a 20% of withholding tax would be imposed on dividends we pay to our non-PRC individual shareholders and with respect to gains derived by our non-PRC individual shareholders from transferring our shares or ADSs.

It is unclear whether, if we are considered a PRC resident enterprise, holders of our shares or ADSs would be able to claim the benefit of income tax treaties or agreements entered into between China and other countries or areas. See "Item 3.D. Key Information—Risk Factors—Risks Related to Doing Business in China—Under the PRC Enterprise Income

Tax Law, we may be classified as a PRC resident enterprise for PRC enterprise income tax purposes. Such classification would likely result in unfavorable tax consequences to us and our non-PRC shareholders and would have a material adverse effect on our results of operations and the value of your investment."

The SAT issued SAT Circular 59 together with the Ministry of Finance in April 2009 and SAT Circular 698 in December 2009. Both SAT Circular 59 and SAT Circular 698 became effective retroactively as of January 1, 2008. By promulgating and implementing these two circulars, the PRC tax authorities have enhanced their scrutiny over the direct or indirect transfer of equity interests in a PRC resident enterprise by a non-PRC resident enterprise. The SAT further released its Bulletin on Several Issues Concerning Enterprise Income Taxation on Income Arising from the Indirect Transfers of Property by Non-resident Enterprises ("SAT Bulletin 2015 No. 7" or "Bulletin 7") which became effective on February 3, 2015. Bulletin 7 repealed the relevant Indirect Transfer provisions contained in Circular 698 and set forth more detailed rules for the tax treatment of Indirect Transfers of equity interests in PRC resident enterprises and other assets situated in China. Bulletin 7 abolished the previous mandatory reporting requirement for Indirect Transfers under Circular 698, and provides that the parties to an Indirect Transfer transaction have the option to decide whether to report the Indirect Transfer to the competent tax authorities. Applying a "substance over form" principle, when a non-resident enterprise structures an Indirect Transfer of an equity interest in a PRC resident enterprise or other assets situated in China to avoid taxation under the EIT through arrangements lacking reasonable commercial purposes, the Indirect Transfer will be re-characterized as a direct transfer. As a result, any gains derived from the Indirect Transfer may be subject to PRC withholding tax at a rate of up to 10%. Bulletin 7 provides de facto safe harbor treatment for situations in which a non-resident enterprise buys and then sells shares, in the public securities markets, of a foreign listed company that holds an equity interest in a PRC resident enterprise, and thereby realizes a capital gain. However, in order for the safe harbor treatment to apply, both the purchase and sale must be conducted on the public securities markets so as to preclude market manipulation, and the equity interests purchased and sold must be those in the same enterprise. When shares sold in the public securities markets were obtained before such shares were listed on a public securities market or were not purchased through a public securities market, or when shares were purchased on a public market but are to be sold through non-public markets, the safe harbor treatment would not be applicable. There is uncertainty as to the interpretation and application of SAT Circular 698 and Bulletin 7 and we and our non-PRC resident investors may be at risk of being taxed under SAT Circular 698 and Bulletin 7 and we may be required to expend valuable resources to comply with SAT Circular 698 and Bulletin 7 or to establish that we should not be taxed under SAT Circular 698 and Bulletin 7. See "Item 3.D. Key Information—Risk Factors—Risks Related to Doing Business in China—We face uncertainty regarding the PRC tax reporting obligations and consequences for certain indirect transfers of our operating company's equity interests. Enhanced scrutiny over acquisition transactions by the PRC tax authorities may have a negative impact on potential acquisitions we may pursue in the future."

United States Federal Income Tax Considerations

The following discussion is a summary of United States federal income tax considerations relating to the ownership and disposition of our ADSs or ordinary shares by a U.S. Holder, as defined below, that holds our ADSs or ordinary shares as "capital assets" (generally, property held for investment) under the United States Internal Revenue Code of 1986, as amended (the "Code"). This discussion is based upon existing United States federal income tax law, which is subject to differing interpretations or change, possibly with retroactive effect. No ruling has been sought from the Internal Revenue Service (the "IRS") with respect to any United States federal income tax consequences described below, and there can be no assurance that the IRS or a court will not take a contrary position. This discussion does not address all aspects of United States federal income taxation that may be important to particular investors in light of their individual circumstances, including investors subject to special tax rules that differ significantly from those summarized below (such as, for example, certain financial institutions, insurance companies, regulated investment companies, real estate investment trusts, broker-dealers, traders in securities that elect mark-to-market treatment, partnerships and their partners, tax-exempt organizations (including private foundations), investors who are not U.S. Holders, investors that own (directly, indirectly, or constructively) 10% or more of our voting stock, investors that hold their ADSs or ordinary shares as part of a straddle, hedge, conversion, constructive sale or other integrated transaction), or investors that have a functional currency other than the U.S. dollar). In addition, this discussion does not address United States federal estate, gift, Medicare, and alternative minimum tax considerations, or state, local, and non-United States tax considerations. Each U.S. Holder is urged to consult its tax advisor regarding the United States federal, state, local, and non-United States tax considerations of an investment in our ADSs or ordinary shares.

General

For purposes of this discussion, a "U.S. Holder" is a beneficial owner of our ADSs or ordinary shares that is, for United States federal income tax purposes, (i) an individual who is a citizen or resident of the United States, (ii) a corporation (or other entity treated as a corporation for United States federal income tax purposes) created in, or organized under the laws of, the United States or any state thereof or the District of Columbia, (iii) an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source, or (iv) a trust (A) the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust or (B) that has otherwise elected to be treated as a United States person under the Code.

If a partnership (or other entity treated as a partnership for United States federal income tax purposes) is a beneficial owner of our ADSs or ordinary shares, the tax treatment of a partner in the partnership will depend upon the status of the partner and the activities of the partnership. Partnerships and partners of a partnership holding our ADSs or ordinary shares are urged to consult their tax advisors regarding an investment in our ADSs or ordinary shares.

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It is generally expected that a U.S. Holder of ADSs will be treated as the beneficial owner, for United States federal income tax purposes, of the underlying shares represented by the ADSs. The remainder of this discussion assumes that a U.S. Holder of our ADSs will be treated in this manner. Accordingly, deposits or withdrawals of our ordinary shares for our ADSs will not be subject to United States federal income tax.

Passive Foreign Investment Company Considerations

A non-United States corporation, such as our company, will be classified as a "passive foreign investment company," or PFIC, for United States federal income tax purposes, if, in the case of any particular taxable year, either (i) 75% or more of its gross income for such year consists of certain types of "passive" income or (ii) 50% or more of the value of its assets (as determined on the basis of a quarterly average) during such year produce or are held for the production of passive income (the "asset test"). For this purpose, cash is categorized as a passive asset and the company's goodwill and unbooked intangibles associated with active business activities may generally be classified as active assets. Passive income generally includes, among other things, dividends, interest, rents, royalties, and gains from the disposition of passive assets. We will be treated as owning our proportionate share of the assets and earning our proportionate share of the income of any other corporation in which we own, directly or indirectly, more than 25% (by value) of the stock.

Although the law in this regard is unclear, we treat Nanjing Tuniu and its subsidiaries (our "consolidated affiliated entities") as being owned by us for United States federal income tax purposes, not only because we exercise effective control over the operation of such entities but also because we are entitled to substantially all of their economic benefits, and, as a result, we consolidate their operating results in our consolidated financial statements. If it were determined that we are not the owner of our consolidated affiliated entities for United States federal income tax purposes, our risk of being classified as a PFIC may substantially increase. Assuming that we are the owner of our consolidated affiliated entities for United States federal income tax purposes and based upon our income and assets and the market price of our ADSs, we do not believe that we were a PFIC for the taxable year ended December 31, 2015 and do not anticipate becoming a PFIC in the foreseeable future.

While we do not believe that we were a PFIC for the taxable year ended December 31, 2015 and do not anticipate becoming a PFIC in future taxable years, no assurance can be given in this regard because the determination of whether we will be or become a PFIC is a factual determination made annually that will depend, in part, upon the composition of our income and assets. Fluctuations in the market price of our ADSs may cause us to be classified as a PFIC for the current or future taxable years because the value of our assets for purposes of the asset test, including the value of our goodwill and unbooked intangibles, may be determined by reference to the market price of our ADSs from time to time (which may be volatile). In estimating the value of our goodwill and other unbooked intangibles, we have taken into account our current market capitalization. If our market capitalization subsequently declines, we may be or become classified as a PFIC for the current taxable year or future taxable years.

Furthermore, the composition of our income and assets may also be affected by how, and how quickly, we use our liquid assets. Under circumstances where our revenue from activities that produce passive income significantly increase relative to our revenue from activities that produce non-passive income, or where we determine not to deploy significant amounts of cash for active purposes, our risk of becoming classified as a PFIC may substantially increase. In addition, because there are uncertainties in the application of the relevant rules, it is possible that the IRS may challenge our classification of certain income and assets as non-passive or our valuation of our tangible and intangible assets, each of which may result in our becoming a PFIC for the current or subsequent taxable years. If we were classified as a PFIC for any year during which a U.S. Holder held our ADSs or ordinary shares, we generally would continue to be treated as a PFIC for all succeeding years during which such U.S. Holder held our ADSs or ordinary shares.

The discussion below under “Dividends” and “Sale or Other Disposition of ADSs or Ordinary Shares” is written on the basis that we will not be classified as a PFIC for United States federal income tax purposes. The United States federal income tax rules that apply if we are classified as a PFIC for the current taxable year or any subsequent taxable year are discussed below under “Passive Foreign Investment Company Rules.”

Dividends

Subject to the PFIC rules described below, any cash distributions (including the amount of any PRC tax withheld) paid on our ADSs or ordinary shares out of our current or accumulated earnings and profits, as determined under United States federal income tax principles, will generally be includible in the gross income of a U.S. Holder as dividend income on the day actually or constructively received by the U.S. Holder, in the case of ordinary shares, or by the depositary bank, in the case of ADSs. Because we do not intend to determine our earnings and profits on the basis of United States federal income tax principles, a U.S. Holder should expect that any distribution paid on our ADSs or ordinary shares will be treated as a "dividend" for United States federal income tax purposes. A non-corporate recipient of dividend income will generally be subject to tax on dividend income from a "qualified foreign corporation" at a lower applicable capital gains rate rather than the marginal tax rates generally applicable to ordinary income provided that certain holding period and other requirements are met.

A non-United States corporation (other than a corporation that is classified as a PFIC for the taxable year in which the dividend is paid or the preceding taxable year) will be considered to be a qualified foreign corporation (a) if it is eligible for the benefits of a comprehensive tax treaty with the United States which the Secretary of Treasury of the United States determines is satisfactory for purposes of this provision and which includes an exchange of information program, or (b) with respect to any dividend it pays on stock (or ADSs in respect of such stock) which is readily tradable on an established securities market in the United States. Our ADSs are listed on the NASDAQ Global Market, which is an established securities market in the United States, and will be considered readily tradable on an established securities market for as long as the ADSs continue to be listed on the NASDAQ Global Market. Thus, we believe that we will be a qualified foreign corporation with respect to dividends we pay on our ADSs, but there can be no assurance that our ADSs will continue to be considered readily tradable on an established securities market in later years. Since we do not expect that our ordinary shares will be listed on established securities markets, it is unclear whether dividends that we pay on our ordinary shares that are not backed by ADSs currently meet the conditions required for the reduced tax rate. However, in the event we are deemed to be a PRC resident enterprise under the EIT Law (see "People's Republic of China Taxation"), we may be eligible for the benefits of the United States-PRC income tax treaty (which the Secretary of the Treasury of the United States has determined is satisfactory for this purpose) and be treated as a qualified foreign corporation with respect to dividends paid on our ADSs or ordinary shares. U.S. Holders are urged to consult their tax advisors regarding the availability of the reduced tax rate on dividends with respect to our ADSs or ordinary shares in their particular circumstances. Dividends received on our ADSs or ordinary shares will not be eligible for the dividends-received deduction allowed to corporations.

For United States foreign tax credit purposes, dividends paid on our ADSs or ordinary shares will be treated as income from foreign sources and will generally constitute passive category income. In the event that we are deemed to be a PRC resident enterprise under the EIT Law, a U.S. Holder may be subject to PRC withholding taxes on dividends paid, if any, on our ADSs or ordinary shares. A U.S. Holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on our ADSs or ordinary shares. A U.S. Holder who does not elect to claim a foreign tax credit for foreign tax withheld may instead claim a deduction for United States federal income tax purposes in respect of such withholding, but only for a year in which such U.S. Holder elects to do so for all creditable foreign income taxes. The rules governing the foreign tax credit are complex. U.S. Holders are urged to consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

Sale or Other Disposition of ADSs or Ordinary Shares

Subject to the PFIC rules discussed below, a U.S. Holder will generally recognize capital gain or loss, if any, upon the sale or other disposition of ADSs or ordinary shares in an amount equal to the difference between the amount realized upon the disposition and the U.S. Holder's adjusted tax basis in such ADSs or ordinary shares. Any capital gain or loss will be long-term gain or loss if the ADSs or ordinary shares have been held for more than one year and will generally be United States-source gain or loss for United States foreign tax credit purposes. In the event that we are treated as a PRC resident enterprise under the EIT Law, and gain from the disposition of the ADSs or ordinary shares is subject to tax in the PRC, such gain may be treated as PRC-source gain for foreign tax credit purposes under the United States-PRC income tax treaty. The deductibility of a capital loss may be subject to limitations. U.S. Holders are urged to consult their tax advisors regarding the tax consequences if a foreign tax is imposed on a disposition of our ADSs or ordinary shares, including the availability of the foreign tax credit under their particular circumstances.

Passive Foreign Investment Company Rules

If we are classified as a PFIC for any taxable year during which a U.S. Holder holds our ADSs or ordinary shares, unless the U.S. Holder makes a mark-to-market election (as described below) with respect to the ADSs, the U.S. Holder will, except as discussed below, be subject to special tax rules that have a penalizing effect, regardless of whether we remain a PFIC, on (i) any excess distribution that we make to the U.S. Holder (which generally means any distribution paid during a taxable year to a U.S. Holder that is greater than 125% of the average annual distributions paid in the three preceding taxable years or, if shorter, the U.S. Holder’s holding period for the ADSs or ordinary shares), and (ii) any gain realized on the sale or other disposition, including, under certain circumstances, a pledge, of ADSs or ordinary shares. Under the PFIC rules:

- the excess distribution and/or gain will be allocated ratably over the U.S. Holder’s holding period for the ADSs or ordinary shares;

- the amount allocated to the current taxable year and any taxable years in the U.S. Holder’s holding period prior to the first taxable year in which we are classified as a PFIC (each, a pre-PFIC year) will be taxable as ordinary income;

- the amount allocated to each prior taxable year, other than the current taxable year or a pre-PFIC year, will be subject to tax at the highest tax rate in effect applicable to the individuals or corporations, as appropriate, for that year; and

- will be increased by an additional tax equal to interest on the resulting tax deemed deferred with respect to each prior taxable year, other than a pre-PFIC year.

If we are a PFIC for any taxable year during which a U.S. Holder holds our ADSs or ordinary shares and any of our non-United States subsidiaries is also a PFIC, such U.S. Holder would be treated as owning a proportionate amount (by value) of the shares of the lower-tier PFIC for purposes of the application of these rules. Each U.S. Holder is advised to consult its tax advisors regarding the application of the PFIC rules to any of our subsidiaries.

As an alternative to the foregoing rules, a U.S. Holder of “marketable stock” in a PFIC may make a mark-to-market election with respect to our ADSs, provided that the ADSs are regularly traded on the NASDAQ Global Market. We anticipate that the ADSs should qualify as being regularly traded, but no assurances may be given in this regard. If a mark-to-market election is made, the U.S. Holder will generally (i) include as ordinary income for each taxable year that we are a PFIC the excess, if any, of the fair market value of ADSs held at the end of the taxable year over the adjusted tax basis of such ADSs and (ii) deduct as an ordinary loss the excess, if any, of the adjusted tax basis of the ADSs over the fair market value of such ADSs held at the end of the taxable year, but only to the extent of the net amount previously included in income as a result of the mark-to-market election. The U.S. Holder’s adjusted tax basis in the ADSs would be adjusted to reflect any income or loss resulting from the mark-to-market election. If a U.S.

Holder makes an effective mark-to-market election, in each year that we are a PFIC, any gain recognized upon the sale or other disposition of the ADSs will be treated as ordinary income and loss will be treated as ordinary loss, but only to the extent of the net amount previously included in income as a result of the mark-to-market election.

If a U.S. Holder makes a mark-to-market election in respect of a corporation classified as a PFIC and such corporation ceases to be classified as a PFIC, the U.S. Holder will not be required to take into account the mark-to-market gain or loss described above during any period that such corporation is not classified as a PFIC.

Because a mark-to-market election cannot be made for any lower-tier PFICs that we may own, a U.S. Holder who makes a mark-to-market election with respect to our ADSs may continue to be subject to the general PFIC rules with respect to such U.S. Holder’s indirect interest in any of our non-United States subsidiaries that is classified as a PFIC.

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We do not intend to provide information necessary for U.S. Holders to make qualified electing fund elections, which, if available, would result in tax treatment different from the general tax treatment for PFICs described above.

As discussed above under "Dividends," dividends that we pay on our ADSs or ordinary shares will not be eligible for the reduced tax rate that applies to qualified dividend income if we are classified as a PFIC for the taxable year in which the dividend is paid or the preceding taxable year. In addition, if a U.S. Holder owns our ADSs or ordinary shares during any taxable year that we are a PFIC, such U.S. Holder must file an annual report with the IRS, subject to certain limited exceptions. Each U.S. Holder is urged to consult its tax advisor concerning the United States federal income tax consequences of owning and disposing our ADSs or ordinary shares if we are or become a PFIC, including the possibility of making a mark-to-market election and the unavailability of the qualified electing fund election.

Information Reporting

Certain U.S. Holders are required to report information to the Internal Revenue Service relating to an interest in "specified foreign financial assets," including shares issued by a non-United States corporation, for any year in which the aggregate value of all specified foreign financial assets exceeds $50,000 (or a higher dollar amount prescribed by the Internal Revenue Service), subject to certain exceptions. These rules also impose penalties if a U.S. Holder is required to submit such information to the Internal Revenue Service and fails to do so.

In addition, U.S. Holders may be subject to information reporting to the IRS with respect to dividends on and proceeds from the sale or other disposition of our ADSs or ordinary shares. Each U.S. Holder is advised to consult with its tax advisor regarding the application of the United States information reporting rules to their particular circumstances.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We previously filed with the SEC our registration statement on Form F-1 (Registration No. 333-195075), as amended, including the prospectus contained therein, to register the issuance and sale of our ordinary shares represented by ADSs in relation to our initial public offering. We have also filed with the SEC registration statements on Form F-6 (Registration No. 333-195515) to register our ADSs.

We are subject to periodic reporting and other informational requirements of the Exchange Act as applicable to foreign private issuers, and are required to file reports and other information with the SEC. Specifically, we are required to file annually an annual report on Form 20-F within four months after the end of each fiscal year, which is December 31. All information filed with the SEC can be obtained over the internet at the SEC's website at *www.sec.gov* or inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You can request copies of documents, upon payment of a duplicating fee, by writing to the SEC. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

We will furnish JPMorgan Chase Bank, N.A., the depositary of our ADSs, with our annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP, and all notices of shareholders' meetings and other reports and communications that are made generally available to our shareholders. The depositary will make such notices, reports and communications available to holders of ADSs and, upon our request, will mail to all record holders of ADSs the information contained in any notice of a shareholders' meeting received by the depositary from us.

In accordance with NASDAQ Stock Market Rule 5250(d), we will post this annual report on Form 20-F on our website at http://ir.tuniu.com. In addition, we will provide hardcopies of our annual report free of charge to shareholders and ADS holders upon request.

I. Subsidiary Information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to interest rate risk primarily relates to the interest income generated by excess cash, which is mostly held in interest-bearing bank deposits. We have not used derivative financial instruments in our investment portfolio. Interest earning instruments carry a degree of interest rate risk. We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in market interest rates. However, our future interest income may fall short of expectations due to changes in market interest rates.

Foreign Exchange Risk

All of our revenues and substantially all of our expenses are denominated in Renminbi. We do not believe that we currently have any significant direct foreign exchange risk and have not used any derivative financial instruments to hedge exposure to such risk. Although in general our exposure to foreign exchange risks should be limited, the value of your investment in our ADSs will be affected by the exchange rate between the U.S. dollar and the Renminbi because the value of our business is effectively denominated in Renminbi, while our ADSs will be traded in U.S. dollars.

The value of the Renminbi against the U.S. dollar and other currencies is affected by changes in China's political and economic conditions and by China's foreign exchange policies, among other things. In July 2005, the PRC government changed its decades-old policy of pegging the value of the Renminbi to the U.S. dollar, and the Renminbi appreciated more than 20% against the U.S. dollar over the following three years. Between July 2008 and June 2010, this appreciation halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. Since June 2010, the Renminbi has fluctuated against the U.S. dollar, at times significantly and unpredictably. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the Renminbi and the U.S. dollar in the future.

To the extent that we need to convert U.S. dollars into Renminbi for our operations, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we receive from the conversion. Conversely, if we decide to convert Renminbi into U.S. dollars for the purpose of making payments for dividends on our ordinary shares or ADSs or for other business purposes, appreciation of the U.S. dollar against the Renminbi would have a negative effect on the U.S. dollar amounts available to us.

As of December 31, 2015, we had Renminbi-denominated cash and cash equivalents, restricted cash and short-term investments of RMB3,666.6 million, and U.S. dollar-denominated cash, cash equivalents and short-term investments of US$566.0 million. Assuming we had converted RMB1.0 million into U.S. dollars at the exchange rate of RMB6.4778 for US$1.00 as of December 31, 2015, our U.S. dollar cash balance would have been US$154,373. If the Renminbi had depreciated by 10% against the U.S. dollar, our U.S. dollar cash balance would have been US$140,339 instead. Assuming we had converted US$1.0 million into Renminbi at the exchange rate of RMB6.4778 for US$1.00 as of December 31, 2015, our Renminbi cash balance would have been RMB6.5 million. If the Renminbi had depreciated by 10% against the U.S. dollar, our Renminbi cash balance would have been RMB7.1 million instead. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk.

Inflation

Inflation in China has not materially affected our results of operations in recent years. According to the National Bureau of Statistics of China, the year-over-year percent changes in the consumer price index for December 2013, 2014 and 2015 were increases of 2.5%, 1.5% and 1.6%, respectively. Although we have not been materially affected by inflation in the past, we may be materially affected if China experiences higher rates of inflation in the future.

Item 12. Description of Securities Other than Equity Securities

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

Fees and Charges Our ADS holders May Have to Pay

The depositary may charge each person to whom ADSs are issued, including, without limitation, issuances against deposits of shares, issuances in respect of share distributions, rights and other distributions, issuances pursuant to a stock dividend or stock split declared by us or issuances pursuant to a merger, exchange of securities or any other transaction or event affecting the ADSs or deposited securities, and each person surrendering ADSs for withdrawal of deposited securities or whose ADRs are cancelled or reduced for any other reason, US$5.00 for each 100 ADSs (or any portion thereof) issued, delivered, reduced, cancelled or surrendered, as the case may be. The depositary may sell (by public or private sale) sufficient securities and property received in respect of a share distribution, rights and/or other distribution prior to such deposit to pay such charge.

The following additional charges shall be incurred by the ADR holders, by any party depositing or withdrawing shares or by any party surrendering ADSs or to whom ADSs are issued (including, without limitation, issuance pursuant to a stock dividend or stock split declared by us or an exchange of stock regarding the ADSs or the deposited securities or a distribution of ADSs), whichever is applicable:

- a fee of US$1.50 per ADR for transfers of certificated or direct registration ADRs;

- a fee of up to US$0.05 per ADS for any cash distribution made pursuant to the deposit agreement;

- a fee of up to US$0.05 per ADS per calendar year (or portion thereof) for services performed by the depositary in administering the ADRs (which fee may be charged on a periodic basis during each calendar year and shall be assessed against holders of ADRs as of the record date or record dates set by the depositary during each calendar year and shall be payable in the manner described in the next succeeding provision);

- a fee for the reimbursement of such fees, charges and expenses as are incurred by the depositary and/or any of its agents (including, without limitation, the custodian and expenses incurred on behalf of holders in connection with compliance with foreign exchange control regulations or any law or regulation relating to foreign investment) in connection with the servicing of the shares or other deposited securities, the sale of securities (including, without limitation, deposited securities), the delivery of deposited securities or otherwise in connection with the depositary's or its custodian's compliance with applicable law, rule or regulation (which fees and charges shall be assessed on a proportionate basis against holders as of the record date or dates set by the depositary and shall be payable at the sole discretion of the depositary by billing such holders or by deducting such charge from one or more cash dividends or other cash distributions);

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- a fee for the distribution of securities (or the sale of securities in connection with a distribution), such fee being in an amount equal to the US$0.05 per ADS issuance fee for the execution and delivery of ADSs which would have been charged as a result of the deposit of such securities (treating all such securities as if they were shares) but which securities or the net cash proceeds from the sale thereof are instead distributed by the depositary to those holders entitled thereto;
- stock transfer or other taxes and other governmental charges;
- cable, telex and facsimile transmission and delivery charges incurred at your request in connection with the deposit or delivery of shares;
- transfer or registration fees for the registration of transfer of deposited securities on any applicable register in connection with the deposit or withdrawal of deposited securities;
- the fees, expenses and other charges charged by JPMorgan Chase Bank, N.A. and/or its agent (which maybe a division, branch or affiliate) in connection with the conversion of foreign currency into U.S. dollars; and
- fees of any division, branch or affiliate of the depositary utilized by the depositary to direct, manage and/or execute any public and/or private sale of securities under the deposit agreement.

JPMorgan Chase Bank, N.A. and/or its agent may act as principal for such conversion of foreign currency. We will pay all other charges and expenses of the depositary and any agent of the depositary (except the custodian) pursuant to agreements from time to time between us and the depositary. The charges described above may be amended from time to time by agreement between us and the depositary.

Fees and Other Payments Made by the Depositary to Us

The depositary has agreed to reimburse us for certain expenses we incur that are related to establishment and maintenance of the ADR program upon such terms and conditions as we and the depositary may agree from time to time. The depositary may make available to us a set amount or a portion of the depositary fees charged in respect of the ADR program or otherwise upon such terms and conditions as we and the depositary may agree from time to time. The depositary collects its fees for issuance and cancellation of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions, or by directly billing investors, or by charging the book-entry system accounts of participants acting for them. The depositary will generally set off the amounts owing from distributions made to holders of ADSs.

If, however, no distribution exists and payment owing is not timely received by the depositary, the depositary may refuse to provide any further services to holders that have not paid those fees and expenses owing until such fees and expenses have been paid. At the discretion of the depositary, all fees and charges owing under the deposit agreement are due in advance and/or when declared owing by the depositary. For the fiscal year 2015, we received a reimbursement of approximately US$1.1 million from the depositary net of US$0.3 million United States withholding tax.

The fees and charges you may be required to pay may vary over time and may be changed by us and by the depositary. You will receive prior notice of any increase in any such fees and charges.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

See "Item 10.B. Additional Information—Memorandum and Articles of Association—Ordinary Shares" for a description of the rights of our securities holders, which remain unchanged. For information on limitations on our payment of dividends, see "Item 4.B. Information on the Company—Business Overview—PRC Regulation—Regulations on Dividend Distribution" and "Item 12.D. Description of Securities Other than Equity Securities— American Depositary Shares."

The following "Use of Proceeds" information relates to the registration statement on Form F-1, or the Form F-1, as amended (File No. 333-195075) in relation to our initial public offering, which registration statement was declared effective by the SEC on May 8, 2014. In May 2014, we completed our initial public offering in which we issued and sold an aggregate of 8,580,000 ADSs, representing 25,740,000 Class A ordinary shares. Morgan Stanley, Credit Suisse, and China Renaissance were the representatives of the underwriters for our initial public offering. We received proceeds of approximately US$68.2 million from our initial public offering.

For the period from May 8, 2014, the date that the Form F-1 was declared effective by the SEC, through December 31, 2015, we used all the net proceeds we received from our initial public offering for the following purposes, as set forth in the Form F-1: (i) expanding our sales and marketing efforts; (ii) expanding our product selection and offerings; (iii) strengthening our technology and products developments capabilities; and (iv) general corporate purposes, including funding strategic investments in and acquisitions of complementary businesses, assets and technologies. We still intend to continue using the remainder of the proceeds from our initial public offering for the above purposes, in line with our disclosure in the Form F-1.

We filed another registration statement on Form F-1 (File No. 333-200667) in relation to the sale of our ordinary shares represented by ADSs in a follow-on public offering. We filed a Registration Withdrawal Request (File No. 333-200667) related to that follow-on offering on December 14, 2014 because we were able to acquire funds on favorable terms by entering into a share subscription agreement with five investors, including the respective personal holding companies of Tuniu's chief executive officer and chief operating officer, pursuant to which we sold newly issued class A ordinary shares to the investors.

Item 15. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with participation of our chief executive officer and chief financial officer, has performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the

Securities Exchange Act of 1934, as amended) as of December 31, 2015, the end of the period covered by this annual report.

Based upon that evaluation, our management has concluded that, as of December 31, 2015, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports that we file and furnish under the Exchange Act was recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting

In connection with the audits of our consolidated financial statements as of and for the years ended December 31, 2013 and 2014, we and our independent registered public accounting firm identified one material weakness in our internal control over financial reporting, as defined in the standards established by the U.S. Public Company Accounting Oversight Board of the United States, or PCAOB. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness identified related to the lack of sufficient financial reporting and accounting personnel with appropriate knowledge of US GAAP and the SEC reporting requirements to formalize key controls over financial reporting and to prepare and review consolidated financial statements and related disclosures. The material weakness, if not timely remedied, may lead to significant misstatements in our consolidated financial statements in the future.

To remedy our identified material weakness, we have adopted several measures to improve our internal control over financial reporting. We have hired personnel with relevant experience and necessary expertise to strengthen our financial reporting function and to set up a financial and system control framework. In early 2013, we hired our chief finance officer, who has extensive experience with multiple U.S.-listed companies, to lead our financial department. We also hired personnel with U.S. GAAP experience who formerly worked in Big Four accounting firms, including our finance controller who was formerly a senior manager at a Big Four accounting firm, who joined us in April 2014, and our U.S. GAAP financial reporting manager, who joined us in late 2015, as well as four additional accounting staff members, three with Big Four accounting firm experience and the other one with financial reporting experience for a U.S.-listed company.

In addition to hiring experienced personnel, we have maintained regular and ongoing U.S. GAAP accounting and financial reporting training programs for our accounting and financial reporting personnel. Our accounting and financial reporting personnel attend training seminars on U.S. GAAP, SEC reporting and other accounting-related topics provided by Big Four accounting firms and other professional organizations on a regular basis to maintain up-to-date knowledge on U.S. GAAP and SEC rules.

We have developed and implemented a comprehensive set of U.S. GAAP policies and standardized financial closing and reporting procedures, including an accounting manual and financial closing and reporting checklists.

Moreover, we have set up an internal audit department in September 2014, comprising of a department head and an internal audit manager, each with more than ten years of relevant experience, as well as one former Big Four auditor, to focus on internal audits. In addition, we have engaged a professional consulting firm to assist us to improve our overall internal controls for complying with the Sarbanes-Oxley Act of 2002, which are supervised by our independent audit committee in December 2014.

As of December 31, 2015, based on our management assessment on the performance of the above mentioned remediation measures, we determined that the material weakness previously identified in our internal control over financial reporting had been remediated.

Other than as described above, there were no changes in our internal controls over financial reporting that occurred during the period covered by this annual report on Form 20-F that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of our company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with GAAP, and that receipts and expenditures of our company are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of the unauthorized acquisition, use or disposition of our company's assets that could have a material effect on the consolidated financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management has excluded all the travel agencies (as discussed in Note 4 of the Notes to the Consolidated Financial Statements) that we acquired during 2015 from our assessment of the effectiveness of the internal control over financial reporting as of December 31, 2015. The financial statements of the travel agencies in aggregate constitute approximately 2.7% of the total assets and 6.8% of the net revenue of the respective amounts presented in the consolidated financial statements as of and for the year ended December 31, 2015.

Our management conducted an evaluation of the effectiveness of our company's internal control over financial reporting as of December 31, 2015 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2015.

PricewaterhouseCoopers Zhong Tian LLP, our independent registered public accounting firm, audited the effectiveness of our company's internal control over financial reporting as of December 31, 2015, which has also excluded the travel agencies acquired during 2015 from audit of internal control over financial reporting, as stated in its report, which appears on page F-2 of this Form 20-F.

Changes in Internal Control over Financial Reporting

Other than as described above, there were no changes in our internal controls over financial reporting that occurred during the period covered by this annual report on Form 20-F that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 16A. Audit Committee Financial Expert

Our board of directors has determined that Mr. Onward Choi and Mr. Jack Xu, each an independent director (under the standards set forth in NASDAQ Stock Market Rule 5605(a)(2) and Rule 10A-3 under the Exchange Act) and a member of our audit committee, are audit committee financial experts.

Item 16B. Code of Ethics

Our board of directors adopted a code of business conduct and ethics that applies to our directors, officers and employees, including certain provisions that specifically apply to our chief executive officers, chief financial officer, senior finance officer and any other persons who perform similar functions for us. We filed our code of business conduct and ethics as Exhibit 99.1 to our registration statement on Form F-1, as amended, which was originally filed with the SEC on April 4, 2014. We have posted a copy of our code of business conduct and ethics on our website at http://ir.tuniu.com.

Item 16C. Principal Accountant Fees and Services

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by PricewaterhouseCoopers Zhong Tian LLP, our principal external auditors, for the periods indicated.

	2014	2015
Audit fees(1)	US$834,450	US$1,436,719
Audit-related fees(2)	US$1,134,844	—
Tax fees(3)	US$58,102	—

(1) "Audit fees" means the aggregate fees billed for professional services rendered by our principal external auditors for the audits of our annual financial statements and effectiveness of internal control over financial reporting, as well as the quarterly reviews of condensed consolidated financial information. In 2014, services rendered by our principal external auditors did not include audit of effectiveness of internal control over financial reporting.

(2) "Audit-related fees" means the aggregate fees billed for assurance and related services rendered by our principal external auditors that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under "Audit fees". No audit-related services were provided by our principal external auditors in 2015.

(3) "Tax fees" means the aggregate fees billed for professional services rendered by our principal external auditors for tax advice and tax planning. No tax services were provided by our principal external auditors in 2015.

The policy of our audit committee is to pre-approve all audit and non-audit services provided by PricewaterhouseCoopers Zhong Tian LLP, including audit services, audit-related services and tax services as described above, other than those for de minimis services which are approved by the audit committee prior to the completion of the audit.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Not applicable.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 16F. Change in Registrant's Certifying Accountant

Not applicable.

Item 16G. Corporate Governance

As a Cayman Islands company listed on NASDAQ, we are subject to the NASDAQ corporate governance listing standards. However, NASDAQ rules permit a foreign private issuer like us to follow the corporate governance practices of its home country. Travers Thorp Alberga, our Cayman Islands counsel, has advised us that certain corporate governance practices in the Cayman Islands, our home country, may differ significantly from the NASDAQ corporate governance listing standards. We followed home country practice for our private placements in December 2014, May 2015 and January 2016, which would have required shareholder approval under the NASDAQ Rules but for which there was no such requirement under Cayman Islands law. In addition, we have elected to follow home country practice in lieu of the requirement to hold an annual meeting of shareholders under NASDAQ Rule 5620(a).

We currently do not plan to rely on the home country exemption for any other corporate governance matters. However, if we choose to follow home country practice in other matters in the future, our shareholders may be afforded less protection than they otherwise would under the NASDAQ corporate governance listing standards applicable to U.S. domestic issuers. See "Item 3.D. Key Information — Risk Factors — Risks Related to Our ADSs — We are a foreign private issuer within the meaning of the rules under the Exchange Act, and as such we are exempt from certain provisions applicable to United States domestic public companies."

Item 16H. Mine Safety Disclosure

Not applicable.

PART III

Item 17. Financial Statements

We have elected to provide financial statements pursuant to Item 18.

Item 18. Financial Statements

The consolidated financial statements of Tuniu Corporation, its subsidiaries and its consolidated affiliated entities are included at the end of this annual report.

Item 19. Exhibits

Exhibit Number	Description of Document
1.1	Fifth Amended and Restated Memorandum and Articles of Association of the Registrant (incorporated by reference to Exhibit 3.2 to the Registration Statement on Form F-1 (file no. 333-195075), as amended, initially filed with the Securities and Exchange Commission on April 4, 2014).
2.1	Registrant’s Specimen American Depositary Receipt (included in Exhibit 2.3).
2.2	Registrant’s Specimen Certificate for Class A ordinary shares (incorporated herein by reference to Exhibit 4.2 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
2.3	Deposit Agreement among the Registrant, the depositary and holders of the American Depositary Receipts dated May 8, 2014 (incorporated herein by reference to Exhibit 4.3 to the registration statement on Form S-8 (File No. 333-198111), filed with the Security and Exchange Commission on August 13, 2014).
2.4	Third Amended and Restated Investors’ Rights Agreement dated as of August 28, 2013 among the Registrant, its ordinary shareholders, preferred shareholders and several other parties named therein (incorporated herein by reference to Exhibit 4.4 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.1	2008 Incentive Compensation Plan (incorporated herein by reference to Exhibit 10.1 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.2	2014 Share Incentive Plan (incorporated herein by reference to Exhibit 10.2 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.3	Form of Indemnification Agreement with the Registrant’s directors (incorporated herein by reference to Exhibit 10.3 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.4	English Translation of Form of Employment Agreement between the Registrant and an Executive Officer of the Registrant (incorporated herein by reference to Exhibit 10.4 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.5	English Translation of Amended and Restated Cooperation Agreement dated January 24, 2014 between Beijing Tuniu and Nanjing Tuniu (incorporated herein by reference to Exhibit 10.5 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).

4.6	English Translation of Shareholders' Voting Rights Agreement dated September 17, 2008 among Beijing Tuniu, Nanjing Tuniu and the shareholders of Nanjing Tuniu (incorporated herein by reference to Exhibit 10.6 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.7	English Translation of Amended and Restated Powers of Attorney dated January 24, 2014 granted to Beijing Tuniu by each of the shareholders of Nanjing Tuniu (incorporated herein by reference to Exhibit 10.7 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).

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Exhibit Number	Description of Document
4.8	English Translation of Equity Interest Pledge Agreement dated September 17, 2008 among Beijing Tuniu and the shareholders of Nanjing Tuniu (incorporated herein by reference to Exhibit 10.8 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.9	Subscription Agreement dated April 27, 2014 between Tuniu Corporation and Ctrip Investment Holding Ltd. (incorporated herein by reference to Exhibit 10.13 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.10	Subscription Agreement dated April 25, 2014 between Tuniu Corporation and DCM Hybrid RMB Fund, L.P. (incorporated herein by reference to Exhibit 10.11 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.11	Subscription Agreement dated April 25, 2014 between Tuniu Corporation and Qihoo 360 Technology Co. Ltd. (incorporated herein by reference to Exhibit 10.12 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
4.12	Subscription Agreement dated December 15, 2014 between Tuniu Corporation, JD.com E-commerce (Investment) Hong Kong Corporation Limited, Unicorn Riches Limited, Ctrip Investment Holding Ltd., Verne Capital Limited and Dragon Rabbit Capital Limited. (incorporated by reference to Exhibit 4.12 from our annual report on Form 20-F (file no. 001-36430) filed with the Securities and Exchange Commission on April 17, 2015).
4.13	Subscription Agreement dated May 8, 2015 between Tuniu Corporation and Fabulous Jade Global Limited (incorporated herein by reference to Exhibit 99.5 to amendment no. 1 to Schedule 13D filed by JD.com, Inc. and its affiliates with the Securities and Exchange Commission on May 29, 2015).
4.14	Subscription Agreement dated May 8, 2015 between Tuniu Corporation and Unicorn Riches Limited (incorporated herein by reference to Exhibit 7.02 to Schedule 13D filed by Unicorn Riches Limited and its affiliates with the Securities and Exchange Commission on May 18, 2015).
4.15	Subscription Agreement dated May 8, 2015 between Tuniu Corporation and Sequoia Capital 2010 CV Holdco, Ltd. (incorporated herein by reference to Exhibit 99.4 to amendment no. 2 to Schedule 13D filed by Sequoia Capital 2010 CV Holdco, Ltd. with the Securities and Exchange Commission on May 18, 2015).
4.16	Subscription Agreement dated May 8, 2015 between Tuniu Corporation and DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P. (incorporated herein by reference to Exhibit 2 to amendment no. 2 to Schedule 13D filed by DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P. with the Securities and Exchange Commission on May 28, 2015).

4.17	Business Cooperation Agreement dated May 8, 2015 between Tuniu Corporation and JD.com, Inc. (incorporated herein by reference to Exhibit 99.6 to amendment no. 1 to Schedule 13D filed by JD.com, Inc. and its affiliates with the Securities and Exchange Commission on May 29, 2015).
4.18	Investor Rights Agreement dated May 22, 2015 between Tuniu Corporation and Fabulous Jade Global Limited (incorporated herein by reference to Exhibit 99.7 to amendment no. 1 to Schedule 13D filed by JD.com, Inc. and its affiliates with the Securities and Exchange Commission on May 29, 2015).

Exhibit Number	Description of Document
4.19	Registration Rights Agreement dated as of May 22, 2015 between Tuniu Corporation and Unicorn Riches Limited (incorporated herein by reference to Exhibit 7.08 to amendment no. 1 to Schedule 13D filed by Unicorn Riches Limited with the Securities and Exchange Commission on May 26, 2015).
4.20	Subscription Agreement dated as of November 20, 2015 between Tuniu Corporation and HNA Tourism Holding (Group) Co., Ltd. (incorporated herein by reference to Exhibit 7.1 to Schedule 13D filed by BHR Winwood Investment Management Limited and its affiliates with the Securities and Exchange Commission on February 1, 2016).
4.21	Amendment No. 1 to Subscription Agreement dated as of December 31, 2015 between Tuniu Corporation and HNA Tourism Holding (Group) Co., Ltd. (incorporated herein by reference to Exhibit 7.2 to Schedule 13D filed by BHR Winwood Investment Management Limited and its affiliates with the Securities and Exchange Commission on February 1, 2016).
4.22	Investor Rights Agreement dated as of November 20, 2015 between Tuniu Corporation and HNA Tourism Holding (Group) Co., Ltd. (incorporated herein by reference to Exhibit 7.3 to Schedule 13D filed by BHR Winwood Investment Management Limited and its affiliates with the Securities and Exchange Commission on February 1, 2016).
4.23	Amendment No. 1 to Investor Rights Agreement dated as of December 31, 2015 between Tuniu Corporation and HNA Tourism Holding (Group) Co., Ltd. (incorporated herein by reference to Exhibit 7.4 to Schedule 13D filed by BHR Winwood Investment Management Limited and its affiliates with the Securities and Exchange Commission on February 1, 2016).
4.24	Amendment No. 2 to Investor Rights Agreement dated February 19, 2016 between Tuniu Corporation and BHR Winwood Investment Management Limited (incorporated herein by reference to Exhibit A to amendment no. 1 to Schedule 13D filed by BHR Winwood Investment Management Limited and its affiliates with the Securities and Exchange Commission on February 29, 2016).
8.1*	List of Significant Subsidiaries.
11.1	Code of Business Conduct and Ethics of the Registrant (incorporated herein by reference to Exhibit 99.1 to the registration statement on Form F-1 (File No. 333-195075), as amended, initially filed with the Security and Exchange Commission on April 4, 2014).
12.1*	Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2*	Certification by Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1**	Certification by Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.2**	Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
15.1*	Consent of PricewaterhouseCoopers Zhong Tian LLP.

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Exhibit Number	Description of Document
15.2*	Consent of Travers Thorp Alberga.
15.3*	Consent of Fangda Partners.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

*	Filed herewith
**	Furnished herewith

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Tuniu Corporation

By: /s/ Dunde Yu
Name: Dunde Yu
Title: Chairman and Chief Executive Officer

Date: April 28, 2016

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Tuniu Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of comprehensive loss, of changes in shareholders' equity/(deficit) and of cash flows present fairly, in all material respects, the financial position of Tuniu Corporation and its subsidiaries at December 31, 2015 and December 31, 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the accompanying financial statements schedule I present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing in Item 15 of this Form 20-F. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Report on Internal Control over Financial Reporting appearing under Item 15 in the accompanying Form 20-F, management has excluded the four travel agencies acquired during 2015, as described in Note 4 to the consolidated financial statements, from its assessment of internal control over financial reporting as of December 31, 2015 because the travel agencies were acquired by the Company in purchase business combinations during 2015. We have also excluded these travel agencies acquired during 2015 from our audit of internal control over financial reporting. These travel agencies excluded are subsidiaries of the Company which in aggregate constitute 2.7% and 6.8% of the total assets and the net revenues, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2015.

/s/ PricewaterhouseCoopers Zhong Tian LLP

Shanghai, the People's Republic of China

April 28, 2016

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TUNIU CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2014 and 2015

(All amounts in thousands, except for share and per share data, or otherwise noted)

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
ASSETS			
Current assets			
Cash and cash equivalents	1,457,722	2,101,217	324,372
Restricted cash	44,030	338,997	52,332
Short-term investments	468,570	1,226,415	189,326
Accounts receivable, net	8,008	113,252	17,483
Amounts due from related parties	637	60,004	9,263
Prepayments and other current assets	575,297	1,699,468	262,353
Total current assets	2,554,264	5,539,353	855,129
Non-current assets			
Property and equipment, net	72,310	145,190	22,414
Intangible assets, net	3,075	715,548	110,462
Goodwill	—	136,569	21,083
Other non-current assets	15,368	649,481	100,261
Total non-current assets	90,753	1,646,788	254,220
Total assets	2,645,017	7,186,141	1,109,349
LIABILITIES AND EQUITY			
Current liabilities (including current liabilities of the Affiliated Entities without recourse to the Company amounting to RMB1,168,078 and RMB3,325,804, as of December 31, 2014 and December 31, 2015, respectively):			
Accounts payable	382,705	767,307	118,452
Amounts due to related parties	—	28,762	4,440
Salary and welfare payable	78,739	147,389	22,753
Taxes payable	3,884	8,429	1,301
Advances from customers	638,828	1,223,313	188,847
Accrued expenses and other current liabilities	109,860	1,615,433	249,380
Total current liabilities	1,214,016	3,790,633	585,173
Non-current liabilities	22,278	57,785	8,920
Total liabilities	1,236,294	3,848,418	594,093

Commitments and contingencies (Note 17)			
Equity			
Ordinary shares (US$0.0001 par value; 1,000,000,000 shares (including 780,000,000 Class A shares, 120,000,000 Class B shares and 100,000,000 shares to be designated by the Board of Directors) authorized as of December 31, 2014 and 2015; 188,435,922 shares (including 82,487,876 Class A shares and 105,948,046 Class B shares) and 286,970,892 shares (including 269,597,392 Class A shares and 17,373,500 Class B shares) issued and outstanding as of December 31, 2014 and 2015, respectively)	121	181	28
Additional paid-in capital	2,298,727	5,482,637	846,373
Accumulated other comprehensive income/(loss)	(21,081)	167,025	25,784
Accumulated deficit	(869,044)	(2,328,423)	(359,446)
Total Tuniu Corporation shareholders' equity	1,408,723	3,321,420	512,739
Noncontrolling interests	—	16,303	2,517
Total equity	1,408,723	3,337,723	515,256
Total liabilities and equity	2,645,017	7,186,141	1,109,349

The accompanying notes are an integral part of these consolidated financial statements.

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TUNIU CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

For the Years Ended December 31, 2013, 2014 and 2015

(All amounts in thousands, except for share and per share data, or otherwise noted)

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Revenues				
Organized tours	1,892,826	3,432,825	7,358,879	1,136,015
Self-guided tours	48,901	93,126	194,162	29,973
Others	20,744	28,756	127,745	19,720
Total revenues	1,962,471	3,554,707	7,680,786	1,185,708
Less: Business and related taxes	(12,784)	(19,768)	(35,526)	(5,484)
Net revenues	1,949,687	3,534,939	7,645,260	1,180,224
Cost of revenues	(1,829,665)	(3,308,801)	(7,274,675)	(1,123,016)
Gross profit	120,022	226,138	370,585	57,208
Operating expenses				
Research and product development	(38,994)	(104,881)	(298,199)	(46,034)
Sales and marketing	(110,071)	(434,191)	(1,154,155)	(178,171)
General and administrative	(69,679)	(166,988)	(385,442)	(59,502)
Other operating income	1,689	6,902	12,175	1,879
Total operating expenses	(217,055)	(699,158)	(1,825,621)	(281,828)
Loss from operations	(97,033)	(473,020)	(1,455,036)	(224,620)
Other income/(expenses)				
Interest income	16,163	31,284	76,516	11,812
Foreign exchange gains/(losses), net	1,286	(5,334)	(83,118)	(12,831)
Other loss, net	(48)	(788)	(1,336)	(205)
Loss before income tax expense	(79,632)	(447,858)	(1,462,974)	(225,844)
Income tax benefit	—	—	589	91
Net loss	(79,632)	(447,858)	(1,462,385)	(225,753)
Net loss attributable to noncontrolling interests	—	—	(3,006)	(464)
Net loss attributable to Tuniu Corporation	(79,632)	(447,858)	(1,459,379)	(225,289)
Deemed dividends to preferred shareholders	(59,428)	(15,606)	—	—
Net loss attributable to ordinary shareholders	(139,060)	(463,464)	(1,459,379)	(225,289)
Net loss	(79,632)	(447,858)	(1,462,385)	(225,753)
Other comprehensive income/(loss)				
Foreign currency translation adjustment, net of nil tax	(4,857)	(1,358)	188,106	29,038

Comprehensive loss	(84,489)	(449,216)	(1,274,279)	(196,715)
Comprehensive loss attributable to noncontrolling interests	—	—	(3,006)	(464)
Comprehensive loss attributable to Tuniu Corporation	(84,489)	(449,216)	(1,271,273)	(196,251)
Loss per share				
Basic and diluted	(5.35)	(4.38)	(5.88)	(0.91)
Weighted average number of ordinary shares used in computing basic and diluted loss per share	26,000,000	105,746,313	248,362,837	248,362,837

The accompanying notes are an integral part of these consolidated financial statements.

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TUNIU CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY/(DEFICIT)

For the Years Ended December 31, 2013, 2014 and 2015

(All amounts in thousands, except for share and per share data, or otherwise noted)

	Ordinary shares		Additional	Accumulated other comprehensive	Accumulated	Total Tuniu Corporation Shareholders' equity	Noncontrolling	Total
	Shares	Amount	paid-in capital	income/(loss)	deficit	(deficit)	interests	Equity/(Deficit)
		RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2013	26,000,000	18	200	(14,866)	(266,520)	(281,168)	—	(281,168)
Foreign currency translation adjustments	—	—	—	(4,857)	—	(4,857)	—	(4,857)
Deemed dividend from redesignation of Series A Convertible Preferred Shares	—	—	—	—	(59,428)	(59,428)	—	(59,428)
Net loss	—	—	—	—	(79,632)	(79,632)	—	(79,632)
Balance as of December 31, 2013	26,000,000	18	200	(19,723)	(405,580)	(425,085)	—	(425,085)
Capital contribution from shareholders of VIE	—	—	70	—	—	70	—	70
Conversion of Series A,B,C and D Convertible Preferred Shares into ordinary shares upon the completion of initial public	85,852,919	56	731,991	—	—	732,047	—	732,047

offering								
Issuance of ordinary shares upon the initial public offering, net of issuance costs of RMB22,732	37,406,666	23	632,449	—	—	632,472	—	632,472
Issuance of ordinary shares upon the private placement, net of issuance costs of RMB14,279	36,812,868	22	891,491	—	—	891,513	—	891,513
Issuance of ordinary shares pursuant to share incentive plan	2,363,469	2	3,353	—	—	3,355	—	3,355
Share-based compensation expenses	—	—	39,173	—	—	39,173	—	39,173
Foreign currency translation adjustments	—	—	—	(1,358)	—	(1,358)	—	(1,358)
Deemed dividend from modification of Series D Convertible Preferred Shares	—	—	—	—	(15,606)	(15,606)	—	(15,606)
Net loss	—	—	—	—	(447,858)	(447,858)	—	(447,858)
Balance as of December 31, 2014	188,435,922	121	2,298,727	(21,081)	(869,044)	1,408,723	—	1,408,723

The accompanying notes are an integral part of these consolidated financial statements.

TUNIU CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY/(DEFICIT)

For the Years Ended December 31, 2013, 2014 and 2015

(All amounts in thousands, except for share and per share data, or otherwise noted)

	Ordinary shares		Additional	Accumulated other	Accumulated	Total Tuniu Corporation	Noncontrolling	Total
				comprehensive		Shareholders' equity		
	Shares	Amount	paid-in capital	income/(loss)	Deficit	(deficit)	interests	Equity/(Deficit)
		RMB	RMB	RMB	RMB	RMB	RMB	RMB
Issuance of ordinary shares upon the private placement, net of issuance costs of RMB1,078	93,750,000	57	3,104,457	—	—	3,104,514	—	3,104,514
Acquisition of subsidiaries	—	—	—	—	—	—	20,122	20,122
Issuance of ordinary shares pursuant to share incentive plan	4,784,970	3	14,993	—	—	14,996	—	14,996
Share-based compensation expenses	—	—	65,143	—	—	65,143	—	65,143
Foreign currency translation adjustments	—	—	—	188,106	—	188,106	—	188,106
Acquisition of noncontrolling interests	—	—	(683)	—	—	(683)	(813)	(1,496)
Net loss	—	—	—	—	(1,459,379)	(1,459,379)	(3,006)	(1,462,385)
	286,970,892	181	5,482,637	167,025	(2,328,423)	3,321,420	16,303	3,337,723

Balance as of
December 31,
2015

The accompanying notes are an integral part of these consolidated financial statements.

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TUNIU CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2013, 2014 and 2015

(All amounts in thousands, except for share and per share data, or otherwise noted)

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Cash flows from operating activities:				
Net loss	(79,632)	(447,858)	(1,462,385)	(225,753)
Adjustments to reconcile net loss to net cash provided by /(used in) operating activities:				
Depreciation of property and equipment	8,764	10,869	28,041	4,329
Amortization of intangible assets	482	984	57,810	8,924
Foreign exchange (gain)/loss	(1,286)	2,729	106,271	16,405
Loss from disposal of property and equipment	114	62	210	32
Share-based compensation expenses	—	39,173	65,143	10,056
Change of deferred tax liabilities	—	—	(1,057)	(163)
Changes in operating assets and liabilities:				
Accounts receivable	4,574	(6,356)	(74,475)	(11,497)
Amounts due from related parties	—	(637)	(59,367)	(9,165)
Prepayments and other current assets	(159,510)	(287,811)	(600,346)	(92,677)
Other non-current assets	(331)	(13,374)	(317,775)	(49,056)
Accounts payable	161,608	84,394	320,502	49,477
Amounts due to related parties	—	—	28,762	4,440
Taxes payable	725	2,560	4,089	631
Advances from customers	152,524	242,090	532,335	82,178
Accrued expenses and other liabilities	28,704	102,073	857,507	132,377
Net cash provided by /(used in) operating activities	116,736	(271,102)	(514,735)	(79,462)
Cash flows from investing activities:				
Purchase of short-term investments	(451,800)	(547,575)	(1,139,691)	(175,938)
Proceeds from maturity of short-term investments	154,800	405,000	442,136	68,254
Changes in restricted cash	(2,375)	(34,780)	(294,387)	(45,446)
Purchase of property and equipment and intangible assets	(4,843)	(50,622)	(155,478)	(24,002)
Proceeds from disposal of property and equipment	—	54	155	24
Acquisition, net of cash received	—	—	(60,149)	(9,285)
Purchase of yield enhancement products	—	—	(718,619)	(110,935)
Proceeds from maturity of yield enhancement products	—	—	10,865	1,677

Net cash used in investing activities	(304,218)	(227,923)	(1,915,168)	(295,651)
Cash flows from financing activities:				
Proceeds from issuance of Series D Convertible Preferred Shares, net of issuance cost	306,360	—	—	—
Proceeds from the initial public offering, net of issuance cost	—	632,472	—	—
Proceeds from the private placement, net of issuance cost	—	905,590	2,430,223	375,162
Proceeds from issuance of ordinary shares upon exercise of options	—	2,335	12,637	1,951
Proceeds from sales of yield enhancement products	—	—	579,474	89,456
Repayment of short-term debt	—	—	(15,000)	(2,316)
Acquisition of noncontrolling interests	—	—	(1,496)	(231)
Net cash provided by financing activities	306,360	1,540,397	3,005,838	464,022
Effect of exchange rate changes on cash and cash equivalents	1,287	(3,053)	67,560	10,429
Net increase in cash and cash equivalents	120,165	1,038,319	643,495	99,338
Cash and cash equivalents at the beginning of year	299,238	419,403	1,457,722	225,034
Cash and cash equivalents at the end of year	419,403	1,457,722	2,101,217	324,372
Supplemental disclosure of non-cash investing and financing activities				
Accrual related to purchase of property and equipment	117	9,345	18,953	2,926
Deemed dividends to preferred shareholders	59,428	15,606	—	—
Accrued issuance cost related to private placement	—	14,076	—	—
Accrual related to deferred initial public offering costs	2,127	—	—	—
Receivables related to exercise of stock options	—	(1,020)	(3,379)	(522)
Accrual related to business acquisition	—	—	42,116	6,502

The accompanying notes are an integral part of these consolidated financial statements.

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TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

1. Organization and Principal Activities

Tuniu Corporation (the “Company”) is an exempted company with limited liability incorporated in the Cayman Islands. The Company, its subsidiaries, including the consolidated variable interest entity (“VIE”) and its subsidiaries (collectively referred to as the “Affiliated Entities”) are collectively referred to as the “Group”. The Group’s principal activity is the provision of travel-related services in the People’s Republic of China (“PRC”).

As of December 31, 2015, the Company’s significant consolidated subsidiaries and the consolidated Affiliated Entities are as follows:

Name of subsidiaries and VIE	Date of establishment/acquisition	Place of incorporation	Percentage of direct or indirect economic ownership	
Subsidiaries of the Company:				
Tuniu (HK) Limited	Established on May 20, 2011	Hong Kong	100	%
Tuniu (Nanjing) Information Technology Co., Ltd.	Established on August 24, 2011	PRC	100	%
Beijing Tuniu Technology Co., Ltd. (“Beijing Tuniu”)	Established on September 8, 2008	PRC	100	%
Variable Interest Entity (“VIE”)				
Nanjing Tuniu Technology Co., Ltd. (“Nanjing Tuniu”)	Established on December 18, 2006	PRC	100	%
Subsidiaries of VIE				
Shanghai Tuniu International Travel Service Co., Ltd.	Acquired on August 22, 2008	PRC	100	%
Nanjing Tuniu International Travel Service Co., Ltd.	Acquired on December 22, 2008	PRC	100	%
Beijing Tuniu International Travel Service Co., Ltd.	Acquired on November 18, 2009	PRC	100	%
Nanjing Tuzhilv Tickets Sales Co., Ltd.	Established on April 19, 2011	PRC	100	%

Tianjin Classic Holiday International Travel Agency Co., Ltd.	Acquired on April 1, 2015	PRC	100	%
Zhejiang Zhongshan International Agency Co., Ltd.	Acquired on April 1, 2015	PRC	100	%
Beijing Global Tour International Travel Service Co., Ltd.	Acquired on July 1, 2015	PRC	75.02	%
Tuniu Insurance Brokers Co., Ltd.	Acquired on August 11, 2015	PRC	100	%
Beijing Hengxin International Travel Agency Co., Ltd.	Acquired on October 1, 2015	PRC	80	%

2. Principal Accounting Policies

(a) Basis of Presentation

The consolidated financial statements of the Group have been prepared in accordance with the accounting principles generally accepted in the United States of America ("U.S. GAAP").

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(b) Principles of Consolidation

The consolidated financial statements include the financial statements of the Company, its subsidiaries, the Affiliated Entities for which the Company is the primary beneficiary. Subsidiaries are those entities in which the Company, directly or indirectly, controls more than one half of the voting power, has the power to appoint or remove the majority of the members of the board of directors, or to cast a majority of votes at the meeting of board of directors, or has the power to govern the financial and operating policies of the investee under a statute or agreement among the shareholders or equity holders.

A VIE is an entity in which the Company, or its subsidiary, through contractual arrangements, bears the risks of, and enjoys the rewards normally associated with, ownership of the entity, and therefore the Company or its subsidiary is the primary beneficiary of the entity. All significant transactions and balances among the Company, its subsidiaries and the Affiliated Entities have been eliminated upon consolidation.

To comply with PRC laws and regulations that restrict foreign equity ownership of companies that operate internet content, travel agency and air-ticketing services, the Company operates its website and engaged in such restricted services through Nanjing Tuniu and its subsidiaries. Nanjing Tuniu's equity interests are held by Dunde Yu, the Company's Chief Executive Officer, Haifeng Yan, the Company's Chief Operating Officer, and several other PRC citizens. On September 17, 2008, Beijing Tuniu, one of the Company's wholly foreign owned subsidiaries, entered into a series of agreements with Nanjing Tuniu and its shareholders. Pursuant to these agreements, Beijing Tuniu has the ability to direct substantially all the activities of Nanjing Tuniu, and absorb substantially all of the risks and rewards of the Affiliated Entities. As a result, the Company is the primary beneficiary of Nanjing Tuniu, and has consolidated the Affiliated Entities.

Contractual arrangements

On September 17, 2008, Beijing Tuniu entered into a series of contractual agreements with Nanjing Tuniu and its shareholders. The following is a summary of the agreements which allow the Company to exercise effective control over Nanjing Tuniu:

(1) Purchase Option Agreement.

Under the purchase option agreement entered between Beijing Tuniu and the shareholders of Nanjing Tuniu on September 17, 2008, Beijing Tuniu has the irrevocable exclusive right to purchase, or have its designated person or persons to purchase all or part of the shareholders' equity interests in Nanjing Tuniu at RMB1,800 which was increased to RMB2,430 in March 2014. The option term remains valid for a period of 10 years and can be extended indefinitely at Beijing Tuniu's discretion. The purchase consideration was paid by Beijing Tuniu to the shareholders of Nanjing Tuniu shortly after the purchase option agreement was entered. On January 24, 2014, the Company amended and restated the purchase option agreement, and the effective term of the purchase option agreement has been changed to until all equity interests held in Nanjing Tuniu are transferred or assigned to Beijing Tuniu or its designated person or persons.

(2) Equity Interest Pledge Agreement.

Under the equity interest pledge agreement entered between Beijing Tuniu and the shareholders of Nanjing Tuniu on September 17, 2008, the shareholders pledged all of their equity interests in Nanjing Tuniu to guarantee their performance of their obligations under the purchase option agreement. If the shareholders of Nanjing Tuniu breach their contractual obligations under the purchase option agreement, Beijing Tuniu, as the pledgee, will have the right to either conclude an agreement with the pledgor to obtain the pledged equity or seek payments from the proceeds of the auction or sell-off of the pledged equity to any person pursuant to the PRC law. The shareholders of Nanjing Tuniu agreed that they will not dispose of the pledged equity interests or create or allow any encumbrance on the pledged equity interests. During the equity pledge period, Beijing Tuniu is entitled to all dividends and other distributions made by Nanjing Tuniu. The equity interest pledge agreement remains effective until the shareholders of Nanjing Tuniu discharge all their obligations under the purchase option agreement, or Beijing Tuniu enforces the equity interest pledge, whichever is earlier.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(b) Principles of Consolidation - continued

(3) Shareholders' Voting Rights Agreement.

Under the shareholders' voting rights agreement entered between Beijing Tuniu and the shareholders of Nanjing Tuniu on September 17, 2008, each of the shareholders of Nanjing Tuniu appointed Beijing Tuniu's designated person as their attorney-in-fact to exercise all of their voting and related rights with respect to their equity interests in Nanjing Tuniu, including attending shareholders' meetings, voting on all matters of Nanjing Tuniu, nominating and appointing directors, convene extraordinary shareholders' meetings, and other voting rights pursuant to the then effective articles of association. The shareholders' voting rights agreement will remain in force for an unlimited term, unless all the parties to the agreement mutually agree to terminate the agreement in writing or cease to be shareholders of Nanjing Tuniu.

(4) Irrevocable Powers of Attorney.

Under the powers of attorney issued by the shareholders of Nanjing Tuniu on September 17, 2008, the shareholders of Nanjing Tuniu each irrevocably appointed Mr. Tao Jiang, a person designated by Beijing Tuniu, as the attorney-in-fact to exercise all of their voting and related rights with respect to their equity interests in Nanjing Tuniu. Each power of attorney will remain in force until the shareholders' voting rights agreement expires or is terminated. On January 24, 2014, the shareholders of Nanjing Tuniu issued powers of attorney to irrevocably appoint Beijing Tuniu as the attorney-in-fact to exercise all of their voting and related rights with respect to their equity interests in Nanjing Tuniu. These powers of attorney replaced the powers of attorney previously granted to Mr. Tao Jiang on September 17, 2008.

(5) Cooperation Agreement.

Under the cooperation agreement entered between Beijing Tuniu and Nanjing Tuniu, Beijing Tuniu has the exclusive right to provide Nanjing Tuniu technology consulting and services related to Nanjing Tuniu's operations, which require certain licenses. Beijing Tuniu owns the exclusive intellectual property rights created as a result of the performance of this agreement. Nanjing Tuniu agrees to pay Beijing Tuniu a monthly service fee for services performed, and the monthly service fee shall not be lower than 100% of Nanjing Tuniu's profits generated from such cooperation, which equal revenues generated from such cooperation, after deducting the expenses it incurred. This agreement remains effective for an unlimited term, unless the parties mutually agree to terminate the agreement, one of the parties is declared bankrupt or Beijing Tuniu is not able to provide consulting and services as agreed for more than three consecutive years because of force majeure. On January 24, 2014, the Company amended and restated the Cooperation Agreement. In the amended and restated agreement, the service fee has been changed to a quarterly payment which equals the profits of each of Nanjing Tuniu and its subsidiaries, and that Beijing Tuniu can adjust the service fee at its own discretion. Also in the amended and restated Cooperation Agreement, Beijing Tuniu has the unilateral right to terminate the agreement.

In the years ended December 31, 2013, 2014 and 2015, the Company received service fees of RMB22,587, RMB20,535 and RMB42,367, respectively, from its consolidated Affiliated Entities, which were eliminated on the consolidated financial statement.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(b) Principles of Consolidation - continued

Risks in relation to the VIE structure

The Group believes that each of the agreements and the powers of attorney under the contractual arrangements among Beijing Tuniu, Nanjing Tuniu and its shareholders is valid, binding and enforceable, and does not and will not result in any violation of PRC laws or regulations currently in effect. The legal opinion of Fangda Partners, which was the Company's PRC legal counsel, also supports this conclusion. The shareholders of Nanjing Tuniu are also shareholders, nominees of shareholders, or designated representatives of shareholders of the Company and therefore have no current interest in seeking to act contrary to the contractual arrangements. However, uncertainties in the PRC legal system could limit the Company's ability to enforce these contractual arrangements and if the shareholders of Nanjing Tuniu were to reduce their interest in the Company, their interests may diverge from that of the Company and that may potentially increase the risk that they would seek to act contrary to the contractual terms.

The Company's ability to control Nanjing Tuniu also depends on the power of attorney Beijing Tuniu has to vote on all matters requiring shareholder approval in Nanjing Tuniu. As noted above, the Company believes this power of attorney is legally enforceable but it may not be as effective as direct equity ownership.

In addition, if the legal structure and contractual arrangements were found to be in violation of any existing PRC laws and regulations, the PRC government could:

- levying fines or confiscate the Group's income;
- revoke the Group's business or operating licenses;

- require the Group to discontinue, restrict or restructure its operations;
- shut down the Group's servers or block the Group's websites and mobile platform;
- restrict or prohibit the use of the Group's financing proceeds to finance its business and operations in China; or
- take other regulatory or enforcement actions against the Group that could be harmful to the Group's business

The imposition of any of these penalties may result in a material and adverse effect on the Group's ability to conduct the Group's business. In addition, the imposition of any of these penalties may cause the Group to lose the right to direct the activities of Nanjing Tuniu (through its equity interest in its subsidiaries) or the right to receive economic benefits from the Affiliated Entities. Therefore, a risk exists in that the Group would no longer be able to consolidate Nanjing Tuniu and its subsidiaries. On February 19, 2015, the PRC Ministry of Commerce ("MOFCOM") published the draft Foreign Investment Law. If enacted as proposed, the Foreign Investment Law may cause the Group's VIE to be deemed as entities with foreign investment and as a result the Group's VIE and subsidiaries in which the VIE has direct or indirect equity ownership could become explicitly subject to the current restrictions on foreign investment that engaged in an industry on the negative list. If the enacted version of the foreign investment Law and the final negative list mandate further actions, such as MOFCOM market entry clearance or certain restructuring of corporate structure and operations to be completed by companies with existing VIE structure similar to the one described above, the Group will face substantial uncertainties as to whether these actions can be timely completed, or at all. As a result, the Group's operating result and financial condition may be adversely affected.

Summary financial information of the Affiliated Entities in the consolidated financial statements

As of December 31, 2015, the aggregate accumulated deficit of the Affiliated Entities was RMB1,348 million prior to intercompany elimination.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(b) Principles of Consolidation - continued

The following financial statement amounts and balances of the Affiliated Entities were included in the consolidated financial statements as of December 31, 2014 and 2015 and for the years ended December 31, 2013, 2014 and 2015:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
ASSETS			
Current assets			
Cash and cash equivalents	102,356	376,883	58,181
Restricted cash	44,030	138,997	21,457
Short-term investments	100,000	499,402	77,094
Accounts receivable, net	8,645	116,669	18,011
Intercompany receivables	65,474	130,945	20,214
Prepayments and other current assets	566,731	1,402,919	216,573
Total current assets	887,236	2,665,815	411,530
Non-current assets			
Property and equipment, net	22,600	72,582	11,205
Intangible assets, net	1,975	100,125	15,457
Goodwill	—	136,569	21,083
Other non-current assets	14,290	323,403	49,925
Total non-current assets	38,865	632,679	97,670
Total assets	926,101	3,298,494	509,200
LIABILITIES			
Current liabilities			
Accounts payable	373,464	1,036,226	159,966

Salary and welfare payable	66,075	123,071	18,999
Taxes payable	2,079	6,668	1,029
Advances from customers	638,803	1,223,313	188,847
Intercompany payable	52,114	1,263,100	194,989
Accrued expenses and other current liabilities	87,657	936,526	144,575
Total current liabilities	1,220,192	4,588,904	708,405
Non-current liabilities	—	39,750	6,136
Total liabilities	1,220,192	4,628,654	714,541

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Net revenues	1,937,485	3,736,473	7,755,914	1,197,307
Net loss	(39,597)	(128,299)	(1,051,691)	(162,353)
Net cash provided by/(used in) operating activities	161,148	(51,446)	(87,299)	(13,477)
Net cash provided by/(used in) investing activities	(201,058)	72,161	(1,374,894)	(212,247)
Net cash provided by financing activities	—	700	1,736,720	268,103

There were no pledges or collateralization of the Affiliated Entities' assets. Currently there is no contractual arrangement that could require the Company to provide additional financial support to the Affiliated Entities. As the Company is conducting its business mainly through the Affiliated Entities, the Company may provide such support on a discretionary basis in the future, which could expose the Company to a loss.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(b) Principles of Consolidation - continued

Under the contractual arrangements with Nanjing Tuniu and through its equity interest in its subsidiaries, the Group has the power to direct the activities of the Affiliated Entities and direct the transfer of assets out of the Affiliated Entities. Therefore, the Group considers that there are no assets of the Affiliated Entities that can be used only to settle their obligations. As the consolidated Affiliated Entities are each incorporated as a limited liability company under the PRC Company Law, the creditors do not have recourse to the general credit of the Company for all of the liabilities of the consolidated Affiliated Entities.

Liquidity

The Group's consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and liquidation of liabilities during the normal course of operations. The Group incurred net losses of approximately RMB79,632, RMB447,858 and RMB1,459,379 in the years ended December 31, 2013, 2014 and 2015, respectively. Net cash provided by / (used in) operating activities was approximately RMB116,736 and RMB(271,102) and RMB(514,735) for the years ended December 31, 2013, 2014 and 2015, respectively. Accumulated deficit was RMB405,580, RMB869,044 and RMB2,328,423 as of December 31, 2013, 2014 and 2015, respectively. As of December 31, 2015, the Group had net current assets and management believes that the Group's available cash, cash equivalents, short-term investments and cash generated from operations will be sufficient to meet working capital requirements and capital expenditures in the ordinary course of business for the next twelve months.

(c) Use of Estimates

The preparation of the Group's consolidated financial statements in conformity with the U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ materially from those estimates. Significant accounting estimates reflected in the Group's consolidated financial statements mainly include revenue recognition, estimating useful lives and impairment for property and equipment, impairment for goodwill and other acquired intangible assets, the purchase price allocation, fair value of noncontrolling interests and contingent considerations with respect to business combinations, losses due to committed tour reservations, the valuation allowance for deferred tax assets, the determination of uncertain tax positions.

(d) Functional Currency and Foreign Currency Translation

The Group uses Renminbi ("RMB") as its reporting currency. The functional currency of the Company and its subsidiaries incorporated outside of PRC is the United States dollar ("US$"), while the functional currency of the PRC entities in the Group is RMB as determined based on ASC 830, Foreign Currency Matters.

Transactions denominated in other than the functional currencies are re-measured into the functional currency of the entity at the exchange rates prevailing on the transaction dates. Foreign currency denominated financial assets and liabilities are re-measured at the balance sheet date exchange rate. The resulting exchange differences are included in the consolidated statements of comprehensive loss as foreign exchange gains / losses.

Assets and liabilities of the Company and its subsidiaries incorporated outside of PRC are translated into RMB at fiscal year-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the respective fiscal years. Translation adjustments arising from these are reported as foreign currency translation adjustments and are shown as a component of accumulated other comprehensive income or loss in the consolidated statement of changes in shareholders' equity/(deficit).

The unaudited United States dollar amounts disclosed in the accompanying financial statements are presented solely for the convenience of the readers. Translations of amounts from RMB into US$ for the convenience of the reader were calculated at the rate of US$1.00 = RMB 6.4778 on December 31, 2015, as set forth in H.10 statistical release of the Federal Reserve Board. No representation is made that the RMB amounts could have been, or could be, converted into US$ at that rate on December 31, 2015, or at any other rate.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(e) Fair Value Measurement

The Group defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

The established fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs may be used to measure fair value include:

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The Group's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, accounts payable, advances from customers, and certain accrued liabilities and other current liabilities. The carrying values of these financial instruments approximated their fair values due to the short-term maturity of these instruments.

(f) Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand and demand deposits placed with banks, other financial institutions and Alipay, a third party payment processor, which are unrestricted as to withdrawal or use.

(g) Restricted Cash

Restricted cash represents cash that cannot be withdrawn without the permission of third parties. The Group's restricted cash mainly represents (i) cash deposits required by tourism administration departments as a pledge to secure travelers' rights and interests, (ii) cash deposits required by China Insurance Regulatory Commission for engaging in insurance agency or brokering activities, (iii) the secured deposits held in designated bank accounts for issuance of bank acceptance and letter of guarantee, and required by the Group's business partners.

(h) Short-term Investments

Short-term investments are comprised of investments in financial products issued by banks or other financial institutions, which contain a fixed or variable interest rate and with original maturities between three months and one year. Such investments are generally not permitted to be redeemed early or are subject to penalties for redemption prior to maturity. Given the short-term nature, the carrying value of short-term investments approximates their fair value. There was no other-than-temporary impairment of short-term investments for the years ended December 31, 2013, 2014 and 2015.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(i) Accounts Receivable, net

The Group's accounts receivable mainly consist of amounts due from the corporate customers, travel agents, insurance companies and travel boards or bureaus, which are carried at the original invoice amount less an allowance for doubtful accounts. The Group reviews the accounts receivable on a periodic basis and makes allowances when there is doubt as to the collectability of individual balances. The Group evaluates the collectability of accounts receivable considering many factors including reviewing accounts receivable balances, historical bad debt rates, payment patterns, counterparties' credit worthiness and financial conditions, and industry trend analysis. No allowance for doubtful accounts was provided as of December 31, 2014 and 2015 as the Group believes that it is probable the accounts receivable will be fully collected.

(j) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and impairment if applicable. Property and equipment are depreciated over the estimated useful lives on a straight-line basis. The estimated useful lives are as follows:

Category	Estimated useful life
Computers and equipment	3 years
Buildings	16 - 17 years
Furniture and fixtures	3 - 5 years
Vehicles	3 - 5 years
Software	5 years
Leasehold improvements	Over the shorter of the lease term or the estimated useful life of the asset 1 – 9 years

Construction in progress represents leasehold improvements under construction or being installed and is stated at cost. Cost comprises original cost of property and equipment, installation, construction and other direct costs. Construction in progress is transferred to leasehold improvements and depreciation commences when the asset is ready for its intended use.

Gain or loss on the disposal of property and equipment is the difference between the net sales proceeds and the carrying amount of the relevant assets and is recognized in the consolidated statements of comprehensive loss.

(k) Capitalized Software Development Cost

The Group has capitalized certain direct development costs associated with internal-used software in accordance with ASC 350-40, Internal-use software, which requires the capitalization of costs relating to certain activities of developing internal-use software that occur during the application development stage. Costs capitalized mainly include payroll and payroll-related costs for employees who devoted time to the internal-use software projects during the application development stage. Capitalized internal-use software costs are stated at cost less accumulated amortization and the amount is included in “property and equipment, net” on the consolidated balance sheets, with an estimated useful life of five years. Software development cost capitalized amounted to RMB980, RMB6,837 and RMB7,572 for the years ended December 31, 2013, 2014 and 2015, respectively. Costs capitalized mainly include payroll and payroll-related costs for employees who are directly associated with and who devoted time to the internal-use software projects during the application development stage. The amortization expense for capitalized software costs amounted to RMB74, RMB727 and RMB2,212 for the years ended December 31, 2013, 2014 and 2015, respectively. The unamortized amount of capitalized internal use software development costs was RMB12,376 as of December 31, 2015.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(l) Business combination

U.S. GAAP requires that all business combinations not involving entities or businesses under common control be accounted for under the purchase method. The Group has adopted ASC 805 "Business Combinations", and the cost of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred and equity instruments issued. The transaction costs directly attributable to the acquisition are expensed as incurred. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any noncontrolling interests. The excess of the (i) the total of cost of acquisition, fair value of the noncontrolling interests and acquisition date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of operations and comprehensive income.

The determination and allocation of fair values to the identifiable assets acquired and liabilities assumed is based on various assumptions and valuation methodologies requiring considerable management judgment. The most significant variables in these valuations are discount rates, the number of years on which to base the cash flow projections, as well as the assumptions and estimates used to forecast the future cash inflows and outflows. Management determines discount rates to be used based on the risk inherent in the related activity's current business model and industry comparisons. Terminal values are based on the expected life of products and forecasted life cycle and forecasted cash flows over that period. Although management believes that the assumptions applied in the determination are reasonable based on information available at the date of acquisition, actual results may differ from the forecasted amounts and the difference could be material.

A noncontrolling interest is recognized to reflect the portion of a subsidiary's equity which is not attributable, directly or indirectly, to the Company. Consolidated net income on the consolidated statements of operations and comprehensive income includes the net income (loss) attributable to noncontrolling interests when applicable. The cumulative results of operations attributable to noncontrolling interests are also recorded as noncontrolling interests in the Company's consolidated balance sheets. Cash flows related to transactions with noncontrolling interests are presented under financing activities in the consolidated statements of cash flows when applicable.

(m) Intangible Assets

Intangible assets purchased are recognized and measured at cost upon acquisition and intangible assets arising from acquisitions of subsidiaries are recognized and measured at fair value upon acquisition. The Company's purchased intangible assets include computer software, which are amortized on a straight-line basis over their estimated useful lives 3 years. Separately intangible assets arising from acquisitions consist of trade names, customer relationship, software, non-compete agreements, travel licenses, insurance agency license and business cooperation agreement with JD.com Inc., which are amortized on a straight-line basis over their estimated useful lives of 3.5 to 20 years. The estimated life of intangible assets subject to amortization is reassessed if circumstances occur that indicate the life has changed. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. No impairment of intangible assets was recognized for the years ended December 31, 2013, 2014 and 2015.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(n) Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable assets and liabilities acquired in business combinations. Goodwill is not amortized, but tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

The Group adopted Accounting Standards Update ("ASU") 2011-08, Intangibles—Goodwill and Other (Topic 350). This accounting standard gives the Group an option to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, goodwill is then tested following a two-step process. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying amount of a reporting unit's goodwill. The fair value of each reporting unit is determined by the Group using the expected present value of future cash flows. The key assumptions used in the calculation include the long-term growth rates of revenue and gross margin, working-capital requirements and discount rates. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination, with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Management performs its annual goodwill impairment test on October 1.

No impairment loss was recognized for the year ended December 31, 2015.

(o) Impairment of long-lived assets

The Group evaluates its long-lived assets and finite lived intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When these events occur, the Group measures impairment by comparing the carrying amount of the assets to future undiscounted net cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flows is less than the carrying amount of the assets, the Group recognizes an impairment loss equal to the difference between the carrying amount and fair value of these assets. No impairment of long-lived assets was recognized during the years ended December 31, 2013, 2014 and 2015.

(p) Advances from Customers

Customers pay in advance to purchase travel services. Cash proceeds received from customers are initially recorded as advances from customers and are recognized as revenues when revenue recognition criteria are met.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(q) Revenue Recognition

The Group's revenue is primarily derived from sales of organized tours and self-guided tours, and other service fees. Revenue is recognized when the following criteria are met: persuasive evidence of an arrangement exists, the sales price is fixed or determinable, service has been provided, and collectability is reasonably assured in accordance with ASC 605, *Revenue Recognition*.

Organized tours: Substantially all of revenue from organized tours is recognized on a gross basis, as the Group is the primary obligor in the arrangement and bears the risks and rewards, including the customer's acceptance of services delivered. Such commitments are made in the contract the Group enters with its customers. Even though the Group does not generally assume the substantive inventory risk before customers place an order, the Group is the party retained by and paid by its customers, and the Group is responsible for (and solely authorized to) refunding customers their payments in situations of customer disputes. Further, the Group independently selects travel service suppliers, and determines the prices charged to customers and paid to its travel suppliers. Revenue from organized tours is recognized when the tours end as service rendering is only considered completed upon conclusion of the entire organized tour.

Self-guided tours: Revenue from self-guided tours is recognized on a net basis, representing the difference between what the Group receives from its customers and the amounts due to its travel suppliers. In the self-guided tour arrangements, the Group generally does not assume substantive inventory risk, has limited involvement in determining the service, and provides limited additional services to customers. Suppliers are responsible for all aspects of providing the air transportation and hotel accommodation, and other travel-related services. As such, the Group concludes that it is an agent for the travel service providers in these transactions and revenues are reported on a net basis. Revenue from self-guided tours is recognized when the tours end as commissions are not earned until this time according to the contractual arrangements the Group entered into with its travel suppliers.

Other revenues: Other revenues primarily comprise revenues generated from service fees received from insurance companies, other travel-related services, such as sales of tourist attraction tickets and visa processing services, fees for advertising services that the Group provide primarily to domestic and foreign tourism boards and bureaus, commission fees for hotel reservation and air-ticketing and service fees for financial services. Revenue is recognized when the services are rendered or when the tickets are issued.

The Group does not recognize revenue if customer refunds are warranted due to customer satisfaction issues or other reasons, which is generally known at the end of each tour when revenues are recognized. In the event of tour cancellation by customers, the liability associated with prepayments received from customers remains on the Group’s consolidated balance sheets until refunds are issued.

The Group commenced the financial services in 2015. Certain domestic financial assets exchanges (the "Exchange") and trust companies offered the yield enhancement products through the Group’s online platform and the Group charged these companies for the commission fees which were recorded as other revenue upon the delivery of service. For the year ended December 31, 2015, the commission revenue was immaterial.

In addition, the Group purchased the yield enhancement products with maturities ranged from three months to two years from the Exchanges and trust companies and split all of the products into new yield enhancement products with lower yield rate and shorter maturities within one year, which were offered to the individual investors through the Group’s online platform. As of December 31, 2015, RMB407,487 of yield enhancement products purchased by the Group with maturities within one year was recorded as other current assets (see Note 6), and RMB300,267 with the maturities over one year was recorded as other non-current assets (see Note 10). The interest revenue of RMB8,740 was recorded as other revenue for the year ended December 31, 2015. As of December 31, 2015, RMB589,151 of yield enhancement products held by the individual investors with maturities within one year was recorded as accrued expenses and other current liabilities (see Note 11). The interest cost of RMB8,082 was recorded as cost of revenue for the year ended December 31, 2015.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(q) Revenue Recognition - continued

Customer incentives

From time to time customers are offered coupons, travel vouchers, membership points, or cash rewards as customer incentives. The Group accounts for these customer incentives in accordance with ASC 605-50, *Customer Payments and Incentives*. For coupons and travel vouchers offered where prior purchase is not required, the Group accounts for them as a reduction of revenue when revenue is recognized. The Group assessed coupons and travel vouchers offered to customers as part of a current purchase that give customers a right, but do not obligate customers to make future purchases, and concluded the discounts offered are insignificant; as such, no deferral of revenue is considered necessary.

For membership points earned by customers as part of the customer reward program which provides travel awards upon point redemption, the Group estimates the incremental costs associated with the Group’s future obligation to its customers, and records them as sales and marketing expense in the consolidated statements of comprehensive loss. Unredeemed membership points are recorded in other current liabilities in the consolidated balance sheets. Cash rewards earned by customers are recorded as a reduction to revenue, with corresponding unclaimed amount recorded in other current liabilities. The Group estimate liabilities under the customer loyalty program based on accumulated membership points and cash rewards, and the estimate of probability of redemption in accordance with the historical redemption pattern. The actual expenditure may differ from the estimated liability recorded. Prior to April 2015, the Group recorded estimated liabilities for all points earned by customers as the Group did not have sufficient historical information to determine point forfeitures or breakage. The Group, with accumulated knowledge on membership points and cash rewards redemption and expiration, began to apply historical redemption rates in estimating the costs of points earned from May 2015 onwards. As of December 31, 2014 and 2015, liabilities recorded related to membership points and cash rewards are RMB14,764 and RMB34,633, respectively.

Business and related taxes

The Group is subject to business and related taxes on services provided in the PRC at applicable rates, which are recorded as a reduction of revenues.

(r) Cost of Revenues

Cost of revenues mainly consists of costs to suppliers of organized tours, and salaries and other compensation-related expenses related to the Group's tour advisors, customer services representatives, and other personnel related to tour transactions, and other expenses directly attributable to the Group's principal operations, primarily including payment processing fees, telecommunication expenses, rental and depreciation expense.

Committed tour reservations

In order to secure availabilities of organized tours and self-guided tours during peak seasons such as holiday periods, the Group may enter into certain contractual commitments with suppliers to reserve tours for selected destinations. The Group is required to pay a deposit to ensure tour availabilities, and such prepayment is record in prepayments and other current assets on the consolidated balance sheets. Some of these contractual commitments are non-cancellable, and to the extent the reserved tours are not sold to customers, the Group would be liable to pay suppliers a pre-defined or negotiated penalty, thereby assuming inventory risks. Management estimates losses of the committed tour reservations on a periodic basis based on contractual terms and historical experience, and record such losses in the period the loss is considered probable. For the years ended December 31, 2013, 2014 and 2015, losses recorded in "cost of revenues" in the consolidated statements of comprehensive loss amounted to RMB6,682, RMB4,134 and RMB17,780, respectively.

TUNIU CORPORATION

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(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(s) Advertising Expenses

Advertising expenses, which primarily consist of online marketing expense and brand marketing expenses through various forms of media, are recorded in sales and marketing expenses as incurred. Advertising expense were RMB103,142, RMB379,205 and RMB899,015 for the years ended December 31, 2013, 2014 and 2015, respectively.

(t) Research and Product Development Expenses

Research and product development expenses include salaries and other compensation-related expenses to the Group's research and product development personnel, as well as office rental, depreciation and related expenses and travel-related expenses for the Group's research and product development team. The Group recognizes software development costs in accordance with ASC 350-40 "Software—internal use software". The Group expenses all costs that are incurred in connection with the planning and implementation phases of development, and costs that are associated with repair or maintenance of the existing websites or software for internal use. Certain costs associated with developing internal-use software are capitalized when such costs are incurred within the application development stage of software development (see Note 2(k)).

(u) Leases

A lease for which substantially all the benefits and risks incidental to ownership remain with the lessor is classified as an operating lease. All leases of the Group are currently classified as operating leases. When a lease contains rent holidays or requires fixed escalations of the minimum lease payments, the Group records the total rental expense on a straight-line basis over the lease term and the difference between the straight-line rental expense and cash payment under the lease is recorded as deferred rent liabilities. As of December 31, 2014 and 2015, deferred rent of RMB4,244 and RMB16,741, were recorded as current liabilities and RMB22,278 and RMB18,035 were recorded as non-current liabilities, respectively.

(v) Share-based Compensation

The Company applies ASC 718, "Compensation — Stock Compensation" to account for its share-based compensation program. In accordance with the guidance, the Company determines whether a share-based award should be classified and accounted for as a liability award or equity award. All grants of share-based awards to employees classified as equity awards are recognized in the financial statements based on their grant date fair values which are calculated using the binominal option pricing model. Share-based compensation expenses are recorded net of an estimated forfeiture rate over the service period using the straight-line method.

The Company's 2008 Incentive Compensation Plan allows the plan administrator to grant options and restricted shares to the Company's employees, directors, and consultants. The plan administrator is the Company's board of directors or a committee appointed and determined by the board. The board may also authorize one or more officers of the Company to grant awards under the plan. Under the 2008 Incentive Compensation Plan, options granted to employees vest upon satisfaction of a service condition, which is generally satisfied over four years. Additionally, the incentive plan provides an exercisability clause where employees can only exercise vested options upon the occurrence of the following events: (i) after the Company's ordinary shares has become a listed security, (ii) in connection with or after a triggering event (defined as a sale, transfer, or disposition of all or substantially all of the Company's assets, or a merger, consolidation, or other business combination transaction), or (iii) if the employee obtains all necessary governmental approvals and consents required. Options for which the service condition has been satisfied are forfeited should employment terminate three months prior to the occurrence of an exercisable event, which substantially creates a performance condition. This performance condition was met upon completion of the Company's initial public offering, and the associated share-based compensation expense for awards vested as of that date were recognized on May 9, 2014.

In April 2014, the Company adopted the 2014 Share Incentive Plan, which contains no such exercisability clause. For detail of the 2014 Share Incentive Plan, please refer to Note 14 of the consolidated financial statements.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(v) Share-based Compensation - continued

The Group recognized share-based compensation expense of RMB65,143 in the year ended December 31, 2015, which was classified as follows:

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Cost of revenue	—	800	784	121
Research and product development	—	1,972	3,538	546
Sales and marketing	—	857	1,136	175
General and administrative	—	35,544	59,685	9,214
Total	—	39,173	65,143	10,056

(w) Income Taxes

Current income taxes are provided on the basis of net income for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes, in accordance with the regulations of the relevant tax jurisdictions. Deferred income taxes are provided using the liability method. Under this method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. The effect on deferred taxes of a change in tax rates is recognized in the interim condensed consolidated statements of comprehensive loss in the period of change. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of the deferred tax assets will not be realized.

Uncertain tax positions

The guidance prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Guidance also provides for the derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. Significant judgment is required in evaluating the Group’s uncertain tax positions and determining its provision for income taxes. As of December 31, 2014 and 2015, the Group did not have any significant unrecognized uncertain tax positions or any interest or penalties associated with tax positions.

In order to assess uncertain tax positions, the Group applies a more likely than not threshold and a two-step approach for the tax position measurement and financial statement recognition. Under the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

(x) Employee Benefits

Full-time employees of the Group in the PRC are entitled to welfare benefits including pension, work-related injury benefits, maternity insurance, medical insurance, unemployment benefit and housing fund plans through a PRC government-mandated defined contribution plan. Chinese labor regulations require that the Group makes contributions to the government for these benefits based on certain percentages of employees’ salaries, up to a maximum amount specified by the local government. The Group has no legal obligation for the benefits beyond the contributions. The Group recorded employee benefit expenses of RMB24,058, RMB50,617 and RMB131,291 for the years ended December 31, 2013, 2014 and 2015, respectively.

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2. Principal Accounting Policies - continued

(y) Government Subsidies

Government subsidies are cash subsidies received by the Group's entities in the PRC from provincial and local government authorities. The government subsidies are granted from time to time at the discretion of the relevant government authorities. These subsidies are granted for general corporate purposes and to support the Group's ongoing operations in the region. Cash subsidies are recorded in other operating income on the consolidated statements of comprehensive loss when received and when all conditions for their receipt have been satisfied. The Group recognized government subsidies of RMB1,689, RMB6,902 and RMB12,175 in the years ended December 31, 2013, 2014 and 2015, respectively.

(z) Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period using the two-class method. Under the two-class method, net income is allocated between ordinary shares and other participating securities based on their participating rights. Net loss is not allocated to other participating securities if based on their contractual terms they are not obligated to share in the losses. Diluted earnings (loss) per share is calculated by dividing net income (loss) attributable to ordinary shareholders by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of shares issuable upon the conversion of the preferred shares using the if-converted method, and shares issuable upon the exercise of share options using the treasury stock method. Ordinary equivalent shares are not included in the denominator of the diluted loss per share calculation when inclusion of such shares would be anti-dilutive. The preferred shares have been converted into ordinary shares upon the completion of the Group's initial public offering ("IPO") in May 2014. Except for voting rights, Class A and Class B shares have all the same rights and therefore the Group has elected not to use the two-class method.

(aa) Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of the Group during a period arising from transactions and other events and circumstances excluding transactions resulting from investments by shareholders and distributions to shareholders. Comprehensive income or loss is reported in the consolidated statements of comprehensive loss. Accumulated other comprehensive income (loss), as presented on the accompanying consolidated balance sheets, consists of accumulated foreign currency translation adjustments.

(ab) Segment Reporting

In accordance with ASC 280, Segment Reporting, the Group's chief operating decision maker, the Chief Executive Officer, reviews the consolidated results when making decisions about allocating resources and assessing performance of the Group as a whole and hence, the Group has only one reportable segment.

The Group does not distinguish between markets or segments for the purpose of internal reporting. The Group's long-lived assets are substantially all located in the PRC and substantially all the Group's revenues are derived from within the PRC, therefore, no geographical segments are presented.

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(All amounts in thousands, except for share and per share data, or otherwise noted)

2. Principal Accounting Policies - continued

(ac) Recently Issued Accounting Pronouncements

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements – Going Concern" ("ASU 2014-15")., which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements (or within one year after the date on which the financial statements are available to be issued, when applicable). Further, an entity must provide certain disclosures if there is "substantial doubt about the entity's ability to continue as a going concern." The ASU is effective for annual periods ending after December 15, 2016, and interim periods thereafter; early adoption is permitted. The Group is in the process of evaluating the impact of adopting this guidance.

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement—Extraordinary and Unusual Items" ("ASU 2015-01") to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under the ASU, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. The ASU is effective for annual and interim periods beginning after December 15, 2015 and early adoption is permitted. This guidance will not have material impact on the Group's financial position, results of operations or cash flows.

In February 2015, the FASB issued ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis" ("ASU 2015-02"). ASU 2015-02 focuses on the consolidation evaluation for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. The ASU simplifies consolidation accounting by reducing the number of consolidation models from four to two. In addition, the new standard simplifies the FASB Accounting Standards Codification and improves current guidance by: (i) placing more emphasis on risk of loss when determining a controlling financial interest; (ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a VIE; and (iii) changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The ASU is effective for annual and interim periods beginning after December 15, 2015, and early adoption is permitted, including adoption in an interim period. The Group is in the process of evaluating the impact of adopting this guidance.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which amends the existing accounting standards for revenue recognition. In August 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2015-14”): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. Therefore, the effective date of ASU No, 2014-09 for public business entities is for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. The Group is in the process of evaluating the impact of adopting this guidance.

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2. Principal Accounting Policies - continued

(ac) Recently Issued Accounting Pronouncements - continued

In September 2015, the FASB issued ASU No. 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments" ("ASU 2015-16"). This ASU requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. Prior to the issuance of the ASU, entities were required to retrospectively apply adjustments made to provisional amounts recognized in a business combination. The ASU is effective for annual and interim periods beginning after December 15, 2015, and early adoption is permitted. The Group has early adopted ASU 2015-16 in 2015.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes"("ASU 2015-17"), which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheet. The ASU is effective for annual and interim periods beginning after December 15, 2016 and early adoption is permitted. The Group early adopted the new standard on a retrospective basis as of December 31, 2015. The early adoption has no impact on the consolidated financial statements as there was a fully valuation allowance on the deferred tax assets.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): "Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01") which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Although the ASU retains many current requirements, it significantly revises an entity's accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The ASU also amends certain disclosure requirements associated with the fair value of financial instruments. The ASU is effective for annual and interim periods beginning after December 15, 2017. The Group is in the process of evaluating the impact of adopting this guidance.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)”(“ASU 2016-02”), which requires lessees to recognize assets and liabilities for all leases with lease terms of more than 12 months on the balance sheet. Under the new guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. The ASU is effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted on a modified retrospective basis. The Group is in the process of evaluating the impact of adopting this guidance.

3. Risks and Concentration

(a) Credit and Concentration Risks

The Group’s credit risk arises from cash and cash equivalents, restricted cash, short-term investments, prepayments and other current assets, and accounts receivables. The maximum exposure of such assets to credit risk is their carrying amounts as of the balance sheet dates.

The Group expects that there is no significant credit risk associated with the cash and cash equivalents and short-term investments which are held by reputable financial institutions in the jurisdictions where the Company, its subsidiaries and the Affiliated Entities are located. The Group believes that it is not exposed to unusual risks as these financial institutions have high credit quality.

The Group has no significant concentrations of credit risk with respect to its customers, as customers usually prepay for travel services. Accounts receivable are typically unsecured and are primarily derived from revenue earned from corporate customers, travel agents, insurance companies and travel boards or bureaus. The risk with respect to accounts receivable is mitigated by credit evaluations performed on the corporate customers, travel agents and insurance companies and ongoing monitoring processes on outstanding balances. No individual customer accounted for more than 10% of net revenues in the years ended December 31, 2013, 2014 and 2015.

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3. Risks and Concentration - continued

(a) Credit and Concentration Risks - continued

The following table summarized customers with greater than 10% of the accounts receivables:

	As of December 31,	
	2014	2015
Customer A	26.0%	13.3%

During the year ended December 31, 2015, the Group has purchased financial products which include yield enhancement products issued by domestic Financial Assets Exchanges and Trust companies. The Group has set up a risk evaluation system on the issuers of credit quality, ultimate borrowers of asset management schemes, and conducts collect ability assessment of the financial assets on timely basis. As of December 31, 2015, the Group believes the financial assets are financially sound based on public available information and the assessment and does not foresee substantial credit risk with respect to these financial products.

(b) Foreign Currency Risk

The Group's operating transactions and its assets and liabilities are mainly denominated in RMB. RMB is not freely convertible into foreign currencies. The value of RMB is subject to changes influenced by central government policies, and international economic and political developments. In the PRC, certain foreign exchange transactions are required by law to be transacted only by authorized financial institutions at exchange rates set by the People's Bank of China (the "PBOC"). Remittances in currencies other than RMB by the Group in China must be processed through the PBOC or other China foreign exchange regulatory bodies which require certain supporting documentation in order to effect the remittance.

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TUNIU CORPORATION

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4. Business acquisition

Travel agencies

During the year ended December 31, 2015, the Group acquired the 90%, 100%, 75.02% and 80% of equity interests of the four offline travel agencies, respectively. The Group gained access to the expanding Taiwan tours market and improved the capability in the direct procurement of products with these acquisitions. The total purchase price of RMB117,997 included cash consideration of RMB102,662 and RMB15,335, the fair value of contingent cash consideration to be made based on the achievement of certain revenue and profit target over the next three to four years. The fair value of the contingent cash consideration was estimated using a probability-weighted scenario analysis method. Key assumption included probabilities assigned to each scenario and a discount rate. As of December 31, 2015, the total unpaid consideration was amounted to RMB39,471. The business acquisitions were accounted for under purchase accounting. The following is the summary of the fair values of the assets acquired and liabilities assumed:

	Amount	Estimated useful lives
Net liabilities (including the cash acquired of RMB24 million)	(57,032)	
Travel licenses	25,100	20 years
Customer relationship	13,596	14.25-14.5 years
Trade names	39,619	7-14 years
Software	3,013	5 years
Non-compete agreement	1,782	3.5-5.25 years
Goodwill	132,819	
Deferred tax liability	(20,778)	
Noncontrolling interest	(20,122)	
Total considerations	117,997	

The Group measured the fair value of the trade names and travel licenses under the relief-from-royalty method. Under the methodology, fair value is calculated as the discounted cash flow savings accruing to the owner for not having to pay the royalty. Key assumptions included expected revenue attributable to the assets, royalty rates, discount rate and estimated asset lives. Customer relationships were valued using the excess-earnings method, which measures the present value of the projected cash flows that are expected to be generated by the existing intangible asset after deduction of cash flows attributable to other contributory assets to realize the projected earnings attributable to the intangible asset. Key assumptions included discounted cash flow analyses, for other contributory assets, discount rate, remaining useful life, tax amortization benefit and customer attrition rates. The Group measured the fair value of non-compete agreements based on incremental discounted cash flow analyses computed with and without the non-compete terms as described in share purchase agreement and the probability that such competition exists. The Group measured the fair value of the software under the replacement cost method.

A preliminary allocation of the purchase price of two offline travel agencies, which were acquired on July 1, 2015 and October 1, 2015, respectively, to the assets acquired and liabilities assumed was made based on available information and incorporated with management's current estimates, and is subject to revision as additional information about the fair value of individual assets and liabilities becomes available. The Group is in the process of finalizing the fair value of the current assets and current liabilities, and the amount of purchase price allocable to goodwill be updated accordingly.

During the year ended December 31, 2015, the Group acquired the remaining 10% equity interest of one of travel agencies with the consideration of RMB1,496, which was treated as equity acquisition and the difference between the purchase consideration and the related carrying value of the noncontrolling interests of RMB683 was recorded as a reduction of additional paid-in capital during the year ended December 31, 2015.

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4. Business acquisition - continued

Other acquisition

In July 2015, the Group acquired 100% equity interests of in a technology company of focusing on air ticketing platform development. The total consideration was RMB8,645. As of December 31, 2015, the total unpaid consideration was amounted to RMB 2,645. The business acquisitions were accounted for under purchase accounting. The following is the summary of the fair values of the assets acquired and liabilities assumed:

	Amount	Estimated useful lives
Net liabilities	(355)	
Software	5,960	6 years
Non-compete agreement	1,040	6 years
Goodwill	3,750	
Deferred tax liability	(1,750)	
Total considerations	8,645	

Pro forma results of operations for the acquisitions described above have not been presented because they are not material to the consolidated income statements, either individually or in aggregate.

5. Transaction with JD.com, Inc.

On May 8, 2015, the Company entered into a share subscription agreement with Fabulous Jade Global Limited, an affiliate of JD.com, Inc., and a Business Cooperation Agreement (“BCA”) with JD. Com, Inc. (“JD”) for a period of five years. Pursuant to these agreements, the Company issued 65,625,000 Class A ordinary shares for a cash consideration of RMB1,528.2 million (US$250 million) and the business resource contributed by JD. According to BCA, the business resource includes the exclusive rights to operate the leisure travel channel for both JD’s website and mobile application and JD's preferred partnership for hotel and air ticket reservation service, the internet traffic support and marketing support for the leisure travel channel for a period of five years started from August 2015.

The acquisition of BCA is considered as assets acquisition and the intangible assets acquired include the exclusive operation right of leisure travel channel, preferred partnership of hotel and air tickets reservation service, traffic and marketing supports. The Group estimated the fair value of exclusive operation right and preferred partnership using a form of the income approach known as excess earning method. The key assumption includes expected revenue attributable to assets, margin discount rate and the remaining useful life. The Group estimated the fair value of internet traffic support and marketing support using a form of income approach known as operating cost saving method. Key assumption includes the market price of the services to be provided, the volume of the services to be provided, discount rate and the remaining useful life. The Group made estimates and judgments in determining the fair value of the assets with assistance from an independent valuation firm.

The summary of the fair value about acquired intangible assets is as follows:

	Amount	Estimated useful lives
Exclusive operation right of leisure travel channel	405,406	5 years
Preferred partnership of hotel and air ticket reservation service	1,431	5 years
Internet traffic support	139,358	5 years
Marketing support	114,020	5 years
Total consideration	660,215	

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6. Prepayments and other current assets

The following is a summary of prepayments and other current assets:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Prepayments to suppliers	498,298	1,095,918	169,181
Interest income receivable	6,510	26,376	4,072
Prepayment for advertising expenses	53,664	92,339	14,255
Yield enhancement products from Exchange and trust companies	—	407,487	62,905
Others	16,825	77,348	11,940
Total	575,297	1,699,468	262,353

7. Property and equipment, net

The following is a summary of property and equipment, net:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Computers and equipment	43,961	89,127	13,758
Leasehold improvements	43,684	71,800	11,084
Buildings	—	2,578	398
Furniture and fixtures	6,343	15,479	2,390
Vehicles	—	156	24
Software	11,920	23,850	3,682

Subtotal	105,908	202,990	31,336
Less: Accumulated depreciation	(36,542)	(63,287)	(9,770)
Property and equipment subject to depreciation	69,366	139,703	21,566
Construction in progress	2,944	5,487	848
Total	72,310	145,190	22,414

Depreciation expenses for the years ended December 31, 2013, 2014 and 2015 were RMB8,764, RMB10,869 and RMB28,041, respectively.

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8. Intangible assets, net

Intangible assets, net, consist of the following:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Travel license	4,313	29,206	4,509
Insurance agency license	—	11,711	1,807
Software	1,945	19,164	2,959
Trade names	—	39,619	6,116
Business Cooperation Agreements	—	660,215	101,920
Customer relationship	—	13,596	2,099
Non-compete agreements	—	2,822	436
Subtotal	6,258	776,333	119,846
Less: Accumulated amortization	(3,183)	(60,785)	(9,384)
Total	3,075	715,548	110,462

During the year 2015, the Group acquired an insurance agency for the total consideration of RMB58,720 to acquire the insurance agency license. The insurance agency was a dormant company and was not qualified as a business as it had no input or process to create output. The Group accounted it as assets acquisition and the difference between the cash consideration and net assets of the insurance agency is recorded as insurance agency license and amortized over the 20 years on a straight line basis.

Amortization expenses for intangible assets were RMB482, RMB984 and RMB57,810 for the years ended December 31, 2013, 2014 and 2015.

The annual estimated amortization expense for the above intangible assets for the following years is as follows:

	Amortization for Intangible Assets	
Years Ending December 31,	RMB	US$ (Note 2(d))
2016	142,280	21,964
2017	141,355	21,821
2018	141,259	21,807
2019	140,851	21,744
2020	87,336	13,482
Thereafter	62,467	9,644
Total	715,548	110,462

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9. Goodwill

The changes in the carrying amount of goodwill for the years ended December 2014 and 2015 were as follows:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Balance at the beginning of year	—	—	—
Increase in goodwill related to acquisitions	—	136,569	21,083
Accumulated impairment loss	—	—	—
Balance at the end of year	—	136,569	21,083

10. Other non-current assets

Other non-current assets consist of the following:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Prepayment to suppliers - HNA	—	324,680	50,123
Yield enhancement products from Exchange and trust companies	—	300,267	46,353
Other long term assets	15,368	24,534	3,785
Balance at the end of year	15,368	649,481	100,261

HNA Tourism Holdings Group Co., Ltd. (“HNA”) agreed to provide the Group with access to its premium airlines and hotels resources at a preferential rate, under fair competition market rules, and the Group undertook to acquire no less than US$100 million (RMB649.4 million) in products and services sourced from HNA over the next two years. The prepayments to suppliers were disclosed as prepayments and other current assets US$50 million (RMB324.7 million) and other non-current assets US$50 million (RMB 324.7 million) according to the service period.

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11. Accrued expenses and other current liabilities

The following is a summary of accrued expenses and other current liabilities:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Deposits from customers	27,807	31,269	4,827
Deposit from HNA	—	649,360	100,244
Payable for business acquisition	—	26,781	4,134
Accrued liabilities related to customers incentive program	14,764	34,633	5,346
Accrued professional service fees	18,361	12,373	1,910
Accrued advertising expenses	12,455	56,293	8,690
Amount due to the individual investors of yield enhancement products	—	589,151	90,949
Notes payable	—	70,000	10,806
Advanced payment from banks	11,036	21,575	3,331
Others	25,437	123,998	19,143
Total	109,860	1,615,433	249,380

Deposits from customers represent cash paid to the Group as a deposit for overseas tours, and such amount is refundable upon completion of the tours.

HNA Tourism Holdings Group Co., Ltd. (“HNA”) provided RMB649 million (US$100 million) as the guarantee to fulfil of the ordinary shares subscription agreement signed on November 20, 2015. The amount was refunded in January 2016 upon the closing of the transaction.

Advanced payment from banks represent cash received by the Group for promotional and marking campaigns. Banks participating in these campaigns would reimburse the Group for tours sold to their credit card holders at a specified discount.

12. Income Taxes

The Company is registered in the Cayman Islands. The Company generated substantially all of its income (loss) from its PRC operations for the years ended December 31, 2013, 2014 and 2015.

Cayman Islands (“Cayman”)

Under the current laws of the Cayman Islands, the Company is not subject to tax on income or capital gain. Additionally, upon payments of dividends to shareholders, no Cayman Islands withholding tax will be imposed.

Hong Kong

Entities incorporated in Hong Kong are subject to Hong Kong profits tax at a rate of 16.5% since January 1, 2010. The operations in Hong Kong have incurred net accumulated operating losses for income tax purposes.

PRC

On March 16, 2007, the National People’s Congress of the PRC enacted an Enterprise Income Tax Law (“EIT Law”), under which Foreign Investment Enterprises (“FIEs”) and domestic companies would be subject to EIT at a uniform rate of 25%. The EIT law became effective on January 1, 2008.

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12. Income Taxes – continued

The EIT Law also provides that an enterprise established under the laws of a foreign country or region but whose "de facto management body" is located in the PRC be treated as a resident Enterprise for PRC tax purposes and consequently be subject to the PRC income tax at the rate of 25% for its global income. The implementing Rules of the EIT Law merely define the location of the "de facto management body" as "the place where the exercising, in substance, of the overall management and control of the production and business operation, personnel, accounting, properties, etc., of a non-PRC company is located."

The EIT Law also imposes a withholding income tax of 10% on dividends distributed by a FIE to its immediate holding company outside of China, if such immediate holding company is considered as a non-resident enterprise without any establishment or place within China or if the received dividends have no connection with the establishment or place of such immediate holding company within China, unless such immediate holding company's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding arrangement. The Cayman Islands, where the Company incorporated, does not have such tax treaty with China. According to the arrangement between Mainland China and Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion in August 2006, dividends paid by a FIE in China to its immediate holding company in Hong Kong will be subject to withholding tax at a rate of no more than 5% if the immediate holding company in Hong Kong owns directly at least 25% of the shares of the FIE and could be recognized as a Beneficial Owner of the dividend from PRC tax perspective.

Nanjing Tuniu obtained in 2010 its HNTE certificate with a valid period of three years and successfully renewed such certificate in December 2013 for additional three years. Therefore, Nanjing Tuniu is eligible to enjoy a preferential tax rate of 15% from 2013 to 2015 to the extent it has taxable income under the EIT Law, as long as it maintains the HNTE qualification and duly conducts relevant EIT filing procedures with the relevant tax authority. Nanjing Tuniu also obtained a software company certificate in 2012. Pursuant to such certificate, Nanjing Tuniu qualifies for a tax holiday during which it is entitled to an exemption from enterprise income tax for two years commencing from its first profit-making year of operation and a 50% reduction of enterprise income tax for the following three years. Nanjing Tuniu entered into the first tax profitable year for the year ended December 31, 2014.

A reconciliation between the effective income tax rate and the PRC statutory income tax rate is as follows:

	For Years Ended December 31,		
	2013	2014	2015
	%	%	%
PRC Statutory income tax rates	25.0	25.0	25.0
Change in valuation allowance	(20.1)	(22.4)	(22.5)
Permanent book – tax difference	(4.9)	(12.1)	(0.1)
Difference in EIT rates of certain subsidiaries	0.0	0.0	(3.1)
Effect of tax holiday	—	9.5	0.7
Total	0.0	0.0	0.0

The aggregate amount and per share effect of the tax holidays are as follows:

	For the Years Ended December 31,			
	2013	2014	2015	
				US$ (Note 2(d))
Aggregate amount	—	(42,567)	(9,974)	(1,540)
Basic net loss per share effect	—	(0.40)	(0.04)	(0.01)
Diluted net loss per share effect	—	(0.40)	(0.04)	(0.01)

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TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

12. Income Taxes - continued

The following table sets forth the significant components of deferred tax assets and liabilities:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Non-current deferred tax assets:			
Accruals and others	16,298	21,765	3,360
Net operating loss carry forwards	133,593	459,109	70,874
Carryforwards of un-deducted advertising expenses	926	31	5
Subtotal	150,817	480,905	74,239
Less: valuation allowance	(150,817)	(480,905)	(74,239)
Total non-current deferred tax assets, net	—	—	—
Non-current deferred tax liabilities:			
Recognition of intangible assets arisen from business combination	—	(24,415)	(3,769)
Total non-current deferred tax assets, net	—	(24,415)	(3,769)

As of December 31, 2015, the Group had net operating loss carryforwards of RMB1,836,436 which can be carried forward to offset taxable income. The carryforwards period for net operating losses under the EIT Law is five years. The net operating loss carry forward of the Group will start to expire in 2016 for the amount of RMB39,069 if not utilized. The remaining net operating loss carryforwards will expire in varying amounts between 2017 and 2020. There is no expiration for the advertising expenses carryforwards. Other than the expiration, there are no other limitations or restrictions upon the Group's ability to use these operating loss carryforwards.

A valuation allowance is provided against deferred tax assets when the Group determines that it is more likely than not that the deferred tax assets will not be utilized in the future. In making such determination, the Group evaluates a variety of factors including the Group's operating history, accumulated deficit, existence of taxable temporary differences and reversal periods.

As of December 31, 2014 and 2015, valuation allowances of RMB150,817 and RMB480,905 were provided because it was more likely than not that the Group will not be able to utilize certain tax losses carry forwards and other deferred tax assets generated by its subsidiaries and Affiliated Entities. If events occur in the future that allow the Group to realize more of its deferred tax assets than the presently recorded amount, an adjustment to the valuation allowances will increase income when those events occur.

Movement of valuation allowance

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Balance as the beginning of the year	34,315	46,121	150,817	23,282
Additions	11,806	112,421	332,086	51,265
Written off for expiration of net operating losses	—	—	(1,998)	(308)
Utilization of previously unrecognized tax losses and un-deductible advertising expenses	—	(7,725)	—	—
Balance as the end of the year	46,121	150,817	480,905	74,239

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TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

13. Ordinary Shares

On February 13, 2014, the Board has approved that all of the Company's existing ordinary shares would be redesignated as Class B ordinary shares and all of the Company's outstanding preferred shares would be redesignated or automatically converted into Class B ordinary shares immediately prior to the completion of the Company's initial public offering ("IPO"). All options, regardless of grant dates, will entitle holders to the equivalent number of Class A ordinary shares once the vesting and exercising conditions on such share-based compensation awards are met. Holders of Class A ordinary shares will be entitled to one vote per share, while holders of Class B ordinary shares will be entitled to ten votes per share on all matters subject to shareholders' vote. Each Class B ordinary share is convertible into one Class A ordinary share at any time by the holder. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances. Upon any transfer of Class B ordinary shares by a holder to any person or entity which is not an affiliate of such holder, such Class B ordinary shares will be automatically and immediately converted into the equivalent number of Class A ordinary shares.

On May 9, 2014, concurrently with the completion of the Company's IPO, the Company issued 5,000,000, 1,666,666 and 5,000,000 shares of Class A ordinary shares at a price per share equal to the IPO price to DCM Hybrid RMB Fund, L.P., the Company's existing shareholder, Qihoo 360 Technology Co. Ltd. and Ctrip Investment Holding Ltd., respectively.

On December 15, 2014, the Company entered into share subscription agreements with Unicorn Riches Limited, JD.com E-commerce (Investment) Hong Kong Corporation Limited, Ctrip Investment Holding Ltd. and the respective personal holding companies of the Group's chief executive officer and chief operating officer, pursuant to which the Company issued 36,812,868 numbers of Class A ordinary shares for a total proceeds of RMB905,792 (US$148 million), net of issuance cost of RMB14,279. The transaction was closed on December 31, 2014.

On May 8, 2015, the Company entered into share subscription agreements with Fabulous Jade Global Limited, Unicorn Riches Limited, Ctrip Investment Holding Ltd., Esta Investments Pte. Ltd., DCM Ventures China Turbo Fund, L.P. and DCM Ventures China Turbo Affiliates Fund, L.P., and Sequoia Capital 2010 CV Holdco, Ltd., pursuant to which the Company issued 93,750,000 Class A ordinary shares for the cash consideration of US$400 million (RMB2,445 million) and certain business resource contributed by JD as part of Business Cooperation Agreement with the Company. The total consideration was RMB3,104,457, including fair value of acquired Business Cooperation Agreement of RMB660,215(see Note 5), net of issuance cost of RMB1,078. The transaction was closed on May 22, 2015.

On November 20, 2015, the Company entered into a share subscription agreement with HNA Tourism Holdings Group Co., Ltd. (“HNA”), pursuant to which the Company issued 90,909,091 Class A ordinary shares for a total proceeds of US$500 million. The transaction was closed on January 21, 2016.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

14. Share-based Compensation Expenses

The Company's 2008 Incentive Compensation Plan (the "2008 Plan") allows the plan administrator to grant options and restricted shares to the Company's employees, directors, and consultants, up to a maximum of 11,500,000 ordinary shares. In December 2012, the Board of Directors approved an increase in the number of shares available for issuance under the plan to 18,375,140 ordinary shares. In April 2014 the Company adopted the 2014 Share Incentive Plan (the "2014 Plan"). The maximum aggregate number of shares which may be issued pursuant to all awards under the 2014 Plan was initially 5,500,000 ordinary shares as of the date of its approval. The number of shares reserved for future issuances under the 2014 Plan will be increased automatically if and whenever the ordinary shares reserved under the 2014 Plan account for less than1% of the total then-issued and outstanding ordinary shares on an as-converted basis, as a result of which increase the ordinary shares reserved under the2014 Plan immediately after each such increase shall equal 5% of the then-issued and outstanding ordinary shares on an as-converted basis.

The options granted under the 2008 plan have a contractual term of six years, and ones under 2014 plan have a contractual term of ten years. The incentive awards under both 2008 plan and 2014 plan vest over a period of four years of continuous service, one fourth (1/4) of which vest upon the first anniversary of the stated vesting commencement date and the remaining vest ratably over the following 36 months. Under the 2008 plan, incentive awards are only exercisable upon occurrence of certain defined exercisable events. The Group did not recognize any share-based compensation expense for the awards granted until the completion of the Company's IPO on May 9, 2014 upon which the performance condition was satisfied. Share-based compensation expense of RMB39,173 and RMB65,143 was recognized for the years ended December 31, 2014 and 2015, respectively.

Share options

The following table summarizes the Company's option activities:

	Number of options	Weighted Average Exercise Price US$	Weighted Average Remaining Contractual Life In Years	Aggregate Intrinsic Value US$'000
Outstanding at January 1, 2015	21,265,846	1.17	4.88	60,165
Granted	14,369,000	4.78		
Exercised	(4,732,482)	0.51		
Forfeited	(820,553)	3.21		
Outstanding at December 31, 2015	30,081,811	2.94	7.01	71,711
Vested and expected to vest at December 31, 2015	28,908,784	2.90	6.95	70,063
Exercisable at December 31, 2015	9,537,339	0.83	3.77	42,853

The total intrinsic value of options exercised for the years ended December 31, 2014 and 2015 were RMB68,094 and RMB150,325 (US$23,206), respectively. No options were exercised for the year ended December 31, 2013.

The weighted-average grant date fair value for options granted during the years ended December 31, 2013, 2014 and 2015 was US$0.90, US$3.57 and US$2.40, respectively, computed using the binomial option pricing model.

The total fair value of share options vested during the years ended December 31, 2013, 2014, and 2015 was RMB8,341, RMB23,849, and RMB50,089 (US$7,732), respectively.

The Company estimated the expected volatility at the date of grant date and each option valuation date based on the annualized standard deviation of the daily return embedded in historical share prices of comparable companies. Risk free interest rate was estimated based on the yield to maturity of US treasury bonds denominated in US$ at the option valuation date. The exercise multiple is estimated as the ratio of fair value of underlying shares over the exercise price as at the time the option is exercised, based on a consideration of research study regarding exercise pattern based on empirical studies on the actual exercise behavior of employees. The Company has never declared or paid any cash dividends on its capital stock, and the Company does not anticipate any dividend payments on its ordinary shares in the foreseeable future. Expected term is the contract life of the option, and estimated forfeiture rates are determined based on historical employee turnover rate.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

14. Share-based Compensation Expenses - continued

The grant date fair value of each option is calculated using a binomial option pricing model with the following assumptions:

	2013		2014		2015	
Expected volatility	50-52	%	50%-51.1	%	50.9%-51.7	%
Risk-free interest rate	1.08-1.75	%	1.99-2.6	%	2.09%-2.24	%
Exercise multiple	2.2-2.8		2.2-2.8		2.2-2.8	
Expected dividend yield	0	%	0	%	0	%
Expected term (in years)	6		6-10		10	
Expected forfeiture rate (post-vesting)	0-20	%	0-20	%	0-20	%
Fair value of the common share on the date of option grant	US$0.91-1.98 RMB5.63-12.26		US$3.33-6.98 RMB20.66-43.31		US$4.21-5.26 RMB27.27-34.07	

On May 15, 2014, the Company modified the exercise price of 576,000 share options granted on April 1, 2014 from US$5.00 to US$3.00. The incremental compensation expense of RMB1,698 (US$276) was equal to the excess of the fair value of the modified award immediately after the modification over the fair value of the original award immediately before the modification. The incremental compensation expense will be recognized over the remaining service period.

On December 8, 2014, the Company extended the contract life of 2,159,812 share options granted under 2008 plan from six years to ten years. The incremental compensation expense was immaterial and was recognized immediately since the options were fully vested.

As of December 31, 2015, there was RMB301,518 (US$46,546) in total unrecognized compensation expense related to unvested options, which is expected to be recognized over a weighted-average period of 3.15 years.

Restricted shares

The total intrinsic value of restricted shares vested for the years ended December 31, 2014 and 2015 were RMB1,011 and RMB1,694 (US$261), respectively.

The fair value of restricted shares with service conditions or performance conditions is based on the fair market value of the underlying ordinary shares on the date of grant.

The following table summarizes the Company’s restricted shares activity under the option plans:

	Numbers of restricted shares	Weighted average grant date fair value
Outstanding as of January 1, 2015	179,382	3.36
Grant	100,914	4.82
Vested	(52,488)	3.36
Forfeited	—	—
Outstanding as of December 31, 2015	227,808	4.00
Vested and expected to vest at December 31, 2015	227,808	4.00

As of December 31, 2015, there was RMB5,723 (US$883) in total unrecognized compensation expense related to restricted shares, which is expected to be recognized over a weighted-average period of 3.15years.

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TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

15. Loss Per Share

The following table sets forth the computation of basic and diluted loss per share for the periods indicated:

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Numerator:				
Net loss attributable to Tuniu Corporation	(79,632)	(447,858)	(1,459,379)	(225,289)
Deemed dividends upon redesignation of Series A Preferred Shares	(59,428)	—	—	—
Deemed dividends upon redesignation of Series D Preferred Shares	—	(15,606)	—	—
Numerator for basic and diluted net loss per share	(139,060)	(463,464)	(1,459,379)	(225,289)
Denominator:				
Weighted average number of ordinary shares outstanding-basic and diluted	26,000,000	105,746,313	248,362,837	248,362,837
Loss per share-basic and diluted	(5.35)	(4.38)	(5.88)	(0.91)

For the years ended December 31, 2013, 2014 and 2015, the Company had securities which could potentially dilute basic loss per share in the future, which were excluded from the computation of diluted loss per share as their effects would have been anti-dilutive. Such outstanding securities consist of the following:

	2013	2014	2015
Series A preferred shares	13,506,748	—	—
Series B preferred shares	21,564,115	—	—
Series C preferred shares	25,782,056	—	—
Series D preferred shares	21,771,472	—	—
Option and restricted shares	17,631,953	21,445,228	30,309,619

Total	100,256,344	21,445,228	30,309,619

16. Restricted Net Assets

Pursuant to laws applicable to entities incorporated in the PRC, the Group's subsidiaries and Affiliated Entities in the PRC must make appropriations from after-tax profit to non-distributable reserve funds. These reserve funds include one or more of the following: (i) a general reserve, (ii) an enterprise expansion fund and (iii) a staff bonus and welfare fund. Subject to certain cumulative limits, the general reserve fund requires an annual appropriation of 10% of after tax profit (as determined under accounting principles generally accepted in the PRC at each year-end) until the accumulative amount of such reserve fund reaches 50% of a company's registered capital; the other fund appropriations are at the subsidiaries' discretion. These reserve funds can only be used for specific purposes of enterprise expansion and staff bonus and welfare and are not distributable as cash dividends. In addition, due to restrictions on the distribution of share capital from the Group's PRC subsidiaries and Affiliated Entities and also as a result of these entities' unreserved accumulated losses, total restrictions placed on the distribution of the Group's PRC subsidiaries and Affiliated Entities' net assets was RMB2,642 million, or 80% of the Group's total consolidated net assets as of December 31, 2015.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

17. Commitments and Contingencies

(a) Operating Lease Agreement

The Group leases its offices under non-cancelable operating lease agreements. Certain of these arrangements contain free or escalating rent clauses. The Group recognizes rental expense under such arrangements on a straight-line basis over the lease term. Rental expenses amounting to RMB12,582, RMB15,969 and RMB36,445 during the years ended December 31, 2013, 2014 and 2015, respectively, were charged to the consolidated statements of comprehensive loss when incurred.

As of December 31, 2015, future minimum commitments under non-cancelable agreements were as follows:

Years Ending December 31,	RMB	US$ (Note 2(d))
2016	53,393	8,243
2017	46,051	7,109
2018	33,978	5,245
2019	26,795	4,136
2020	26,307	4,061
Thereafter	28,508	4,401
Total	215,032	33,195

(b) Capital Commitments

As of December 31, 2015, capital commitments relating to leasehold improvement and purchase of equipment were approximately RMB192.

(c) Contingencies

From time to time, the Group is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is likely to have a material adverse effect on the Group's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Group's view of these matters may change in the future. If an unfavorable outcome were to occur, there exists the possibility of a material adverse impact on the Group's financial position and results of operations for the periods in which the unfavorable outcome occurs.

TUNIU CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except for share and per share data, or otherwise noted)

18. Related party transactions and balances

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operational decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

The following entities are considered to be related parties to the Group:

Name of related parties	Relationship with the Group
Ctrip Investment Holding Co., Ltd. ("Ctrip")	one board director of the Group
JD.com, Inc. ("JD")	one board director of the Group

a) Transactions with related parties:

Ctrip purchased 5,000,000 Class A ordinary shares in a private placement concurrent with the Company's initial public offering, an additional 3,731,034 Class A ordinary shares for a total of US$15,000,000 through a private placement transaction in December 2014 as well as an additional 3,750,000 Class A ordinary shares for a total of US$20,000,000 through a private placement transaction in May 2015.

The Group conducts transactions in the ordinary course of its business with Ctrip on the terms of arm-length transactions. The Group sells the packaged-tours through Ctrip's online platform and the commission fees for Ctrip's service were immaterial. In addition, Ctrip sells the hotel rooms and air tickets products through the Group's online platform and commission fees the Group earned were RMB0.7 million and RMB3.5 million for the years ended December 31, 2014 and 2015, respectively.

On May 8, 2015, the Company issued 65,625,000 Class A ordinary shares to Fabulous Jade Global Limited, a subsidiary of JD, for cash consideration of RMB1,528.2 million (US$250 million) and RMB660.2 million of the business resource contributed by JD, which including the exclusive rights to operate the leisure travel channel for both JD’s website and mobile application, JD's preferred partnership for hotel and air ticket reservation service, the internet traffic support and marketing support for the leisure travel channel for a period of five years started from August 2015.

b) Balances with related parties:

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
Due from Ctrip	637	59,142	9,130
Due from JD	—	862	133
Total	637	60,004	9,263
Due to Ctrip	—	28,669	4,426
Due to JD	—	93	14
Total	—	28,762	4,440

19. Subsequent Events

On March 4, 2016, the Company modified the exercise price for certain outstanding options that have been granted under the Company’s 2014 Share Incentive Plan in order to provide appropriate incentives to the relevant employees. The exercise price were modified to US$3.09 per ordinary share which represent the closing price of the day prior to the modification with other conditions remaining unchanged. The Company estimated that the total incremental cost is approximately US$3.4 million (RMB22.1 million). The incremental cost related to the vested option is immaterial and the incremental cost related to the unvested options will be amortized over the remaining period ranged from 33 months to 45 months.

FINANCIAL STATEMENTS SCHEDULE I

TUNIU CORPORATION

CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY

CONDENSED BALANCE SHEETS

(All amounts in thousands, except for share and per share data, or otherwise noted)

	As of December 31,		
	2014	2015	
	RMB	RMB	US$ (Note 2(d))
ASSETS			
Current assets			
Cash and cash equivalents	1,323,280	1,090,097	168,282
Amounts due from subsidiaries	18,000	3,468,022	535,370
Prepayments and other current assets	1,561	4,888	755
Total current assets	1,342,841	4,563,007	704,407
Intangible assets	—	607,669	93,808
Total assets	1,342,841	5,170,676	798,215
LIABILITIES AND EQUITY			
Current liabilities			
Accrued expenses and other current liabilities	16,723	664,420	102,568
Total current liabilities	16,723	664,420	102,568
Non-current liabilities			
Investments (income)/ deficit in subsidiaries and VIE	(82,605)	1,185,106	182,949
Total non-current liabilities	(82,605)	1,185,106	182,949
Total liabilities	(65,882)	1,849,526	285,517
Equity			
Ordinary shares (US$0.0001 par value; 1,000,000,000 shares (including 780,000,000 Class A shares, 120,000,000 Class B shares and 100,000,000 shares to be designated by the Board of Directors) authorized as of December 31, 2014 and 2015; 188,435,922 shares (including 82,487,876 Class A shares and 105,948,046 Class B shares) and 286,970,892 shares (including 269,597,392 Class A shares and 17,373,500 Class B shares) issued and outstanding as of December 31, 2014 and 2015, respectively)	121	181	28
Additional paid-in capital	2,298,727	5,482,367	846,332

Accumulated other comprehensive income/(loss)	(21,081)	167,025	25,784
Accumulated deficit	(869,044)	(2,328,423)	(359,446)
Total Tuniu Corporation shareholders' equity	1,408,723	3,321,150	512,698
Total liabilities and equity	1,342,841	5,170,676	798,215

FINANCIAL STATEMENTS SCHEDULE I

TUNIU CORPORATION

CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY

CONDENSED STATEMENTS OF COMPREHENSIVE LOSS

(All amounts in thousands, except for share and per share data, or otherwise noted)

	For the Years Ended December 31,			
	2013	2014	2015	
				US$ (Note 2(d))
Operating expenses				
Research and product development	—	—	—	—
Sales and marketing	—	—	—	—
General and administrative	(4,027)	(5,617)	(19,016)	(2,936)
Share of loss of subsidiaries and affiliated entities	(77,414)	(446,159)	(1,341,212)	(207,047)
Other operating income	—	415	—	—
Total operating expenses	(81,441)	(451,361)	(1,360,228)	(209,983)
Loss from operations	(81,441)	(451,361)	(1,360,228)	(209,983)
Other income/(expenses)				
Interest income	1,738	6,619	19,183	2,961
Foreign exchange gains/(losses),net	71	(3,116)	(119,161)	(18,395)
Other income, net	—	—	827	128
Loss before income tax expense	(79,632)	(447,858)	(1,459,379)	(225,289)
Net loss	(79,632)	(447,858)	(1,459,379)	(225,289)
Deemed dividends to preferred shareholders	(59,428)	(15,606)	—	—
Net loss attributable to ordinary shareholders	(139,060)	(463,464)	(1,459,379)	(225,289)
Net loss	(79,632)	(447,858)	(1,459,379)	(225,289)
Other comprehensive income/(loss)				
Foreign currency translation adjustment, net of nil tax	(5,331)	(1,358)	188,106	29,038
Comprehensive loss	(84,963)	(449,216)	(1,271,273)	(196,251)

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FINANCIAL STATEMENTS SCHEDULE I

TUNIU CORPORATION

CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY

CONDENSED STATEMENTS OF CASH FLOWS

(All amounts in thousands, except for share and per share data, or otherwise noted)

	For the Years Ended December 31,			
	2013	2014	2015	
	RMB	RMB	RMB	US$ (Note 2(d))
Cash (used in) provided by operating activities	(3,058)	2,636	645,364	99,627
Cash used in investing activities	(93,595)	(518,690)	(3,434,719)	(530,229)
Cash provided by financing activities	306,360	1,540,397	2,442,860	377,113
Effect of exchange rate changes on cash and cash equivalents	(5,250)	(3,040)	113,312	17,492
Net increase /(decrease) in cash and cash equivalents	204,457	1,021,303	(233,183)	(35,997)
Cash and cash equivalents at the beginning of year	97,520	301,977	1,323,280	204,279
Cash and cash equivalents at the end of year	301,977	1,323,280	1,090,097	168,282
Supplemental disclosure of non-cash investing and financing activities				
Deemed dividends to preferred shareholders	59,428	15,606	—	—
Accrued issuance cost related to private placement	—	14,076	—	—
Accrual related to deferred initial public offering costs	2,127	—	—	—
Receivables related to exercise of stock option	—	(1,020)	(3,379)	(522)

FINANCIAL STATEMENTS SCHEDULE I

TUNIU CORPORATION

CONDENSED FINANCIAL INFORMATION OF THE PARENT COMPANY

Note to Financial Statements Schedule I

Schedule I has been provided pursuant to the requirements of Rule 12-04(a) and 5-04-(c) of Regulation S-X, which require condensed financial information as to the financial position, change in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

The condensed financial information has been prepared using the same accounting policies as set out in the accompanying consolidated financial statements except that the equity method has been used to account for investments in its subsidiaries and VIE. Such investments in subsidiaries are presented on the balance sheets as investment (income)/ deficit in subsidiaries and VIE and the loss of the subsidiaries is presented as share of loss of subsidiaries and VIE.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The footnote disclosures contain supplemental information relating to the operations of the Company and, as such, these statements should be read in conjunction with the notes to the accompanying consolidated financial statements.

As of December 31, 2015, the Company had no significant capital and other commitments, long-term obligations, or guarantee, except for those which have separately disclosed in the consolidated financial statements.