

KONGZHONG CORP  
Form 20-F  
April 29, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2008

OR

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

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Date of event requiring this shell company report \_\_\_\_\_

Commission file number 000-50826

KONGZHONG CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

N/A  
(Translation of Registrant's Name Into English)

Cayman Islands  
(Jurisdiction of Incorporation or Organization)

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(Name, Telephone, Email and/or Facsimile Number and Address of Company Contact Person)

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

Title of Each Class	Name of Each Exchange On Which Registered
Ordinary shares, par value US\$0.0000005 per share* American Depositary Shares, each representing 40 ordinary shares	The NASDAQ Stock Market LLC (The NASDAQ Global Select Market)

\* Not for trading, but only in connection with the listing on The NASDAQ Global Select Market of American Depositary Shares, or ADSs, each representing 40 ordinary shares.

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

None

(Title of Class)

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

None

(Title of Class)

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

As of December 31, 2008, 1,434,232,520 ordinary shares, par value US\$0.0000005 per share, were issued and outstanding.

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

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

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

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

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

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

U.S. GAAP

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

Other

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

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

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FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Such forward-looking statements include, without limitation, statements that are not historical facts relating to:

- our financial performance and business operations;
- our ability to successfully execute our business strategies and plans;
- the state of our relationship with telecommunications operators in the People’s Republic of China, or the PRC;
- our dependence on the substance and timing of the billing systems of the telecommunications operators in the PRC for our performance;
- our development and capital expenditure plans;
- the expected benefit and future prospects of our strategic alliances and acquisitions, and our ability to cooperate with our alliance partners or integrate acquired businesses;
- management estimations with respect to revenues from our wireless value-added services, or WVAS, mobile games and our wireless Internet businesses;
- the development of our latest product offerings, including but not limited to offerings in our WVAS, mobile games and wireless Internet businesses;
- the development of the regulatory environment and changes in the policies or guidelines of the PRC telecommunications operators;
- the effects of the restructuring of the telecommunications industry in the PRC as announced by the Ministry of Industry and Information Technology, or the MII (which also refers to its predecessor, the Ministry of Information Industry prior to the PRC government restructuring in March 2008), the National Development and Reform Commission and the Ministry of Finance of the PRC in May 2008; and
- competitive pressures and future growth in the WVAS, mobile games, wireless Internet, mobile advertising, telecommunications and related industries in the PRC.

The words “forecast,” “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “seek,” “will,” “would” expressions, as they relate to us, are intended to identify a number of these forward-looking statements.

These forward-looking statements are subject to risks, uncertainties and assumptions, some of which are beyond our control. In addition, these forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from the information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in “Item 3 — Key Information — Risk Factors” and the following:

- any changes in our relationship with telecommunications operators in the PRC;



- any changes in the regulatory regime or the policies for the PRC telecommunications industry, including changes in the structure or functions of the primary industry regulator, the MII, or its policies, or the policies or other regulatory measures of other relevant government or industry authorities relating to, among other matters, the granting and approval of licenses, procedures for customers to access and subscribe to WVAS or mobile games, restrictions on wireless Internet content, or the introduction of new technology platforms, products and services;
  - the effects of competition on the demand for or the price of our products or services;
  - any changes in customer demand or usage preference for our products or services;
- any changes in the telecommunications operators' systems for billing users of our WVAS or mobile games or remitting payments to us;
- any changes in technologies related to telecommunications, WVAS, mobile games or wireless Internet or applications based on such technologies;
- any changes in political, economic, legal or social conditions in the PRC, including the PRC government's specific policies with respect to foreign investment and entry by foreign companies into the telecommunications, WVAS, mobile games or wireless Internet market, economic growth, inflation, foreign exchange or the availability of credit; and
- changes in population growth or gross domestic product, or GDP, growth or the impact of those changes on the demand for our products or services.

We do not intend to update or otherwise revise the forward-looking statements in this annual report, whether as a result of new information, future events or otherwise. Because of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this annual report might not occur in the way we expect, or at all. You should not place undue reliance on any forward-looking information.

## PART I

## Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

## Item 2. Offer Statistics and Expected Timetable

Not Applicable.

## Item 3. Key Information

## Selected Financial Data

The following selected historical consolidated financial data should be read in conjunction with our audited historical consolidated financial statements, the notes thereto and “Item 5 — Operating and Financial Review and Prospects.” The selected historical consolidated statement of operations data for the years ended December 31, 2006, 2007 and 2008 and the selected historical consolidated balance sheet data as of December 31, 2007 and 2008 set forth below are derived from our audited historical consolidated financial statements included elsewhere in this annual report. The selected historical consolidated statement of operations data for the years ended December 31, 2004 and 2005 and the selected historical consolidated balance sheet data as of December 31, 2004, 2005 and 2006 set forth below are derived from our audited historical consolidated financial statements, which are not included in this annual report.

Our audited historical consolidated financial statements have been prepared and presented in accordance with the generally accepted accounting principles in the United States, or U.S. GAAP.

For the year ended December 31,

Consolidated statements of operations data	2004	2005	2006 (2)	2007	2008
	(in thousands of U.S. dollars, except shares and per shares data)				
Revenues	\$ 47,969.2	\$ 77,752.8	\$ 106,769.2	\$ 74,016.9	\$ 96,689.7
WVAS	47,185.6	74,111.8	103,974.2	70,178.8	86,911.7
Mobile games	783.6	3,041.0	2,506.0	2,835.9	7,743.3
WIS	—	—	289.0	1,002.2	2,034.7
Cost of revenues	(15,704.8)	(31,323.1)	(47,665.4)	(36,495.6)	(51,612.5)
WVAS	(15,011.7)	(29,207.4)	(45,863.4)	(34,440.3)	(46,985.4)
Mobile games	(693.1)	(2,115.7)	(1,266.0)	(1,375.9)	(3,479.8)
WIS	—	—	(536.0)	(679.4)	(1,147.3)
Gross profit	32,264.4	46,429.7	59,103.8	37,521.3	45,077.2
Operating expenses:					
Product development	(4,483.4)	(8,530.8)	(12,026.2)	(12,535.2)	(15,180.8)
Selling and marketing	(3,287.9)	(5,389.8)	(16,755.2)	(18,094.2)	(21,338.9)
General and administrative	(4,704.6)	(7,607.0)	(9,105.2)	(7,221.0)	(11,640.0)
Provision for impairment of goodwill and intangibles	—	—	—	—	(21,623.3)
Class action lawsuit settlement and legal expenses	—	(4,843.4)	—	—	—
Total operating expenses	(12,475.9)	(26,371.0)	(37,886.6)	(37,850.4)	(69,783.0)
	19,788.5	20,058.7	21,217.2	(329.1)	(24,705.8)



(Loss) Income from operations					
Other (expenses) income, net	(23.9)	6.5	(49.1)	—	—
Interest income, net	604.7	2,639.5	3,866.9	3,810.0	4,897.4
Gain on sales of investment	—	—	1,240.8	207.6	—
Net (loss) income before income taxes	20,369.3	22,704.7	26,275.8	3,688.5	(19,808.4)
Income tax expense	—	530.4	1,584.2	856.8	851.9
Net (loss) income	\$ 20,369.3	\$ 22,174.3	\$ 24,691.6	\$ 2,831.7	\$ (20,660.3)
Net income (loss) per share:					
Basic	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.00	\$ (0.01)
Diluted	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.00	\$ (0.01)
Weighted average shares used in calculating net income per share:					
Basic	903,010,929	1,377,102,380	1,399,872,743	1,423,156,120	1,424,581,293
Diluted (1)	1,250,640,982	1,424,683,570	1,418,252,296	1,430,910,421	1,424,581,293

(1) As of December 31, 2004, 2005, 2006, 2007 and 2008, we had 33,260,000, nil, 60,464,840, 82,346,060 and 137,452,493 ordinary share equivalents, respectively, outstanding that could potentially dilute income per share in the future, but that were excluded in the computation of diluted income per share in the periods, because the exercise prices of such ordinary share equivalents were above the average market values of our ordinary shares in 2004, 2005, 2006 and 2007 and the inclusion of such ordinary share equivalents would have an anti-dilutive effect in 2008 due to a net loss per share in 2008.

(2) The amounts of share-based compensation included in operating expenses for 2006, 2007 and 2008 reflect the adoption of Statement of Financial Accounting Standard No. 123 (revised 2004), or SFAS 123(R), "Share-Based Payment," effective on January 1, 2006. If our company had applied the fair value recognition provisions of SFAS 123(R) to prior periods, it would have reported net income of \$19.5 million and \$20.7 million for 2004 and 2005, respectively, and net income per share (diluted) of \$0.02 and \$0.01 for 2004 and 2005, respectively.

Consolidated balance sheet data	As of December 31,				
	2004	2005	2006	2007	2008
	(in thousands of U.S. dollars)				
Cash and cash equivalents	\$ 90,714.1	\$ 117,141.5	\$ 131,402.0	\$ 122,342.7	\$ 136,054.3
Accounts receivable, net	10,198.8	10,833.9	11,568.6	14,992.9	16,196.0
Property and equipment, net	2,484.2	3,116.4	3,100.8	4,498.1	3,369.3
Acquired intangible assets, net	—	260.6	1,997.6	1,266.3	673.4
Long-term investment	—	500.0	—	—	2,963.0
Goodwill	—	1,169.1	15,835.9	34,918.7	15,683.1
Total assets	104,372.7	135,083.2	166,741.0	181,891.9	178,852.4
Total current liabilities	4,443.6	11,285.3	10,821.5	11,293.1	18,108.7
Total shareholders' equity	99,808.3	123,773.7	155,777.0	170,475.8	160,688.2
Total liabilities, minority interests and shareholders' equity	104,372.7	135,083.2	166,741.0	181,891.9	178,852.4
		For the year ended December 31,			
Consolidated cash flow data	2004	2005	2006	2007	2008
	(in thousands of U.S. dollars)				
Net cash (used in) provided by:					
Operating activities	\$ 15,844.7	\$ 29,569.0	\$ 28,010.2	\$ 3,315.3	\$ 12,521.5
Investing activities	(2,430.2)	(4,081.7)	(17,916.5)	(18,720.1)	(4,811.9)
Financing activities	73,555.5	205.8	2,190.3	152.2	(759.3)

#### Exchange Rate Information

We present our historical consolidated financial statements in U.S. dollars. In addition, this annual report contains translations of certain Renminbi amounts to U.S. dollar amounts for transactions denominated in Renminbi. Unless otherwise specified or indicated by context, the translations of Renminbi amounts into U.S. dollar amounts have been made at the rate of RMB6.8353 = US\$1.00, the base exchange rate set by the People's Bank of China, China's central bank, at 0:00 a.m., Beijing time, on December 31, 2008. The translations are not a representation that the Renminbi amounts could actually be converted to U.S. dollars at this rate. For a discussion of the exchange rates used for the presentation of our financial statements, see note 2 to our financial statements.

The People's Bank of China sets and publishes daily a base exchange rate with reference primarily to the supply and demand of Renminbi against a basket of currencies in the market during the prior day. The People's Bank of China also takes into account other factors such as the general conditions existing in the international foreign exchange

markets. Although PRC governmental policies were introduced in 1996 to reduce restrictions on the convertibility of Renminbi into foreign currency for current account items, conversion of Renminbi into foreign exchange for capital items, such as foreign direct investment, loans or security, requires the approval of the State Administration for Foreign Exchange and other relevant authorities. We make no representation that the Renminbi or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or Renminbi, as the case may be, at any particular rate or at all.

The noon buying rate in New York City for cable transfers as certified for customs purposes by the Federal Reserve Bank of New York was RMB 6.8250 = US\$1.00 on April 24, 2009. The following table sets forth the high and low noon buying rates between Renminbi and U.S. dollars for each of the periods shown:

Period	Noon Buying Rate RMB per \$1.00	
	High	Low
October 2008	6.8521	6.8171
November 2008	6.8373	6.8220
December 2008	6.8842	6.8225
January 2009	6.8403	6.8225
February 2009	6.8470	6.8241
March 2009	6.8438	6.8240
April 2009 (through April 24, 2009)	6.8361	6.8250

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars for each of 2004, 2005, 2006, 2007, 2008 and 2009 (through April 24, 2009), calculated by averaging the noon buying rates on the last day of each month of the periods shown:

Period	Average Noon Buying Rate RMB per \$1.00
2004	8.2768
2005	8.1826
2006	7.9579
2007	7.5806
2008	6.9193
2009 (through April 24, 2009)	6.8342

#### Capitalization and Indebtedness

Not applicable.

#### Reasons for the Offer and Use of Proceeds

Not applicable.

## Risk Factors

You should consider carefully all of the information in this annual report, including the risks and uncertainties described below. If any of the following risks actually occurs, our business, financial condition or results of operations could be harmed. In such an event, the trading price of our ADSs, could decline and you might lose all or part of your investment.

### Risks Relating to Our Business

We depend on China Mobile and other PRC telecommunications operators for the majority of our revenues, and any loss or deterioration of our relationship with these telecommunications operators may result in severe disruptions to our business operations and the loss of the majority of our revenues.

We derive substantially all of our revenues from the provision of WVAS and mobile games through the networks of the PRC telecommunications operators. We rely primarily on the networks of China Mobile Communications Corporation, or China Mobile, to deliver our services. For each of the two years ended December 31, 2007 and December 31, 2008, we derived 75% of our total revenues from our cooperation arrangements with China Mobile. The remainder of our revenues is derived from cooperation arrangements with China United Telecommunications Corporation, or China Unicom (which acquired China Network Communications Group Corporation, or China Netcom, in October 2008), and China Telecommunications Corporation, or China Telecom.

Through Beijing AirInbox Information Technologies Co., Ltd., or Beijing AirInbox, Beijing Boya Wuji Technologies Co., Ltd., or Beijing Boya Wuji, Beijing Wireless Interactive Network Technologies Co., Ltd., or Beijing WINT, Beijing Chengxitong Information Technology Co., Ltd., or Beijing Chengxitong, Beijing Xinrui Technology Co., Ltd., or BJXR, and Shanghai Mailifang Communications Ltd., or Mailifang, as the case may be, we have entered into a series of cooperation agreements with China Mobile and other PRC telecommunications operators and their provincial subsidiaries to provide WVAS and mobile games through the telecommunications operators' networks. Pursuant to our agreements with the telecommunications operators, the telecommunications operators bill and collect fees from phone users for the WVAS and mobile games we provide. Our agreements with the telecommunications operators are generally for terms of one year or less and they do not all have automatic renewal provisions. We usually renew these agreements or enter into new ones when the prior agreements expire, but on occasion the renewals or new contracts can be delayed by periods of one month or more.

Furthermore, telecommunications operators may discontinue the use of external WVAS providers such as our company. If any of the PRC telecommunications operators ceases to cooperate with us, it is unlikely that such operator's customers will continue to use our services. In particular, if China Mobile ceases to cooperate with us, it is unlikely that we will be able to build up sufficient new customers through the networks of other PRC telecommunications operators to develop a customer base comparable to that which we have developed through China Mobile. Due to our reliance on China Mobile and other PRC telecommunications operators to deliver our WVAS and mobile games to our customers, any loss or deterioration of our relationship with China Mobile or other PRC telecommunications operators may result in severe disruptions to our business operations, the loss of the majority of our revenues and a material adverse effect on our financial condition and results of operations.

In addition, in May 2008, in order to optimize the allocation of telecommunications resources in the PRC and improve the competitive landscape, the MII, the National Development and Reform Commission and the Ministry of Finance jointly announced a policy initiative to further reform the PRC telecommunications industry by encouraging the formation of three telecommunications services providers of comparable scale and standing, each with nationwide network resources, full-service capabilities and competitive strength, by way of a series of restructuring transactions. Under this initiative, China Unicom acquired China Netcom, China Telecom purchased the code-division multiple access, or CDMA, network and related business from China Unicom and China Mobile acquired China Tietong

Telecommunications Corporation, a fix-line telecommunications services provider, in 2008. In January 2009, the MII issued licenses for operating businesses on the third-generation standard, or 3G, of wireless telecommunications transmissions to China Mobile, China Unicom and China Telecom. We cannot predict at this point the precise impact that the restructuring transactions or the issuance of the 3G licenses may have on our business and prospects, particularly our relationship with China Mobile and other PRC telecommunications operators. While we are currently assessing the impact that the restructuring transactions or the issuance of the 3G licenses may have on us, we cannot assure you that any potential change in the telecommunications industry in the PRC would not impact our relationship with telecommunications operators or such change would not have a material adverse effect on our business or results of operations.

The termination or alteration of our cooperation agreements with China Mobile or other PRC telecommunications operators would materially and adversely impact our business operations and financial conditions.

Our negotiating leverage with China Mobile and other PRC telecommunications operators is limited because China Mobile and other PRC telecommunications operators operate the telecommunications networks through which we deliver our products and services to mobile phone users. Our revenues and profitability could be materially and adversely affected if China Mobile or other PRC telecommunications operators decide to change the terms of the cooperation agreements with us, such as materially increase their transmission fees or service fees or do not comply with the terms of such agreements.

In addition, China Mobile or other PRC telecommunications operators could impose monetary penalties upon us or even terminate cooperation with us under the terms of the cooperation agreements with us, for a variety of reasons, such as the following:

- if we fail to achieve the performance standards established by the relevant operator from time to time;
- if we breach certain provisions under the agreements, which include, in many cases, the obligation not to deliver content that violates the relevant operator's policies and applicable law; or
- if the relevant operator receives a high level of customer complaints about our services.

Due to our dependence on our relationship with China Mobile and other PRC telecommunications operators, any termination or material alteration of our cooperation agreements with China Mobile or other PRC telecommunications operators would materially and adversely impact our business operations and financial conditions.

We cannot guarantee that China Mobile or any of the other PRC telecommunications operators will not impose penalties upon us in the future, and such penalties could have a material impact on our results of operations. In August 2004, China Mobile notified us that it had imposed sanctions on 22 WVAS providers, including us. In our case, the notice stated that China Mobile had determined that one of our interactive voice response, or IVR, services in early June 2004 had contained inappropriate content. For this infraction, China Mobile suspended until the end of 2004 approval of our new applications for new products and services on all platforms and also suspended joint promotions with us. In addition, China Mobile suspended for one year, until June 30, 2005, the approval of our applications to operate on new platforms.

Significant changes in the policies or guidelines of China Mobile or other PRC telecommunications operators with respect to services provided by us may result in lower revenues or additional costs for us and materially adversely affect our business operations, financial condition or results of operations.

China Mobile or other PRC telecommunications operators may from time to time issue policies or guidelines, requesting or stating their preferences for certain actions to be taken by all WVAS providers using their networks. Due to our reliance on China Mobile and other PRC telecommunications operators, a significant change in their policies or guidelines may result in lower revenues or additional operating costs for us. We cannot assure you that our financial condition and results of operations will not be materially adversely affected by policy or guideline changes by China Mobile or other PRC telecommunications operators.

For example, since the second half of 2004, China Mobile and its provincial subsidiaries have been gradually implementing a series of policies designed to improve customer service and satisfaction. These policies include:

- not charging customers on their monthly statements for multimedia messaging service, or MMS, that cannot be delivered because of network or handset problems;
- canceling monthly subscriptions of customers who have not accessed their WVAS subscriptions for a certain period of time;
- implementing more complicated procedures for customers to confirm new monthly subscriptions to certain WVAS; and
- removing from subscriber lists those customers who fail to pay China Mobile or the provincial subsidiaries, or who cannot be billed because they use pre-paid telecommunications service cards.

On July 6, 2006, China Mobile announced a series of additional measures with respect to the billing of customers of WVAS on its network, with focus on customers' monthly subscriptions to WVAS. Among the measures announced by China Mobile, those which have had a significant impact on our results of operations and financial condition are summarized as follows:

- beginning July 10, 2006, for any new monthly subscriptions to WVAS, China Mobile sends customers two reminder notices prior to charging monthly subscription fees in the customers' monthly mobile phone bills, and customers must confirm twice, once in response to each reminder, that they wish to subscribe to those services on a monthly basis. Previously, China Mobile sent one reminder notice immediately after a monthly subscription order was placed, and customers needed to confirm only once;
- customers enjoy a free trial period of 11 to 41 days, depending on the day of the month on which they place their monthly subscriptions. Previously, customers enjoyed a free trial period of three to 11 days; and
- China Mobile cancels wireless application protocol, or WAP, monthly subscriptions that have not been active for more than four months.

During the fourth quarter of 2006, other PRC telecommunications operators also began implementing new policies requiring double confirmation of monthly subscriptions. In May 2007, China Mobile started to send to its customers' handsets notices of transmission fees to be incurred by using general packet radio services, or GPRS, when those customers launched their browsers, which discouraged some customers from purchasing our WAP products or visiting our wireless Internet sites Kong.net and Ko.cn.

Mainly because of these new policies and measures of the telecommunications operators, our WVAS revenues in 2007 decreased 32.5% as compared to 2006. We cannot assure you that China Mobile or other PRC telecommunications operators will not introduce additional requirements with respect to the procedures for ordering monthly subscriptions or single-transaction downloads of our WVAS, notifications to customers, the billing of customers or other consumer-protection measures, or adopt other policies that may require significant changes in the way we promote and sell our WVAS and develop our wireless Internet sites, any of which new requirements or policies could have a material adverse effect on our financial condition and results of operations.



Competition with the competing services offered by China Mobile and other PRC telecommunications operators may lower our revenues and materially adversely affect our business operations, financial condition and results of operations.

The PRC telecommunications operators have launched services competing with ours. For example, China Mobile has begun to develop and market its own MMS and WAP products that compete with ours. The PRC telecommunications operators may launch additional competing services in the future. Similar to our practice, China Mobile and other PRC telecommunications operators have entered into cooperation agreements with mobile handset manufactures to pre-load their icons and codes in new handsets to make it easier for handset users to access and subscribe to the WVAS provided by China Mobile and other telecommunications operators. Furthermore, in the past, China Mobile entered into strategic alliances with selected handset manufacturers pursuant to which it embedded menus in their handsets for all the best-selling products on China Mobile's Monternet™ wireless portal, including certain of our products. However, beginning in May 2007, China Mobile has promoted only its own WVAS products in such menus and not those of ours or other third-party WVAS providers. In addition, we have developed our own wireless Internet sites, Kong.net and Ko.cn, which are independent of the wireless Internet portals of China Mobile and other PRC telecommunications operators and which China Mobile and other PRC telecommunications operators may view as engaging in direct competition with their Internet sites. Competition with the competing services offered by China Mobile and other PRC communications operators may lower our revenues and harm our relationship with China Mobile and other PRC telecommunications operators, which may materially adversely affect our business operations, financial condition and results of operations.

Our dependence on the substance and timing of the billing systems of the telecommunications operators and their subsidiaries may require us to estimate portions of our reported revenues and cost of revenues for WVAS and mobile games. As a result, subsequent adjustments may have to be made to our financial statements.

As we do not bill our WVAS and mobile games customers directly, we depend on the billing systems and records of the telecommunications operators to record the volume of our WVAS and mobile games provided, bill our customers, collect payments and remit to us our portion of the fees. We record revenues based on monthly statements from the telecommunications operators confirming the value of our services that the telecommunications operators billed to customers during the month. It is our practice to release our unaudited quarterly financial statements to the market. Due to our past experience with the timing of receipt of the monthly statements from the operators, we expect that we may need to rely on our own internal estimates for the portion of our reported revenues and cost of revenues for which we will not have received monthly statements. In such an instance, our internal estimates would be based on our own internal data of expected revenues and related fees from services provided. As a result of reliance on our internal estimates, we may overstate or understate our revenues and cost of revenues for the relevant reporting period, and may be required to make adjustments in our financial reports when we actually receive the telecommunications operators' monthly statements for such period. We endeavor to reduce the discrepancy between our revenue estimates and the revenues calculated by the telecommunications operators and their subsidiaries, but we cannot assure you that such effort will be successful. Moreover, to the extent that the telecommunications operators may take longer to send us monthly statements, we may be required to increase our reliance on our internal estimates when preparing our quarterly financial statements. For example, beginning with the statement for April 2007, it has taken China Unicom on average about 105 days as compared to about 40 days it previously had taken to send us a statement after the end of each month. As a result, estimated revenues may account for a larger proportion of our reported revenues during 2007 and 2008 than in previous years. If we are required to make adjustments to our quarterly financial statements in subsequent quarters, it could adversely affect market sentiment toward us.

In addition, we generally do not have the ability to independently verify or challenge the accuracy of the billing systems of the telecommunications operators. We cannot assure you that any negotiations between us and telecommunications operators to reconcile billing discrepancies would be resolved in our favor or that our results of operations would not be adversely affected as a result. See "Item 5 — Operating and Financial Review and Prospects —

Critical Accounting Policies — Revenue Recognition.”

Our effort to develop additional distribution channels for our WVAS and mobile games may not succeed or may be restricted or halted by the MII or the telecommunications operators.

Cooperation with mobile handset manufacturers has provided us with an important distribution channel for our WVAS and mobile games. We pre-load into the menus of certain mobile handsets our mobile games, WAP icons and short codes for products offered on the MMS, short messaging service, or SMS, Java™ and IVR platforms. A consumer who buys a new handset pre-loaded with our mobile games, icons and codes can access and subscribe to our services quickly and easily. Over the years, cooperation with mobile handset manufacturers has become one of the most important distribution channels for us and a significant portion of our revenues is derived from such cooperation. However, in recent years, China Mobile and other PRC telecommunications operators have entered into cooperation agreements with mobile handset manufacturers similar to our agreements with mobile handset manufactures. We cannot guarantee that mobile handset manufacturers will continue their cooperation with us or maintain their current revenue-sharing arrangements with us.

In addition, we cannot guarantee that the MII, China Mobile or other PRC telecommunications operators will not restrict or halt our cooperation with the mobile handset manufacturers. For example, in addition to pre-loading our mobile games, WAP icons and MMS, SMS, Java™ and IVR short codes into the menus of selected mobile handsets, until recently we also embedded our icons and codes in selected handsets. On April 11, 2007, the MII issued a notice barring the production of mobile handsets with embedded icons and codes that cannot be changed or deleted by consumers. We have altered our arrangements with mobile handset manufacturers to comply with the notice, which took effect on June 1, 2007. Although mobile handset manufacturers are still permitted to pre-load our icons into the handset menus as long as such icons can be changed, such as change to other WVAS providers' icons, or deleted, we cannot assure you that the MII will not expand its regulation to bar pre-loading icons and codes in the future.

Beginning in May 2007, China Mobile has promoted only its own WVAS products and not those of ours or other third-party value-added service providers in the embedded menus of those handsets with whose manufacturers China Mobile has entered into strategic alliance. We cannot assure you that China Mobile or other telecommunications operators will not take other steps to limit or halt our use of mobile handsets as a distribution channel. Any further actions by the telecommunications operators or the MII to limit or halt our use of mobile handsets as a distribution channel could materially adversely affect our revenues and growth of revenues.

We have made significant effort in developing our mobile games business, based on the expectation that such business could contribute a significant part of our revenues in the future, but our mobile games business has a short operating history, which may make it difficult for us to evaluate such business, and the mobile games market in the PRC is subject to many uncertainties, which may prevent us from generating significant revenues from offering mobile games.

We have made significant effort in recent years, especially in 2008, in developing our mobile games business, which includes our downloadable mobile games and online mobile games. Prior to 2008, we operated in two segments, WVAS and WIS. As our mobile games business grows, it has required separate management in respect of decision making, allocation of resources and assessment of performance. We anticipate that mobile games could provide significant contributions to our future revenues. As a result, we started to have three operating segments in 2008, WVAS, mobile games and WIS. However, our mobile games business, especially our online mobile games, has a short operating history. We launched our first online mobile game on China Mobile's Online Game Platform in September 2008. As a result, we have limited financial data that can be used to evaluate our mobile games business and its potential to generate revenues in the future. Moreover, our past success and financial data regarding the mobile games segment may not be indicative of our future performance. We cannot guarantee that we will be successful in developing our mobile games business, which will depend, among other things, on our abilities to:

- respond to market developments, including the development of new platforms and technologies, and changes in pricing and distribution models;
- maintain and diversify our distribution channels, including through our own wireless Internet sites and handset manufacturers;
- develop new high-quality mobile games that can achieve significant market acceptance, and timely improve our existing mobile games to extend their life spans and to maintain their competitiveness in the mobile games market;
- supplement our internally developed mobile games by acquiring mobile games from third-party mobile games developers or cooperating with third-party mobile games developers to jointly develop mobile games;
- develop and upgrade our technologies;
- execute our business and marketing strategies successfully; and



- attract, integrate, retain and motivate qualified personnel.

In addition, the mobile games market is an emerging market in the PRC. The growth of this market and the level of demand and market acceptance of our mobile games are subject to many uncertainties. The development of this market and our ability to derive revenues from this market depend on a number of factors, some of which are beyond our control, including but not limited to:

- the growth rate of mobile data services in the PRC;
- changes in consumer demographics and public tastes and preferences;
- potential competition from established companies that develop and operate personal-computer-based online games and may enter the mobile online game market; and
- the popularity and price of new mobile games and merchandise and premium features embedded in games that we and our competitors may launch and distribute in the future.

Due to the uncertainties in connection with our mobile games business in particular and the mobile games market in the PRC generally, we cannot guarantee that our mobile games business would contribute significantly to our future revenues. Our failure to successfully develop this business could have a material adverse effect on our business operations, financial condition and results of operations.

Our effort to develop our wireless Internet sites is based on the expectation that the sale of advertising on our wireless Internet sites could become a more significant part of our future revenues, but the mobile advertising market is subject to many uncertainties that could prevent us from generating significant revenues from advertising.

We have expended significant effort in recent years in developing our wireless Internet sites, Kong.net and Ko.cn, with the expectation that the sale of advertising on these sites will provide more significant contributions to future revenues. However, the growth of mobile advertising in the PRC is subject to many uncertainties. Many of our current and potential advertisers have limited experience with wireless Internet sites as an advertising medium, have not traditionally devoted a significant portion of their advertising expenditures to mobile advertising, and may not find mobile advertising to be effective for promoting their products or services relative to traditional print, broadcast or Internet media. Our ability to generate and maintain significant advertising revenue will depend on a number of factors, many of which are beyond our control, including but not limited to:

- the development and retention of a large base of wireless Internet users possessing demographic characteristics attractive to advertisers;
  - the maintenance and enhancement of our brand in a cost-effective manner;
  - the level of competition and its impact on mobile advertising prices;
- changes in government policies or the policies of the PRC telecommunications operators that could curtail or restrict our mobile advertising services;
  - the acceptance of mobile advertising as an effective way for advertisers to market their business;
- the development of independent and reliable means of verifying levels of mobile advertising and wireless Internet traffic; and

- the effectiveness of our advertising delivery, tracking and reporting systems.

If any developments impede the establishment of the wireless Internet generally as an accepted medium for advertising or the ability of our wireless Internet sites specifically to attract significant advertising, our ability to generate increased mobile advertising revenue could be negatively affected.

We face increasing competition in the PRC from providers of WVAS, mobile games and wireless Internet services, which could reduce our market share and materially adversely affect our financial condition and results of operations.

The PRC WVAS market has seen increasingly intense competition. The MII reported on its website that more than 1,700 service providers held nationwide licenses as of April 8, 2009 to supply WVAS on the PRC telecommunications operators' networks. We compete with these companies primarily on the basis of brand, price, type and timing of service offerings, content, customer service, business partners and distribution channel relationships. We also compete for experienced and talented employees. While we believe that we have certain advantages over our competitors, some of them may have more human and financial resources and a longer operating history than we do. For example, Internet portal companies that provide WVAS may have an advantage over us with their more established brand names, user base and Internet distribution channels. Furthermore, our competitors may be able to develop or exploit new technologies faster than we can, or offer a broader range of products and services than we are presently able to offer.

The development, distribution and sale of mobile games are also highly competitive in the PRC. We compete for customers, primarily on the basis of game quality, brand and price. We compete for telecommunications operators to distribute our mobile games, primarily on the basis of the popularity of our games among customers, our historical performance, perception of our sales potential and our relationships with content and brand licensors. We compete for content and brand licensors who supply game content and brands, primarily on the basis of the economic terms, such as royalty rates, of our cooperation agreements with the licensors, the licensors' perception of our ability to develop games and pre-load games in mobile handsets, our speed of execution, diversity of distribution channels and relationships with telecommunications operators. We also compete for experienced and talented employees in the mobile games business. Furthermore, the entry of new competitors, such as developers of personal-computer-based online games, major media companies, traditional video game developers, content aggregators, mobile software providers and independent mobile games developers, would likely intensify competition in the mobile games market. Growing competition in this market could make it difficult for us to maintain and increase our market share and have a material adverse effect on our business operations, financial condition and results of operations.

In addition, barriers to entry of wireless Internet services are relatively low and current and new competitors can launch new wireless Internet sites at a relatively low cost. We compete with the operators of other wireless Internet sites for visitors, employees and advertisers, and also compete with traditional media companies such as newspapers, television networks and radio stations for advertisers.

Also, China Mobile has begun to develop and market its own MMS, WAP and other wireless Internet services that compete with ours. Other PRC telecommunications operators may decide to do the same. If the PRC telecommunications operators decide to enter the mobile games market, they may refuse or limit the distribution of some or all of our mobile games or deny us access to all or parts of their networks. The PRC telecommunications operators' Internet sites also compete with our wireless Internet sites. Growing competition from the telecommunications operators could have a material adverse effect on our business operations, financial condition and results of operations.

We have a limited operating history and operate in an evolving and highly dynamic market, which may make it difficult for you to evaluate our business.

We were incorporated in May 2002. Because we have a limited operating history and operate in an evolving and highly dynamic market, the revenues and income potential of our business and markets are unproven and our

historical operating results may not be useful to you for evaluating our business or predicting our future operating results. In addition, we face numerous risks, uncertainties, expenses and difficulties frequently encountered by companies at an early stage of development. Some of these risks and uncertainties relate to our ability to:

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- maintain our current cooperation arrangements and develop new cooperation arrangements upon which our business depends;
- increase the number of our users by expanding the type, scope and technical sophistication of the content and services we offer;
  - respond effectively to competitive pressures;
  - increase awareness of our brand and continue to build user loyalty; and
  - attract and retain qualified management and employees.

We cannot predict whether we will meet internal or external expectations of our future performance. If we are not successful in addressing these risks and uncertainties, our business, financial condition and results of operations may be materially adversely affected.

Our historical financial information may not be indicative of our future results of operations.

We historically experienced rapid growth in our business in some years in part due to the growth in the WVAS industry in the PRC, and such industry growth may not be indicative of future growth. In addition, we are developing new businesses such as mobile games and wireless Internet services, or WIS. We cannot assure you that our historical financial information is indicative of our future operating or financial performance, or that our profitability will be resumed and sustained.