

KONGZHONG CORP
Form 20-F
April 16, 2014

**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 20-F

**..REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE SECURITIES
EXCHANGE ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF
^x1934**

For the fiscal year ended December 31, 2013

OR

**..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934**

OR

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

Date of event requiring this shell company report

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	35th Floor, Tengda Plaza No. 168 Xizhimenwai Street Beijing, China 100044
<i>(Jurisdiction of incorporation or organization)</i>	<i>(Address of principal executive offices)</i>

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The People's Republic of China

(Name, Telephone, E-mail 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*	The NASDAQ Stock Market LLC
American Depositary Shares, each representing 40 ordinary shares	(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, 2013, 1,834,883,063 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

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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 Section 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 ability to successfully execute our business strategies and plans;

our financial performance and business operations;

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;

our ability to anticipate and launch games that respond to changing consumer tastes and preferences and predict trends in the Internet games market in the People's Republic of China, or the PRC;

our ability to license quality Internet games from the PRC and overseas Internet game developers that complement our internally developed Internet games;

our dependence on a small number of Internet games developed by third party Internet games developers for a significant portion of our Internet games revenues;

management estimations with respect to revenues from our wireless value-added services, or WVAS, mobile games and Internet games businesses;

the development of our latest product offerings, including, but not limited to, offerings in our WVAS, mobile games and Internet games businesses;

the development of the regulatory environment and changes in the policies or guidelines of the telecommunications operators in the PRC, as well as our relationships with those operators;

the development of the PRC smartphone mobile games market and the regulatory environment and changes in policies or guidelines relating to those markets;

our dependence on the substance and timing of the billing systems of the telecommunications operators in the PRC for our performance; and

competitive pressures and future growth in the WVAS, mobile games, telecommunications, Internet games and related industries in the PRC.

The words “anticipate,” “believe,” “could,” “estimate,” “expect,” “forecast,” “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 our relationships with our Internet games licensors whose games we have the rights to operate in the PRC or other markets;

the effects of competition on, as well as changes in, the demand for or the price of 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 Internet games or applications based on such technologies;

future developments, trends, regulatory environment and consumer preferences in China with respect to mobile and Internet games and means by which these games are distributed;

any changes in the regulatory regime or the policies for the Internet games industry in the PRC, including changes in the structure, functions or policies of the regulators, which include (i) the Ministry of Industry and Information Technology, or the MIIT (formerly the Ministry of Information Industry), (ii) the State Administration for Industry and Commerce, or the SAIC, (iii) the Ministry of Culture, or the MOC, (iv) the State Administration of Press, Publication, Radio, Film and Television, or the SAPPRFT (formerly the General Administration of Press and Publication and the State Administration of Radio, Film and Television), and (v) the Ministry of Public Security, or the MPS;

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 MIIT, 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 Internet content, or the introduction of new technology platforms, products and services;

any changes in political, economic, legal or social conditions in the PRC, including the PRC government's specific policies with respect to (i) foreign investment and entry by foreign companies into the telecommunications, WVAS, mobile games or Internet games market, (ii) economic growth, (iii) inflation, (iv) foreign exchange or (v) 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. Due to 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. Accordingly, you should not place undue reliance on any forward-looking information. All forward-looking statements contained in this annual report are qualified by reference to the cautionary statements set out in this section.

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The following selected consolidated financial data should be read in conjunction with our audited consolidated financial statements, the notes thereto and “Item 5 — Operating and Financial Review and Prospects.” The selected consolidated statement of operations data for the years ended December 31, 2011, 2012 and 2013 and the selected consolidated balance sheet data as of December 31, 2012 and 2013 set forth below are derived from our audited consolidated financial statements and the notes thereto, which are included elsewhere in this annual report. The selected consolidated statement of operations data for the years ended December 31, 2009 and 2010 and the historical consolidated balance sheet data as of December 31, 2009, 2010 and 2011 set forth below are derived from our audited consolidated financial statements and the notes thereto, which are not included in this annual report.

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

Consolidated statements of operations data	For the year ended December 31,				
	2009	2010	2011	2012	2013
	(in thousands of U.S. dollars, except shares and per share data)				
Revenues	US\$ 131,298.2	US\$ 149,583.4	US\$ 160,008.4	US\$ 186,379.7	US\$ 179,440.4
WVAS	104,001.6	83,280.3	80,265.9	77,765.5	63,922.2

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Mobile games	27,296.6	49,171.5	40,850.5	21,190.3	17,069.0
Internet games	—	17,131.6	38,892.0	87,423.9	98,449.2
Sales tax	(2,885.1)	(3,209.0)	(3,827.8)	(5,793.6)	(5,786.6)
WVAS	(2,273.6)	(1,584.4)	(1,390.9)	(1,053.2)	(969.0)
Mobile games	(611.5)	(925.1)	(621.1)	(219.3)	(160.7)
Internet games	—	(699.5)	(1,815.8)	(4,521.1)	(4,656.9)
Net revenues	128,413.1	146,374.4	156,180.6	180,586.1	173,653.8
WVAS	101,728.0	81,695.9	78,875.0	76,712.3	62,953.2
Mobile games	26,685.1	48,246.4	40,229.4	20,971.0	16,908.3
Internet games	—	16,432.1	37,076.2	82,902.8	93,792.3
Cost of revenues	(65,946.8)	(80,238.6)	(91,930.2)	(103,130.3)	(96,399.9)
WVAS	(54,258.5)	(48,329.5)	(50,758.6)	(52,655.5)	(43,085.2)
Mobile games	(11,688.3)	(29,570.8)	(25,248.0)	(10,935.0)	(7,780.3)
Internet games	—	(2,338.3)	(15,923.6)	(39,539.8)	(45,534.4)
Gross profit	62,466.3	66,135.8	64,250.4	77,455.8	77,253.9
WVAS	47,469.5	33,366.5	28,116.4	24,056.8	19,868.0
Mobile games	14,996.8	18,675.4	14,981.4	10,036.0	9,128.0
Internet games	—	14,093.9	21,152.6	43,363.0	48,257.9
Operating expenses:					
Product development	(18,272.0)	(23,964.7)	(15,416.9)	(18,382.4)	(26,401.7)
Selling and marketing	(17,821.2)	(18,975.6)	(20,891.6)	(24,586.0)	(26,674.0)
General and administrative	(10,186.9)	(10,481.8)	(11,582.2)	(11,629.3)	(8,976.2)
Impairment loss on goodwill	—	(2,998.3)	(20,255.3)	—	—
Impairment loss on intangible assets	—	(5,730.6)	(3.9)	—	(1,562.4)
Total operating expenses	(46,280.1)	(62,151.0)	(68,149.9)	(54,597.7)	(63,614.3)

Consolidated statements of operations data	For the year ended December 31,			
	2009	2010	2011	2012
	(in thousands of U.S. dollars, except shares and per share data)			
Change in fair value of contingent consideration for business acquisition	—	10,894.5	(3,729.5)	—
Government subsidies	—	337.7	319.2	301.4
Income (loss) from operations	16,186.2	15,217.0	(7,309.8)	23,159.5
Interest income	3,114.3	2,342.8	3,569.2	5,231.3
Interest income from loans to third party	—	—	1,193.2	453.6
Interest expense	(725.9)	(1,059.9)	(487.8)	(262.7)
Impairment loss on cost method investment	(1,500.0)	(1,509.9)	—	—
Loss on extinguishment of debt upon prepayment of convertible senior note	—	—	(1,567.5)	—
Exchange gain	—	—	—	387.6
Investment income	206.9	883.2	85.6	261.5
Net income (loss) before income taxes	17,281.5	15,873.2	(4,517.1)	29,230.8
Income taxes expense	(4,698.1)	(3,950.0)	(3,137.8)	(3,490.8)
Net income (loss)	US\$12,583.4	US\$11,923.2	US\$(7,654.9)	US\$25,740.0
Net income (loss) per share:				
Basic	US\$0.01	US\$0.01	US\$(0.00)	US\$0.02
Diluted	US\$0.01	US\$0.01	US\$(0.00)	US\$0.01
Weighted average shares used in calculating net income (loss) per share:				
Basic	1,385,201,479	1,466,947,693	1,607,110,119	1,661,864,846
Diluted (1)	1,537,771,051	1,547,870,678	1,607,110,119	1,721,622,756

As of December 31, 2009, 2010, 2011, 2012 and 2013, we had 76 million, 76 million, 210 million, 285 million and 11 million 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 as their effect would have been anti-dilutive.

Consolidated balance sheet data	As of December 31,				
	2009	2010	2011	2012	2013
Cash and cash equivalents	US\$139,289.5	US\$157,170.8	US\$129,511.5	US\$120,694.7	US\$123,427.7
Term deposits	—	—	—	—	4,448.8
Held-to-maturity securities	—	—	17,299.1	17,465.3	51,866.5
Trading securities	100.6	20.3	7,754.6	—	—
Loans to third party	—	—	22,187.3	—	—
Accounts receivable, net	25,276.8	21,794.0	19,903.0	23,699.7	17,230.8
Property and equipment, net	3,116.0	3,738.6	3,620.3	3,065.5	5,842.5

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Intangible assets, net	2,284.9	4,452.7	2,347.9	75,069.3	78,726.6
Long-term investment	1,464.5	—	—	4,000.0	2,000
Goodwill	23,042.3	87,705.7	72,967.1	87,551.0	90,266.6
Restricted cash	—	—	—	35,773.3	36,870.7
Total assets	200,078.6	281,445.3	280,248.0	372,784.1	419,240.3
Total current liabilities	23,565.3	63,474.7	32,526.0	71,229.6	67,370.8
Convertible note payable	3,001.0	3,552.7	1,272.6	—	—
Total shareholders' equity	173,040.7	213,940.4	246,177.7	282,884.1	332,609.5
Total liabilities and shareholders' equity	200,078.6	281,445.3	280,248.0	372,784.1	419,240.3

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Consolidated cash flow data	For the year ended December 31,				
	2009	2010	2011	2012	2013
	(in thousands of U.S. dollars)				
Net Cash (used in) provided by:					
Operating activities	US\$15,289.1	US\$26,013.6	US\$33,433.8	US\$46,655.9	US\$35,729.5
Investing activities	(8,282.6)	(10,314.9)	(40,284.8)	(41,206.8)	(43,944.6)
Financing activities	(3,865.7)	(776.5)	(26,335.0)	(14,313.0)	8,956.8

Exchange Rate Information

We present our 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 RMB6.1024 = US\$1.00, the central parity rate set by the People's Bank of China, or the PBOC, China's central bank, on December 31, 2013. 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 included elsewhere in this annual report on Form 20-F.

The PBOC sets and publishes daily central parity rates with reference primarily to the supply and demand of Renminbi against a basket of currencies in the market. The PBOC 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 securities, requires the approval of the State Administration for Foreign Exchange, or the SAFE, 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 RMB6.2111 = US\$1.00 on April 11, 2014. 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	
	High	Low
October 2013	6.1209	6.0815
November 2013	6.0993	6.0903

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December 2013	6.0927	6.0537
January 2014	6.0600	6.0402
February 2014	6.1448	6.0591
March 2014	6.2273	6.1183
April 2014 (through April 11, 2014)	6.2123	6.1966

The following table sets forth the average noon buying rates between Renminbi and U.S. dollars for each of 2009, 2010, 2011, 2012, 2013 and 2014 (through April 11, 2014), calculated by averaging the noon buying rates on the last day of each month of the periods shown:

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Period	Average Noon Buying Rate RMB per US\$1.00
2009	6.8295
2010	6.7696
2011	6.4630
2012	6.3088
2013	6.1478
2014(through April 11, 2014)	6.1159

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 event, the trading price of our ADSs could decline and you could lose all or part of your investment.

Risks Relating to Our Business

We depend on China Mobile and other PRC telecommunications operators for a significant portion of our revenues, and any loss or deterioration of our relationship with these telecommunications operators could result in severe

disruptions to our business operations and the loss of the majority of our revenues.

We derive a significant portion 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 Limited, or China Mobile, to deliver our products and services. In 2013, we derived approximately 25.9% of our total revenues and approximately 56.7% and 59.9%, respectively, of our WVAS and mobile games revenues from our cooperation arrangements with China Mobile. The remainder of our WVAS and mobile games revenues is derived from cooperation arrangements with China United Telecommunications Corporation, or China Unicom, and China Telecommunications Corporation, or China Telecom.

Through our consolidated variable interests entities, 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, Nanjing Net Book Culture Co., Ltd., or Zhulang, Beijing Xinrui Technology Co., Ltd., or BJXR, Shanghai Mailifang Communications Ltd., or Mailifang, and Xiamen Xinreli Technology Co., Ltd., or Xinreli, as the case may be, we have entered into a series of cooperation agreements with the subsidiaries of China Mobile and other PRC telecommunications operators to provide WVAS and mobile games through the networks of these telecommunications operators. Pursuant to our agreements with these telecommunications operators, the telecommunications operators bill and collect fees from mobile 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 are typically not renewed automatically. We usually renew these agreements or enter into new agreements when the prior agreements expire, but on occasion the actual renewals, or entering into, of new contracts could be delayed for one month or more. Any inability to renew these contracts or enter into new contracts could severely disrupt our business and operations and materially decrease our revenues and profitability.

Furthermore, telecommunications operators could discontinue or de-emphasize the use of external WVAS or mobile games providers, such as our company. If any of the PRC telecommunications operators ceases or de-emphasizes its cooperation with us, we would no longer be able to provide WVAS or distribute mobile games to such operator's customers or generate related revenues, and our revenues from such operator's customers would decrease substantially. In particular, if China Mobile ceases or de-emphasizes its cooperation with us, it is unlikely that we would be able to build up sufficient number of new customers through the networks of other PRC telecommunications operators to timely replace those lost from 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 could result in severe disruptions to our business operations, the loss of the majority of our revenues and have a material adverse effect on our financial condition and results of operations.

The termination or alteration of our cooperation agreements with China Mobile or other PRC telecommunications operators could materially harm our business and have a material adverse effect on our financial condition and results of operations.

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 in China. Our revenues and profitability could be materially reduced if China Mobile or other PRC telecommunications operators decided to change the terms of their cooperation agreements with us, such as by increasing their transmission or service fees, or if they fail to comply with the terms of these agreements. For example, in 2009, China Mobile relocated operations for certain of its WVAS and mobile games services to facilities of its provincial subsidiaries, including a majority of the operations of its mobile games services (covering 31 provinces) from its Beijing headquarters to a subsidiary in the Jiangsu province. As part of these relocations, we were required to alter our cooperation agreements with China Mobile. We cannot assure you that China Mobile will not seek to terminate or materially alter our cooperation agreements with its provincial subsidiaries as a result of similar relocations in the future.

In addition, China Mobile or other PRC telecommunications operators could impose monetary penalties on us or terminate their cooperation agreements with us for a variety of reasons, including, if:

- we fail to achieve the performance standards established by the relevant telecommunications operator from time to time;

- 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

- the relevant operator receives a high level of customer complaints about our services.

Any termination or material alteration of our cooperation agreements with China Mobile or other PRC telecommunications operators could severely disrupt our business and operations and have a material adverse effect on our financial condition and results of operations.

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

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, or not taken, by all WVAS or mobile games providers using their networks. Due to our reliance on China Mobile and other PRC telecommunications operators, any significant change in their policies or guidelines could cause our revenues to decrease or operating costs to increase. As a result, we cannot assure you that our financial condition and results of operations would not be materially and adversely affected by policy or guideline changes by China Mobile or other PRC telecommunications operators.

In January 2010, China Mobile began implementing an additional series of measures targeted at further improving user experience for mobile handset embedded services, in addition to the introduction of a new short message service, or SMS, code management system. Under these measures, WVAS that are embedded in handsets are required to introduce additional notices and confirmations to end-consumers during the purchase of such services. In addition, services relating to SMS short codes are required to be more tailored to the specific service offerings or service partners. Previously, a single SMS code could be used for multiple service offerings or partners.

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 or mobile games, notifications to customers, the billing of customers, or other consumer-protection-related measures, or adopt other policies that may require significant changes in the way we promote, sell and distribute our WVAS and mobile games, the occurrence of any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

Competition with services offered by China Mobile and other PRC telecommunications operators could lower our revenues and have a material adverse effect on our business, financial condition, results of operations and prospects.

We face competition from WVAS offered by PRC telecommunications operators. For example, China Mobile has been developing and marketing its own multimedia messaging service, or MMS, and WAP products that compete with our services. The PRC telecommunications operators may launch additional competing services in the future. Similar to our practices, China Mobile and other PRC telecommunications operators have entered into cooperation agreements with mobile handset manufacturers to pre-load their icons and codes on new handsets, in order to make accessing and subscribing to WVAS provided by China Mobile and other telecommunications operators easier for users of those handsets. Furthermore, China Mobile has entered into strategic alliances with selected handset manufacturers to embed menu items for only its own WVAS products and not the products of other WVAS providers, such as our company. The competing services offered by China Mobile and other PRC telecommunications operators could decrease our market share and result in a material decrease in our revenues, or harm our relationship with China Mobile and other PRC telecommunications operators, the occurrence of any of which could materially and adversely affect our business, financial condition, results of operations and prospects.

Our dependence on the billing systems and records 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, which could result in subsequent significant adjustments 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 revenues. 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. 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. We may overstate or understate our revenues and cost of revenues for the relevant reporting period, which could result in subsequent significant adjustments in our financial reports when we actually receive the telecommunications operators' monthly statements for such period. Moreover, to the extent that the telecommunications operators require longer periods of time to send us monthly statements, we may be required to increase our reliance on our internal estimates when preparing our financial statements. If we are required to make adjustments to our quarterly financial statements in subsequent quarters, it could severely damage market sentiment toward us, and the trading price of our ADSs could decline significantly. In addition, we generally do not have the ability to independently verify or challenge the accuracy of the billing systems of the telecommunications operators. Nor could we assure you that any negotiations between us and the telecommunications operators to reconcile billing discrepancies will be resolved in our favor. See "Item 5 — Operating and Financial Review and Prospects — Critical Accounting Policies — Revenue Recognition."

Our business and growth prospects would be severely disrupted if we lose the services of our key personnel, and we may not be able to grow effectively if we cannot attract and retain skilled management.

Our future success depends heavily upon the continued service of our key executives. In particular, we rely on the expertise and experience of Leilei Wang, the Chairman of our Board of Directors and our Chief Executive Officer, in our business operations, and on his personal relationships with the regulatory authorities, our clients, our suppliers, the telecommunications operators and our operating companies, Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng. If Mr. Wang becomes unable or unwilling to continue in his present positions, or if he joins a competitor or forms a competing company in contravention of his employment agreement, we may not be able to replace him easily, our business would be significantly disrupted and our financial condition, results of operations and prospects would be materially and adversely affected.

In addition, the incentives to attract and retain employees, in particular skilled management personnel, provided by our equity incentive plans may not be as effective as in the past, in light of the volatility of the market conditions and the price of our ADSs in recent years. The expansion of our Internet games business also requires us to hire and retain experienced Internet game developers and operational staff. We cannot assure you that we will be able to attract or retain such personnel or that any personnel we hire will successfully integrate into our organization or ultimately make a positive contribution to our business. Competition among companies in the PRC Internet industry for skilled and experienced personnel may also result in our having to incur increased compensation costs. If we do not succeed in attracting skilled key personnel or retaining or motivating existing management personnel, we may be unable to manage or develop our business effectively.

Any damage to our reputation could have a material adverse effect on our business and prospects, as well as our financial condition and results of operations.

We are vulnerable to negative market perceptions regarding our company, our products and services, our personnel and other aspects of our business. Furthermore, we are exposed to the risk that litigation, employee misconduct, operational failures, senior personnel changes, customer complaints, outcome of regulatory investigations or other proceedings, and negative publicity generally, among other things, whether or not with merit, could severely damage our reputation. In particular, negative publicity could be based, for example, on allegations that we have failed to comply with applicable regulatory requirements or could result from loss of customer or confidential data, misconduct by employees (including senior management), dissatisfied customers, decline in operating performance or actions by regulatory authorities. Any damage to our reputation could materially and adversely affect our business and prospects, as well as our revenues and profitability.

Our efforts to develop additional distribution channels for our WVAS and mobile games may not succeed or may be restricted or halted by the MIIT 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, SMS and interactive voice response, or IVR, platforms. A consumer who buys a new handset pre-loaded with our mobile games, icons and codes may 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 material 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 manufacturers. We cannot assure you that mobile handset manufacturers will continue their cooperation with us or maintain their current revenue-sharing arrangements with us.

In addition, we cannot assure you that the MIIT, 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 and IVR short codes into the menus of selected mobile handsets, until recently, we also embedded our icons and codes in selected handsets. After the MIIT issued a notice barring the production of mobile handsets with embedded icons and codes that cannot be changed or deleted by consumers, we had to alter our arrangements with mobile handset manufacturers to comply with the notice. Although mobile handset manufacturers are still permitted to pre-load our icons into the handset menus, so long as such icons can be changed or deleted, we cannot assure you that the MIIT will not expand its regulations to bar the pre-loading of icons and codes in the future.

China Mobile has been in recent years promoting only its own WVAS products in the embedded menus of those handsets with those manufacturers China Mobile has entered into strategic alliances. We cannot assure you that China Mobile or other telecommunications operators will not, in the future, 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 MIIT to limit or halt our use of mobile handsets as a distribution channel could materially decrease our revenues, profitability and future growth.

Our ability to succeed in the PRC Internet games market is subject to many challenges and uncertainties.

We entered into the Internet games business with our acquisition of Shanghai Dacheng Network Technology Co., Ltd., or Dacheng, in 2010. Our ability to succeed in the PRC Internet games market is subject to many challenges, such as our ability to develop and license popular games. In particular, new Internet games are regularly introduced in the PRC, but only a relatively small number of high quality, popular games account for a significant portion of the PRC Internet games market. Moreover, it is difficult to predict prior to the introduction of an Internet game whether any particular game would be well received by PRC game players. Accordingly, any negative development relating to our Internet games could materially and adversely affect our business, financial condition, results of operations and prospects. Potential negative developments include:

our failure to make quality upgrades, expansion packs, enhancements or improvements to our Internet games in a timely manner;

- our failure to avoid, or detect and correct, defects in our Internet games in a timely manner;

any reduction in our server capacity for any reason, including our failure to adequately project our future server needs and make advanced purchases of servers to accommodate the expected increase in the number of game players;

any reduction in or failure to grow our games or player base, or any decrease in the popularity of our Internet games in the market due to intensifying competition or other factors;

any failure to license quality Internet games from other Internet game developers that complement our internally developed Internet games;

- any failure to properly tailor and localize any foreign games we have licensed for PRC game players;

- any decrease in or failure to grow the amount of revenues generated from our Internet games;

a failure in our Internet games billing system, which we rely on for revenue recognition and tracking of the consumption patterns of game players; or

any breach of game-related software security or prolonged server interruption due to network failures or hacking activities.

In addition, our ability to succeed in the Internet games market is subject to many uncertainties beyond our control. As the Internet games industry is a relatively new and evolving industry, the growth of the Internet games industry and the level of demand and market acceptance of our Internet games are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors, including:

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the Internet infrastructure, growth of personal computer, Internet and broadband penetration in the PRC and other markets in which we offer our games;

whether the Internet games industry, particularly in the PRC and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;

our ability to license or operate our games in overseas markets;

laws, rules, regulations and policies affecting the Internet games industry, including those affecting Internet cafes in the PRC, where a substantial portion of our game players access Internet games;

general economic conditions, particularly those affecting discretionary consumer spending;

the availability and popularity of other forms of entertainment, particularly console game systems, such as those made by Sony Corporation, Nintendo Co., Ltd. and Microsoft Corporation, which are already popular in developed countries and may gain popularity in the PRC and other countries in which we market our games;

public opinion regarding Internet games;

the popularity, pricing and business model of new Internet games and in-game items that we and our competitors launch and distribute; and

our ability to upgrade and improve our existing games to extend their life spans and to maintain their competitive positions in the Internet games market in a timely manner.

Due to these challenges and uncertainties, we cannot assure you that our Internet games business will make a positive contribution to our future revenues. Our failure to successfully develop this business could have a material adverse effect on our business, financial condition, results of operations and prospects.

If we fail to anticipate and launch games that respond to changing consumer tastes and preferences or predict trends in the PRC Internet games market, our revenues and profitability could be materially reduced, and our growth and prospects would suffer.

The success of our Internet games business will largely depend on our ability to anticipate and launch games that effectively respond to changing consumer tastes and preferences, as well as technological advances, in a timely

manner. For example, we may need to license from overseas developers popular game titles that we believe may gain popularity in the PRC. However, licenses for these games may subject us to significant up-front non-refundable license fees, and there is no assurance these games will be commercially viable in the PRC market. In addition, we will need to replace our existing Internet games as they reach the end of their useful economic lives, which we believe are typically one to three years, as well as operate a larger number of Internet games to increase our overall player base and revenues to meet our growth strategy. If we fail to launch and operate these games successfully in the PRC in a timely manner to meet PRC consumers' changing tastes and preferences, or if these games fail to respond to their tastes and preferences, our operating costs could be materially increased, profitability could be materially reduced, and we may need to write down all or part of the up-front non-refundable license fees paid to game developers.

Moreover, any failure by us to predict and adapt our Internet games to meet trends in the Internet games market in the PRC could materially reduce our revenues and profitability, and severely harm our growth and prospects. For example, a majority of our Internet games depend on our players to download and install large client-side software, which can be well over one thousand megabytes in many cases and take many hours to download. Game players in the PRC have been increasingly turning to web browser-based games in cases where downloading large client-side software is inconvenient or impracticable. As such, we cannot assure you that game players in the PRC will continue to download and install such types of software to play Internet games, nor can we assure you that our existing game players will not, in the future, find downloading and installing large software packages inconvenient or impracticable or otherwise prefer the convenience and ease of use offered by browser-based or other games.

In addition, expanding our Internet game portfolio may add complexities to our Internet games business and require us to effectively adapt our business and management processes to address the unique operational challenges and different requirements of new Internet games in which we operate, which we may not be able to do due to the lack of institutional expertise or otherwise. Accordingly, if we fail to anticipate and successfully launch and operate games that effectively respond to changing consumer tastes and preferences in a timely manner, our revenue and profitability could be materially reduced, and our growth and prospects would suffer.

Our mobile games business has experienced high volatility in its operations, and the mobile games market in the PRC is subject to many uncertainties.

Since 2008, we have made significant efforts to develop our mobile games business. As our mobile games business has developed, it has required separate management in respect of decision making, allocation of resources and assessment of performance. However, our mobile games business has experienced high volatility in its operations. For example, revenues from our mobile games business decreased 48.1% from US\$40.9 million in 2011 to US\$21.2 million in 2012, and further decreased 19.4% to US\$17.1 million in 2013. We cannot assure you that we will be successful in developing our mobile games business, which will depend, among other things, on our ability to:

respond to market developments, including the development of new platforms and technologies, such as smartphone mobile gaming platform, and changes in pricing and distribution models, such as the advent of application stores, or “app stores,” operated by handset manufacturers;

respond to changes in policies of China Mobile or other PRC telecommunications operators relating to mobile games distributed through them;

maintain and diversify our distribution channels, including through China Mobile and the other PRC telecommunications operators and handset manufacturers;

develop new high quality mobile games that 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;

successfully identify, acquire and integrate other mobile games development companies that could complement our internal mobile games development resources;

supplement our internally developed mobile games by acquiring mobile games from third party mobile game developers or cooperating with third party mobile game developers to jointly develop mobile games; and

· develop and upgrade our mobile-game platform technologies.

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:

· the growth rate of mobile data services in the PRC;

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- changes in consumer demographics, tastes and preferences;

- changes in handset platform technologies that accommodate consumer needs and preferences;

- changes in mobile games distribution channels that accommodate consumer needs and preferences;

the extent that the mobile games business remains a key area of development for our telecommunications operator partners;

potential competition from established companies that develop and operate personal-computer-based Internet games and may enter the mobile games 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 PRC mobile games market generally, we cannot assure you that our mobile games business will contribute significantly to our future revenues. Our failure to successfully develop this business could have a material adverse effect on our business, financial condition, results of operations and prospects.

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

The PRC WVAS market has experienced increasingly intense competition. The MIIT reported on its website that more than 2,545 service providers held nationwide licenses as of December 31, 2013 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 with these companies for experienced and talented employees. While we believe that we have certain advantages over our competitors, some of them may have greater personnel and financial resources and a longer operating history than we do. In particular, Internet portal companies that provide WVAS may have an advantage over us as a result of their more established brand names, user bases 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. In addition, we compete for telecommunications

operators to distribute our mobile games, principally 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. Furthermore, we compete for content and brand licensors who supply game content and brands, mainly 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. Moreover, the entry of new competitors, such as developers of personal computer-based Internet 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. Increasing competition in this market could make it difficult for us to maintain or increase our market share and have a material adverse effect on our business, financial condition, results of operations and prospects.

The Internet games business is also highly competitive in the PRC. Given the relatively low entry barriers to operating Internet games, we expect more companies to enter the Internet games industry in the PRC and a wider range of Internet games to be introduced to the PRC market. Our principal competitors in the PRC include Perfect World Co. Ltd., Shanda Interactive Entertainment Limited, Netease.com, Inc., Changyou.com Limited, Giant Interactive Group Inc. and Tencent Holdings Limited. Our potential competitors include major Internet portal operators, other domestic and foreign game developers and publishers and alliances between our existing and new competitors. Many of our competitors have significantly greater financial and marketing resources and name recognition than we do. Some of our competitors or potential competitors, especially major foreign Internet games developers, have greater game development resources than we do. In addition, many of our competitors have developed and operated games that have proven commercially successful for a longer period of time than our games and have a larger portfolio of Internet games than we do.

Moreover, our competitors may introduce new business models that may be more attractive to customers than the business models we currently use. We believe that competition in the PRC Internet games market may become more intense as increasing numbers of Internet games are introduced in the market. We cannot assure you that we will be able to compete successfully against any new or existing competitors, or against any new business models implemented by them. In addition, the increased competition in the Internet games industry may reduce the number of our players or growth rate of our player base, or create pressure for us to reduce usage fees or the prices of certain in-game items. Any of these events could materially decrease our revenues and profitability.

We apply an item-based revenue model for all of our current Internet games, which is a relatively new revenue model and may have a negative impact on our financial condition and results of operations.

We have adopted an item-based revenue model for all of our Internet games, under which players are able to play the Internet games free of charge for an unlimited amount of time, but are charged for purchases of in-game items, such as performance-enhancing items, clothing, accessories and pets. While several other Internet games companies have adopted the item-based model, it is still relatively new compared to time-based billing models, and may create new risks and uncertainties for us. The item-based model will require us to design games that not only attract players to spend more time playing, but also encourage them to purchase in-game items. The sale of in-game items will require us to track closely consumer tastes and preferences, particularly as shown by in-game spending trends. In addition, the item-based model may raise additional concerns for the PRC regulators, who have expressed reservations over the amount of time that Chinese youths spent on Internet games. A model that does not charge based on time spent may be viewed by the PRC regulators as undesirable. We cannot assure you that the item-based revenue model will be successful, or that it will not have a negative impact on our financial condition and results of operations.

In addition, our revenue recognition policy for the item-based games relies on our estimates of the useful lives of various items associated with each of our item-based games. As we have adopted the item-based revenue model beginning in 2009, we have a limited operating history and data for our item-based games on which to base our revenue recognition policy for these games. With respect to permanent ownership items that we sell to players, we recognize revenues over the estimated useful lives of such items. We take into account player behavior patterns in

estimating the lives of permanent life in-game items, including the average period that the typical player plays our games based on log-on data, which are affected by various factors such as acceptance and popularity of the game, game updates and other in-game items, promotional events launched, future operating strategies and market conditions. We calculate the actual playing periods of the players based on historical log-on patterns of all the players over years of game operations starting from the launch of the games. We review the actual average playing periods for all active games and evaluate other various factors, such as acceptance and popularity of the game, game updates and other in-game items, promotional events launched, future operating strategies and market conditions at least annually, to assess if the estimated life of permanent ownership items remains reasonable. Given the relatively short operating history of our item-based games, however, our estimate of the period that players typically play our games may not accurately reflect the actual useful lives of the items, and changes in player behavior observed over time may also affect the estimate. We revise our estimates as we continue to gather operating data, and refining our estimation process and results accordingly. Any future revisions to estimates could affect the time period during which we recognize revenues from these items. In particular, an increase in the estimated lives of these items would increase the period of time over which the revenues from the items are recognized. If we are required to make adjustments to our financial statements as a result of revisions to our estimates, it could materially and adversely affect market sentiments toward us, and the trading price of our ADSs could decline significantly.

Moreover, in the future, we may adopt other business models in our Internet games business to supplement our item-based revenue model, such as the CD-Key model, under which players are able to have full access to our Internet games but only after they have paid an upfront fee. We have adopted the CD-Key model for the Guild Wars 2 game and may in the future apply such model or other revenue models to our other Internet games. We cannot assure you that these new business models will be successful, or that it will not have a negative impact on our financial condition and results of operations, including our revenues, profitability and cash flows.

We depend on a small number of Internet games for a significant portion of our Internet games revenues. As a result, any factors that could have an adverse impact on the development, marketing and distribution of these Internet games, or on our business relationships with the licensors of these Internet games, could materially decrease our Internet games revenues, and have a material adverse effect on our business, financial condition, results of operations and prospects.

A substantial majority of our Internet games revenues is generated from purchases of in-game items by game players based on a small number of Internet games we offer. The revenues generated from these Internet games are responsible for a disproportionate amount of our Internet games revenues. In 2013, revenues generated by in-game items purchased by game players who play the World of Tanks game represented over 95.5% of our Internet games revenues. If the World of Tanks game players become dissatisfied with the World of Tanks game or with the in-game items, they may choose not to purchase additional in-game credits in the future.

Moreover, we depend on Internet games licensors whose games we have the rights to operate in the PRC or other markets to make quality in-game items, upgrades, enhancements, and localized updates and improvements to our licensed Internet games. For example, we entered into a cooperation arrangement with WarGaming.net LLP, or WarGaming, the licensor of the World of Tanks game, under which WarGaming is responsible for developing upgrades, enhancements and improvements to the World of Tanks game. In addition, WarGaming is responsible for providing timely localized updates and enhancements to the game, as well as developing new in-game items that track the preferences and tastes of game players in the PRC. If WarGaming ceased to cooperate with us, we would no longer be able to provide the World of Tanks game to game players in the PRC or generate the corresponding revenues from the game.

Due to the concentration of our Internet games revenue in a small number of Internet games and our dependence on licensors of certain Internet games to continue to develop new in-game items and to upgrade and enhance those games, any factors that could have an adverse impact on the development, marketing and distribution of these Internet games, or on our business relationships with the licensors of these Internet games, could materially reduce our Internet games revenues, and have a material adverse effect on our business, financial condition, results of operations and prospects.

Our Internet games business depends on our ability to acquire and maintain licenses to popular Internet games developed by other developers, and if we are unable to acquire or maintain licenses to these Internet games, our business, financial condition, results of operations and prospects could be materially and adversely affected.

During 2013, approximately 96.1% of our Internet games revenues were generated from Internet games that we licensed from third party Internet games developers. Our ability to acquire and maintain licenses to popular Internet games from third party developers depends on a number of factors, such as:

- identifying and maintaining good relationships with licensors whom we rely on to provide our game players with upgrades, expansion packs, enhancements or improvements;

changes in the terms, or termination, of or the failure to renew, the Internet games licenses with our licensors, which could be caused by, among others, contractual breach by us or our licensors, demand for new royalty payments by our licensors or refusal by our licensors to renew licenses;

- maintaining the reputation and continued marketability of our licensed games if our licensors are unable to provide our game players with satisfactory upgrades, expansion packs or enhancements;

protecting our intellectual property rights both inside and outside the PRC;

complying with the different commercial and legal requirements of the international markets from which we license our games, such as Internet games import regulatory procedures, taxes and other restrictions and expenses;

fluctuations in currency exchange rates; and

interruptions in cross-border Internet connections or other system failures.

If we are unable to maintain a stable relationship with third party Internet game developers due to any of the factors listed above, or if these developers establish similar or more favorable relationships with our competitors in violation of its contractual arrangements with us or otherwise, we may not be able to properly manage our operation of licensed online games, which could materially harm our business as well as our operating results.

Moreover, we have incurred significant payment obligations to third party developers. For example, as part of our license arrangement with ArenaNet, Inc., or ArenaNet, for the exclusive right to operate the Guild Wars 2 game in the PRC, we agreed to pay significant license fees and additional royalties calculated based on revenue generated from the game. To guarantee our payment obligations to ArenaNet, we arranged a standby letter of credit with a maximum guarantee amount of US\$35 million from a PRC commercial bank in ArenaNet's favor. We believe our current cash and cash equivalents and cash flow from operations will be sufficient to meet these obligations. However, if we are unable to meet these obligations, or if financing is not available in amounts or on terms acceptable to us, our ability to operate our licensed games could be materially disrupted and our licenses with third party developers could be terminated, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

Any difficulties or delays in receiving approval from the relevant government authorities for the operation of games we license from Internet games developers outside of the PRC or any expansion packs for, or material changes to, such games could significantly reduce their popularity and profitability.

We currently license six Internet games from third party developers outside of the PRC. We are required to obtain relevant PRC government approvals before we are permitted to operate these games within the PRC. In addition, after such government approvals have been obtained, any expansion packs for or material changes of content to those games may require further government approvals. We may not be able to receive such government approvals, and we cannot be certain of the duration of any necessary approval processes. Any difficulties or delays in receiving these government approvals may significantly reduce the profitability and popularity of the licensed games and may entitle licensors to terminate their licenses with us.

If we fail to manage risks associated with licensing our internally developed games outside the PRC, our business, financial condition, results of operations and prospects could be materially and adversely affected.

We have licensed nine of our Internet games to operators outside the PRC. We plan to license our existing and new internally developed games in additional countries and regions in the future. The offering of our internally developed games to the international markets exposes us to a number of risks, including:

· identifying and maintaining good relationships with licensees who are knowledgeable about, and are able to effectively distribute and operate our Internet games in, international markets;

· developing Internet games and expansion packs catered to markets outside the PRC;

· renewing our license agreements with licensees upon their expiration;

maintaining the reputation of our company and our games that are being operated by licensees in international markets pursuant to their own standards;

protecting our intellectual property rights both inside and outside the PRC;

complying with the different commercial and legal requirements of the international markets in which we offer our games, such as Internet games import regulatory procedures, taxes and other restrictions and expenses;

fluctuations in foreign currency exchange rates; and

interruptions in cross-border Internet connections or other system failures.

We could be liable for breaches of security of our website and third party online payment channels, which may materially harm our reputation, business and prospects.

A portion of our Internet games revenues is generated from sales through third party online payment platforms. In such transactions, secure transmission of confidential information, such as customers' credit card information, personal information and billing addresses, over public networks, in some cases including our websites for our Internet games, is essential to maintain consumer confidence. While we have not experienced any breach of our security measures to date, we cannot assure you that our current security measures are adequate. In addition, we expect that an increasing amount of our sales will be conducted over the Internet as a result of the growing use of online payment systems over time. Over the same period, online theft of confidential information will likely increase and we must be prepared to increase our security measures and efforts so that our customers have confidence in the reliability of the online payment systems that we use. We do not have control over the security measures of our third party online payment vendors, and we cannot assure you that these vendors' security measures are adequate or will be adequate with the expected increased usage of online payment systems. Security breaches of the online payment systems that we use could expose us to litigation and possible liability for failing to secure confidential customer information, and could harm our reputation, ability to attract customers and ability to encourage customers to purchase in-game items, any of which could materially harm our reputation, business and prospects.

Undetected errors or flaws in our services or failure to maintain effective customer service could harm our reputation or decrease market acceptance of our games, which may materially and adversely affect our financial condition and results of operations.

Our products and services, such as our WVAS, mobile games and Internet games, may contain errors or flaws, which may only become apparent after their release, particularly as we often launch new products or services or introduce new features to existing products or services under tight time constraints. From time to time, our customers have

informed us of flaws affecting their experience with our products or services, which we were generally able to resolve promptly. Furthermore, customer service is critical for retaining customers, and we may not be able to maintain and continuously improve the quality of our services to meet customers' expectations. If our products or services contain programming errors or other flaws, or if we fail to provide effective customer service, our customers may be less inclined to continue using our products or services or recommend them to other potential customers, and may use our competitors' products and services. Undetected errors, defects and unsatisfactory customer service can disrupt our operations, adversely affect the experience of our customers, harm our reputation, cause our customers to stop using our products and services, and delay market acceptance of our products and services, any of which could materially and adversely affect our financial condition and results of operations.

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The trading price of our ADSs has been volatile and may continue to be volatile regardless of our operating performance.

The trading price of our ADSs has been and may continue to be subject to wide fluctuations. During the three-year period from December 31, 2010 until December 31, 2013, the closing prices of our ADSs ranged from US\$ 3.55 to US\$ 14.69 per ADS, and the closing price on April 14, 2014 was US\$10.28 per ADS. The market price for our ADSs may continue to be volatile and subject to wide fluctuations in response to factors including:

China Mobile and other PRC telecommunications operators' future policies and measures taken toward WVAS providers;

- actual or anticipated fluctuations in our quarterly operating results;

- conditions in the WVAS, mobile games and Internet games markets;

changes in the economic performance or market valuations of other companies that are perceived to be comparable to us;

announcements by us or our competitors of new products, acquisitions, strategic partnerships, joint ventures or capital commitments;

- addition or departure of key personnel;

- changes in financial estimates by securities research analysts;

- fluctuations of exchange rates between RMB and the U.S. dollar;

- intellectual property litigation;

- general conditions in the global financial markets; and

- general economic or political conditions in the PRC.

The stock market in general and the market prices for Internet-related companies with operations in the PRC in particular have experienced volatility that has sometimes been unrelated to the operating performance of such companies. These broad market and industry fluctuations may materially and adversely affect the price of our ADSs, regardless of our operating performance. In addition, sales of our ADSs in the public market, or the perception that such sales could occur, could cause the market price of our ADSs to decline. Certain of our executive officers who hold our shares or ADSs may sell their shares or ADSs subject to applicable volume and other restrictions under Rule 144 of the Securities Act. To the extent that such shares or ADSs are sold into the market, the market price of our ADSs could decline substantially.

Failure to achieve and maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 could have a material adverse effect on our business, reputation, financial condition and results of operations and could cause the market price of our ADSs to decline significantly.

We are subject to reporting obligations under the U.S. Federal securities laws. We are required by the U.S. Securities and Exchange Commission, or SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act, to include a report by our management on our internal control over financial reporting in our annual reports on Form 20-F that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, our annual reports on Form 20-F shall include an independent registered public accounting firm's attestation report on the effectiveness of our internal control over financial reporting.

Although our management and an independent registered public accounting firm have concluded that our internal controls over our financial reporting were effective as of December 31, 2013, the end of the period covered by this annual report, we may fail to maintain effective internal controls over financial reporting in the future, in which case we and the independent registered public accounting firm may not be able to conclude that we have effective internal control over financial reporting. In addition, even if our management concludes at the end of future reporting periods that our internal controls are effective, the independent registered public accounting firm, or the relevant regulator, may disagree. If such independent registered public accounting firm is not satisfied with our internal control over financial reporting or the level at which our internal control over financial reporting is documented, designed or operated, or if such independent registered public accounting firm interprets the requirements, rules or regulations differently from us, then it may issue an adverse opinion. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our consolidated financial statements, which ultimately could cause the market price of our ADSs to decline significantly. We also may need to incur significant costs and use significant management and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act and other requirements.

Moreover, internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls or fraud. As a result, even effective internal control over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls over financial reporting, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business could be harmed, we could fail to meet our reporting obligations, and the market price of our ADSs could decrease significantly.

Business growth and a rapidly changing operating environment may strain our limited resources.

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As our user base increases and as we diversify into other business segments, we will need to increase our investment in our technological infrastructure, facilities and other areas of operations. In particular, our product development, customer service and sales and marketing are important to our future success. If we are unable to manage our growth and expansion effectively, the quality of our services and our customer support may deteriorate and our business may suffer. Any deterioration in performance could prompt China Mobile or other PRC telecommunications operators to cease offering our services over their networks. Our future success will depend on, among other things, our ability to:

- develop and quickly introduce new services, adapt our existing services and maintain and improve the quality of all of our services, particularly as new mobile technologies are introduced;

- effectively maintain our relationships with China Mobile and other PRC telecommunications operators;

- enter into and maintain relationships with our business partners;

- develop or license attractive mobile and Internet games that can generate recurring revenues;

- continue training, motivating and retaining our existing employees, attract new employees and integrate new employees;

- expand the percentage of our revenues that are recurring and are derived from monthly subscription-based services;

- develop and improve our operational, financial, accounting and other internal systems and controls; and

- maintain adequate controls and procedures relating to our periodic public disclosure under applicable laws.

We may need additional capital and may not be able to obtain such capital on acceptable terms.

Capital requirements are difficult to plan in our rapidly changing industry. We currently expect that we will need capital to fund our future acquisitions, service development, technological infrastructure and sales and marketing activities. Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

investors' perceptions of, and demand for, securities of telecommunications value-added services companies and/or Internet games companies;

· conditions of the U.S. and other capital markets in which we may seek to raise funds;

· our future financial condition, results of operations and cash flows;

· PRC governmental regulation of foreign investment in value-added telecommunications companies;

· economic, political and other conditions in the PRC; and

· PRC governmental policies relating to foreign currency borrowings.

Any failure by us to raise additional funds on terms favorable to us, or at all, may have a material adverse effect on our business, financial condition and results of operations. For example, we may not be able to carry out parts of our growth strategy to acquire assets, technologies and businesses that are complementary to our existing business or necessary to maintain our growth and competitiveness.

We were classified as a passive foreign investment company, or PFIC, in 2012 and certain previous taxable years, which may have resulted in adverse United States Federal income tax consequences to U.S. holders of our ADSs and may continue to result in adverse United States Federal income tax consequences to such holders even in taxable years in which we are not a PFIC. Although we were likely not classified as a PFIC in 2013, we may become a PFIC in 2014 or future taxable years, which may result in additional adverse United States Federal income tax consequences to U.S. holders of our ADSs.

We have substantial passive assets in the form of cash and cash equivalents, which caused us to be classified as a PFIC for U.S. Federal income tax purposes in 2012 and certain previous taxable years. Although the matter is not free from doubt, we were likely not classified as a PFIC in 2013. However, we cannot assure you that we will not be

classified as a PFIC in 2014 or future taxable years. The determination of whether we are a PFIC is principally based upon:

the composition of our assets, including goodwill, the amount of which will depend, in part, on our total net assets and the market value of our ordinary shares and ADSs, which is subject to change; and

the amount and nature of our income from time to time.

We have limited control over these variables. Furthermore, with regard to any additional capital markets or corporate finance transactions we might conduct in the future, we cannot, at this stage, specify the timing, amounts or the particular uses of the net proceeds. As a result, we cannot provide any assurance as to how the net proceeds of any such transactions would impact whether we are classified as a PFIC in any future periods.

In respect of any taxable year during which we are a PFIC, U.S. investors will be subject to adverse U.S. Federal income tax consequences (and may be subject to adverse U.S. Federal income tax consequences in subsequent years as well). For further discussion regarding our status as a PFIC, please see “Item 10 — Additional Information — Taxation — United States Taxation — PFIC Rules.” U.S. investors are urged to consult their own tax advisors regarding the application of the PFIC rules to their particular circumstances.

The audit report included in this annual report is prepared by auditors who are not inspected by the Public Company Accounting Oversight Board, and, as such, you are deprived of the benefits of such inspection.

Our independent registered public accounting firm, Deloitte Touche Tohmatsu Certified Public Accountants LLP, as auditors of companies that are publicly traded in the United States and a firm registered with the Public Company Accounting Oversight Board of the United States, or PCAOB, is required by the laws of the United States to undergo regular inspection by the PCAOB to assess its compliance with the laws of the United States and applicable professional standards. Since the PRC is a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the PRC regulatory authorities, the operations in the PRC of our independent registered public accounting firm, similar to the PRC operations of other independent registered public accounting firms, is not currently inspected by the PCAOB.

Inspections of other firms that the PCAOB has conducted outside the PRC have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in the PRC prevents the PCAOB from regularly evaluating audits of our independent registered public accounting firm and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of the PRC that are subject to PCAOB inspections. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

The exercise of warrants issued to various third parties could result in substantial dilution to the holders of our ordinary shares and ADSs and may depress the market price of our ADSs.

In March 2009, we issued to Nokia Growth Partners II, L.P., or NGP, a warrant to purchase up to 80 million of our ordinary shares, exercisable within five years. In August 2012, NGP transferred a warrant to purchase up to 40 million of our ordinary shares, exercisable prior to March 18, 2014, which constituted 50% of the original warrant, to Fit Run Limited, which is beneficially owned by Han Jun, an individual unaffiliated with us. We consented to this transfer and, in exchange for the original warrant, issued a new warrant to purchase up to 40 million of our ordinary shares, exercisable prior to March 18, 2014, to NGP. In September 2013, NGP exercised the warrant to purchase 40 million of our ordinary shares and Fit Run limited exercised the warrant to purchase 40 million of our ordinary shares.

In August 2012, in connection with the licensing of certain Internet games, we granted to each of Meteor Entertainment, Inc., or Meteor Entertainment, and ArenaNet a warrant to purchase up to 40 million of our ordinary

shares (equivalent to 1 million of our ADSs) respectively. The warrants are exercisable within one year after the launch of the respective licensed games. In addition, we have issued warrants to purchase up to a total of 200 million of our ordinary shares (equivalent to 5 million of our ADSs) to WarGaming in connection with our various licensing arrangements with WarGaming. In May 2013, WarGaming exercised the warrant to purchase 120 million of our ordinary shares.

The issuance of additional ordinary shares under the warrants may result in substantial further dilution to the holders of our ordinary shares and ADSs, and the market price of our ADSs could decline significantly. The sale of the ordinary shares issued as a result of the exercise of the warrants by various parties, or the perception that such events may occur, could also materially and adversely affect the market price of our ADSs. Furthermore, we may issue additional securities in the future that may have a dilutive effect to the holders of our ordinary shares and ADSs.

We may not be able to adequately protect our intellectual property, and we also may be exposed to infringement claims by third parties.

We believe the copyrights, service marks, trademarks, trade secrets and other intellectual property we use are important to our business, and any unauthorized use of such intellectual property by third parties may harm our business and reputation. We rely on the intellectual property laws and contractual arrangements with our employees, clients, business partners and others to protect such intellectual property rights. Third parties may be able to obtain and use such intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property in the WVAS, mobile games, and Internet games industries in the PRC is uncertain and still evolving, and these laws may not protect intellectual property rights to the same extent as the laws of some other jurisdictions, such as the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, which could result in substantial costs and diversion of our resources, and have a material adverse effect on our business, financial condition and results of operations.

Due to the manner in which we obtain, collect, produce and aggregate content and applications for our WVAS, mobile games and Internet games, and because our services may be used for the distribution of information, claims may be filed against us for defamation, negligence, copyright or trademark infringement or other violations. In addition, third parties could assert claims against us for losses in reliance on information distributed by us. When we license third party content or other intellectual properties, we rely on the licensor's representations and warranties of its rights or titles to the content or intellectual properties. Although we perform reasonable due diligence, we cannot guarantee that such a licensor actually has the legal rights or titles to the content or intellectual properties that we distribute or use. We cannot assure you that third parties will not assert claims against us or challenge the validity of our license agreements. If we are found to have infringed any intellectual property rights of others, we may be enjoined from using such intellectual property, and we may incur licensing fees or be forced to develop alternative intellectual property. We may also incur significant costs in investigating and defending these claims.

We are not able to register the Chinese name of our service mark "KongZhong Network" in the PRC, and we may not be able to effectively prevent its unauthorized use by third parties.

We are unable to register the Chinese name of "KongZhong Network" as our service mark because it is deemed a generic term under existing PRC trademark laws, rules and regulations, which prohibit registration of generic terms as trademarks or service marks. As a result, we may not be able to effectively prevent the unauthorized use of the Chinese name of our service mark, "KongZhong Network," and our brand name and reputation may be materially and adversely affected by such unauthorized use.

We may fail to realize the anticipated benefits of our acquisitions, and such acquisitions may also expose us to uncertainties and risks, any of which could materially and adversely affect our business, financial condition, results of operations and prospects.

One of our growth strategies is to continue expanding our businesses and game development capabilities and resources through, among others, acquisitions. We believe that growing our businesses and game development capabilities and resources both organically and through selective acquisitions will enable us to expand our Internet and mobile games businesses more quickly and efficiently. However, we may fail to realize the anticipated benefits of our acquisitions, and such acquisitions may also expose us to uncertainties and risks. In particular, acquisitions may not meet our expectations and the realization of the anticipated benefits may be delayed or reduced as a result of numerous factors, some of which are outside of our control. These factors include:

- unforeseen contingent risks or latent liabilities relating to acquisitions that may only become apparent in the future;
- difficulties in managing a much larger business;
- loss of key personnel; and

increases in competition in the PRC Internet and mobile games industries, which, among other things, may require us to increase our development and/or marketing efforts.

Furthermore, acquisitions may also expose us to uncertainties and risks, including uncertainties and risks associated with:

- the management and development of acquired businesses;
- the integration of acquired businesses with our existing businesses and game development resources and infrastructures;
- the integration of our accounting policies and procedures with those of acquired businesses;
- unforeseen or potential liabilities and exposures relating to acquired businesses and their past financial results;
- the diversion of financial or other resources from our existing businesses; and
- potential loss of, or harm to, relationships with employees or customers.

Future acquisitions may severely disrupt our ability to manage our business as well as our future growth.

Selective acquisitions form part of our strategy to further expand our business and growth prospects. If we are presented with appropriate opportunities, we may acquire additional businesses, technologies, services or products that are complementary to our business, such as Dacheng. Any acquisition and the subsequent integration of new companies into our company may require significant attention from our management to ensure that, among other things, the acquisition does not disrupt our relationships with the telecommunications operators or affect our users' opinion of our services and customer support, and to ensure that the acquired company is effectively integrated with our existing operations. The diversion of our management's attention and any difficulties encountered in any integration process could have an adverse effect on our ability to manage our business. Acquisitions may also expose us to risks, including risks associated with the assimilation of new operations, services and personnel, unforeseen or hidden liabilities, the diversion of resources from our existing businesses and technologies, the inability to generate sufficient revenues to offset the costs and expenses of acquisitions and potential loss of, or harm to, relationships with employees and content providers. Given the sophisticated technologies used in the WVAS, mobile games and Internet games industries, the successful, cost-effective integration of other businesses' technology platforms and services into our company will also be a critical and highly complicated aspect of any acquisition. Acquisitions may also result in potentially dilutive issuances of equity securities.

In addition, we are required under U.S. GAAP to review our intangible assets with definite life for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill and intangible assets with indefinite life are required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our intangible assets may not be recoverable include a decline in stock price and market capitalization and slower growth rates in our industry. We may be required to record a charge to earnings in our financial statements during the period in which any impairment of our goodwill or intangible assets is determined. For example, in the third quarter of 2011, we recorded an impairment charge of US\$20.3 million for intangible assets and goodwill associated with the WVAS unit, and in the third quarter of 2013, we recorded an impairment charge of US\$1.8 million for intangible assets, of which US\$0.2 million impairment loss is recorded as “cost of sales” and US\$1.6 million impairment loss is recorded as “impairment loss on intangible assets”, respectively. As of December 31, 2013, our carrying value of goodwill and intangible assets was approximately US\$169.0 million.

We have limited business insurance coverage.

The insurance industry in the PRC is still at an early stage of development. Insurance companies in the PRC offer limited business insurance products, and do not, to our knowledge, offer business liability insurance. As a result, we do not have any business liability insurance coverage for our operations. Moreover, while business disruption insurance is available, we have determined that the risks of disruption and cost of the insurance are such that we do not require it at this time. Any business disruption, litigation or natural disaster could result in substantial costs and diversion of resources.

Our Articles of Association contain anti-takeover provisions that could adversely affect the rights of holders of our ordinary shares and ADSs.

Our Articles of Association include certain provisions that could limit the ability of others or discourage a third party to acquire control of our company and thus deprive holders of our ordinary shares and ADSs of the opportunity to sell their ordinary shares or ADSs at a premium over the prevailing market price. These provisions provide for, among others, the following:

- a classified board structure, with three classes of board members and each class having a three-year term;

authority of our Board of Directors, or the Board, to issue up to a total of 1,000,000,000,000 ordinary shares, with or without preferred, deferred or other special rights or restrictions, whether with regard to dividend, voting, return of capital or otherwise and to such persons, at such time and on such other terms as the directors think proper;

power of our Board to elect directors either as an addition to the existing directors or to fill a vacancy resulting from death, resignation, retirement, disqualification, removal from office or any other reason; and

- the directors' discretion to decline to register any transfer of ordinary shares without assigning any reason.

Risks Relating to Our Corporate Structure

Our business and operations could be significantly disrupted, and we could be subject to sanctions, if the contractual arrangements between us and our consolidated variable interest entities that we depend on for operating our WVAS, mobile games and Internet games are found to be non-compliant with applicable PRC law.

Under applicable PRC law, foreign investment in the PRC enterprises that provide value-added telecommunications services, including Internet content services, is subject to an ownership limitation of not more than 50%. In addition, foreign investment in Internet game operators in the PRC is also subject to restrictions. In particular, the SAPPRFT, which is responsible for the registration of Internet games operated in the PRC, published a notice in September 2009 indicating that foreign investors are prohibited from obtaining control over Internet game operators in the PRC or participating in the Internet games sector through the establishment of joint venture companies or contractual or technical arrangements. As a result, our ability to directly engage in value-added telecommunications services or Internet games services is severely restricted.

We and our subsidiaries, KongZhong Information Technologies (Beijing) Co., Ltd., or KongZhong Beijing, KongZhong China Co., Ltd., or KongZhong China, and Simlife (Beijing) Science Co., Ltd., or Simlife Beijing, are considered foreign persons or foreign-invested enterprises under applicable PRC law. As a result, we operate our WVAS, mobile games and Internet games in the PRC through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, each of which is owned by PRC citizens. We do not own any equity interest in these operating companies, which are considered to be our consolidated variable interest entities for U.S. GAAP purposes, but are able to enjoy the economic benefits through contractual arrangements entered into between us and consolidated variable interest entities, including contractual arrangements relating to the provision of services and certain corporate governance and shareholder rights matters. These operating companies conduct substantially all of our operations and generate substantially all of our revenues, and also hold the licenses and approvals that are essential to our business. For a detailed description of these contractual arrangements, see “Item 7 — Related Party Transactions — Contractual Arrangements Relating to our Operating Companies.”

As the applicable PRC laws, rules and regulations governing the Internet games sector are evolving and subject to differing interpretations, there are substantial uncertainties regarding the validity and enforceability of the contractual arrangements between us and our consolidated variable interest entities. We have been advised by our PRC legal counsel, Commerce & Finance, that each agreement under the contractual arrangements with our consolidated variable interest entities constitutes a valid and legally binding obligation under applicable PRC law. In addition, Commerce & Finance is of the opinion that, with respect to Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, no consent, approval or license, other than those already obtained, is required under any existing PRC laws, rules and regulations for the effectiveness and enforceability of the contractual arrangements, businesses and operations of these companies. We cannot assure you, however, that the relevant PRC regulatory authorities will not ultimately determine that these contractual arrangements are non-compliant with applicable PRC laws, rules and regulations.

If we or our operating companies were found to violate any existing or future PRC laws, rules or regulations, the relevant PRC regulatory authorities would have broad discretion in dealing with such violation, including:

- revoke the business and operating licenses of our wholly owned subsidiaries, our consolidated variable interest entities and their subsidiaries;

- discontinue or restrict the operations of any related party transactions among our wholly owned subsidiaries, our consolidated variable interest entities and their subsidiaries;

- impose fines or other requirements on our wholly owned subsidiaries, our consolidated variable interest entities and their subsidiaries;

- require us to revise our ownership structure or restructure our operations; and/or

- restrict or prohibit us from using the proceeds from public offerings to finance our business and operations in China.

Any of these or similar actions could cause significant disruptions to our business, as well as materially reduce our revenues, profitability and cash flows.

In addition, if any of these actions results in our inability to direct the activities of our consolidated variable interest entities and their subsidiaries that most significantly impact their economic performance, and/or such actions prevent us from receiving the economic benefits from our consolidated variable interest entities, we may not be able to consolidate the financial results of these variable interest entities into our consolidated financial statements in accordance with U.S. GAAP.

Our contractual arrangements with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.

The applicable PRC laws, rules and regulations currently restrict foreign ownership of companies that provide value-added telecommunications services, which include WVAS, mobile games and Internet content services, or that operate Internet games. As a result, we conduct substantially all of our operations and generate substantially all of our revenues through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng pursuant to a series of direct or indirect contractual arrangements with them and their respective shareholders. These agreements may not be as effective in providing control over our operating companies as direct ownership. In the event we are unable to enforce these contractual arrangements, we may not be able to have the power to direct the activities that most significantly affect the economic performance of our consolidated variable interest entities. In addition, our ability to conduct our business may be negatively affected, and we may not be able to consolidate the financial results of our consolidated variable interest entities into our consolidated financial statements in accordance with U.S. GAAP. In particular, our operating companies could fail to perform or make payments as required under the contractual agreements, and we will have to rely on the PRC legal system to enforce these agreements, which may not be effective.

We believe that we have the ability to cause the contractual arrangements with our variable interest entities to be renewed when necessary based on (i) our exclusive option to purchase all or part of the equity interests in our consolidated variable interest entities, when and to the extent permitted by PRC law, or request any existing shareholder of our consolidated variable interest entities to transfer all or part of the equity interest in our consolidated variable interest entities to another PRC person or entity designated by us at any time in our discretion, and (ii) the power of attorney that our consolidated variable interest entities' shareholders have granted to us.

Our ability to enforce the equity pledge agreements between us and consolidated variable interest entities' shareholder may be subject to limitations based on PRC laws, rules and regulations.

Under our equity pledge agreements with our consolidated variable interest entities and their shareholders, these shareholders have agreed to pledge all of their respective equity interests in the consolidated variable interest entities to us. The purpose of such pledges is to secure the performance of our consolidated variable interest entities' obligations under the various contractual arrangements, including the business operation agreements and technology development agreements. As of December 31, 2013, the pledges of equity interests by shareholders of our consolidated variable interest entities have all been registered with the relevant local SAIC. According to the applicable PRC laws, when an obligor fails to pay its debt, the pledgee may choose 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. If our consolidated variable interest entities or their shareholder fails to perform their respective obligations secured by the pledges under the equity pledge agreements, one remedy in the event of default under the equity pledge agreements is to require the pledgor to sell the pledged equity interests in an auction or private sale and remit the proceeds to our wholly owned subsidiaries in China, net of related taxes and expenses. Such an auction or private sale may not result in our receipt of the full value of the equity interests in consolidated variable interest entities.

In addition, in the registration forms of the local branch of the SAIC for the pledges, the amount of registered equity interests pledged to our wholly owned subsidiaries, including Beijing AirInbox, Beijing WINT, Beijing Chengxitong, Mailifang, Xinreli, BJXR and Dacheng, was stated as RMB10,000,000, RMB10,000,000, RMB10,100,000, RMB10,000,000, RMB10,000,000, RMB10,000,000 and RMB11,182,480, respectively, which in aggregate represent 100% of the registered capital of our consolidated variable interest entities. A PRC court may take the position that the amounts listed on the equity pledge registration forms represent the full amounts of the collateral that have been registered and perfected. In that event, the obligations that are supposed to be secured in the equity pledge agreements in excess of the amount listed on the equity pledge registration forms could be determined by a PRC court to be unsecured debt, and our ability to be repaid may be materially harmed.

The shareholders of our consolidated variable interest entities may have potential conflicts of interest with us, which may substantially disrupt our business.

The registered shareholders of our consolidated variable interest entities are our current or former directors, officers or employees and their relatives. For example, Leilei Wang, our Chairman and Chief Executive Officer, is one of the registered shareholders of Dacheng, a consolidated variable interest entity that was acquired in 2010. In addition, Mr. Wang owned 19.9% of our outstanding ordinary shares as of the date of this annual report on Form 20-F. See “Item 4 - Information on the Company - Our Corporate Structure” for a list of the registered shareholders of our consolidated variable interest entities and their respective shareholdings. Conflicts of interest may arise between such shareholders’ duties to us and our consolidated variable interest entities. If such conflicts arise, these shareholders may not act in our best interests and such conflicts of interest may not be resolved in our favor. In addition, these shareholders may breach or cause our consolidated variable interest entities to breach or refuse to renew their existing contractual arrangements that allow us to exercise effective control over them and to receive economic benefits from them. The laws of the Cayman Islands provide that directors of a company owe a fiduciary duty to the company, which requires them to act in good faith and in the best interests of the company and not to use their positions for personal gain. If certain shareholders of our consolidated variable interest entities do not comply with their fiduciary duties to us as our designated directors, or if we cannot resolve any conflicts of interest or disputes between us and any current or future registered shareholders of our consolidated variable interest entities, we would have to rely on legal proceedings to remedy the situation, the outcome of which is uncertain and which may result in substantial disruptions to our business.

The dividends and other distributions on equity we may receive from our subsidiaries are subject to restrictions under PRC law or agreements that our subsidiaries may enter into with third parties.

We are a holding company and rely largely on dividends and other distributions paid by our subsidiaries for cash, financing and other requirements. Our wholly owned subsidiaries, KongZhong Beijing, KongZhong China and Simlife Beijing, have entered into contractual arrangements with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng through which we conduct business and receive revenues in the form of service fees. We rely on dividends and other distributions on equity paid by KongZhong Beijing, KongZhong China and Simlife Beijing, as well as service fees from Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, for our cash requirements in excess of any cash raised from investors and retained by us. If any of KongZhong Beijing, KongZhong China or Simlife Beijing incurs debt in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us.

Furthermore, PRC law requires that payment of dividends by each of KongZhong Beijing, KongZhong China and Simlife Beijing may be made only out of their respective net income, if any, determined in accordance with PRC accounting standards and regulations. Under the applicable PRC laws, KongZhong Beijing, KongZhong China and Simlife Beijing also are required to set aside no less than 10% of their respective after-tax net income each year as reserve funds unless such reserve funds, after making up losses of preceding years, have reached 50% of their respective registered capital, and these reserves are not distributable as dividends. Any limitation on the payment of dividends by our subsidiaries could have a material adverse effect on our ability to grow, fund investments, make acquisitions, pay dividends and otherwise fund and conduct our business.

In addition, under the PRC enterprise income tax law that took effect on January 1, 2008, and its implementation regulation, a non-PRC-resident enterprise's net income originating from "sources within the PRC" will be subject to a 10% enterprise income tax, or EIT, rate. Whether a dividend payment constitutes income from "sources within the PRC" is determined by the location of the enterprise which pays the dividend. Income tax on dividends from the PRC payable to a non-PRC-resident enterprise is at a rate of 10%. As a result, KongZhong Beijing, KongZhong China and Simlife Beijing may be required to withhold all or part of such income tax when paying us dividends. See "Item 5 — Operating and Financial Review and Prospects — Taxation."

Our Chairman and Chief Executive Office is our single largest shareholder, and his interests may differ from other holders of our ordinary shares or ADSs.

Leilei Wang, our Chairman and Chief Executive Officer, owned 19.9% of our outstanding ordinary shares as of the date of this annual report on Form 20-F. Accordingly, he exerts significant influence in determining the outcome of any corporate transaction or other matter submitted to the holders of our ordinary shares and ADSs for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of Directors and other significant corporate actions. He will also have significant influence in preventing or causing a change in control. In

addition, without his consent, we may be prevented from entering into transactions that could be beneficial to us. Mr. Wang's interests may differ from the interests of the other holders of our ordinary shares or ADSs.

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Our contractual arrangements with our consolidated variable interest entities and their respective shareholders may require us to pay additional taxes.

Arrangements and transactions among related parties may be subject to audits or challenges by the PRC tax authorities. We could face material adverse tax consequences if the PRC tax authorities determine that our contractual arrangements between us and our consolidated variable interest entities are not arm's-length transactions. If this were to occur, the tax authorities could adjust our subsidiaries' and our consolidated variable interest entities' income in the form of a transfer pricing adjustment. A transfer pricing adjustment could, for PRC tax purposes, increase the tax liabilities of our subsidiaries and our consolidated variable interest entities. If our subsidiaries and our consolidated variable interest entities' tax liabilities increase or if our subsidiaries and our consolidated variable interest entities are found to be subject to late payment fees or other penalties, our financial condition and results of operations could be materially and adversely affected.

Risks Relating to Our Industry

Our ability to generate revenues could suffer if the PRC markets for WVAS, mobile games and Internet games do not develop as anticipated.

The WVAS, mobile games and Internet games markets in the PRC have evolved rapidly in recent years, with the introduction of new and advanced services, development of consumer preferences, changes in policies and guidelines initiated government agencies and our partners, market entry by new competitors and adoption of new strategies by existing competitors. Accordingly, it is extremely difficult to accurately predict consumer acceptance and demand for various existing and potential new offerings and services, and the future size, as well as composition and growth, of these markets. Furthermore, given the limited history and rapidly evolving nature of our markets, we cannot predict the prices that users will be willing to pay for our services and games or whether users will have concerns about security, reliability, cost and quality of service associated with WVAS, mobile games and Internet games. If acceptance of our WVAS, mobile games and Internet games is different from what we anticipate, our ability to maintain or increase our revenues and net income could be materially and adversely affected.

The laws, rules and regulations governing the WVAS, mobile games and Internet games industries in the PRC are developing and subject to future changes. Substantial uncertainties exist as to the interpretation and implementation of the applicable laws, rules and regulations.

In recent years, the PRC government has begun to promulgate laws, rules and regulations applicable to the WVAS, mobile games, Internet and Internet games industries in the PRC, many of which are relatively new and untested and are subject to future changes. In addition, various regulatory authorities of the central PRC government, such as the

State Council of the PRC, or the State Council, the MIIT, the MOC, the SAIC, the MPS and the SAPPRFT, are empowered to issue and implement rules to regulate certain aspects of Internet-related services and activities. Furthermore, certain local governments also have promulgated local rules applicable to Internet-related services and activities within their respective jurisdictions. As the Internet industry itself is at a relatively early stage of development in the PRC, it is likely that additional laws, rules and regulations will be promulgated in the future to address issues that may arise from time to time. As a result, uncertainties exist regarding the interpretation and implementation of current and future applicable PRC laws, rules and regulations. We cannot assure you that we will not be found in violation of these PRC laws, rules or regulations due to these uncertainties, in which case we could be subject to various penalties, including redressing the violations, confiscation of income, imposition of fines or even suspension of our operations. See “Item 4 — Information on the Company — Regulation.”

Each of Beijing AirInbox, Beijing Boya Wuji, Beijing WINT, BJXR and Beijing Chengxitong has obtained a telecommunications and information services operating license for their Internet content businesses from the Beijing Telecommunications Administration Bureau. In addition, each of Beijing AirInbox, Beijing WINT, BJXR, Beijing Chengxitong, Mailifang and Xinreli has obtained a value-added telecommunications license from the MIIT in order to provide services in multiple provinces, autonomous regions and municipalities. Each of Beijing Boya Wuji, Zhulang, Dacheng and Shanghai KongZhong Brilliant Game Co., Ltd., or Brilliant Game, has obtained a value-added telecommunications license from branches of the MIIT at the provincial level to provide intra-provincial services. Each of Beijing AirInbox, Dacheng, Zhulang, Xinreli and Brilliant Game has obtained an Internet Culture Business Permit for our Internet games business. If any of Beijing AirInbox, Beijing Boya Wuji, Beijing WINT, BJXR, Beijing Chengxitong, Zhulang, Mailifang, Xinreli, Dacheng or Brilliant Game fails to obtain or maintain any required licenses or permits, it may be subject to various penalties, including redressing the violations, confiscation of income, imposition of fines or even suspension of its operations. Any of these measures could materially disrupt our business and materially and adversely affect our financial condition and results of operations.

The PRC government has promulgated a series of rules, regulations and policies that may have negative impact on the Internet games industry, and we cannot assure you that the PRC government will not promulgate similar rules, regulations or policies in the future.

The PRC government has adopted a series of rules, regulations and policies to monitor and control the Internet games industry in response to, among other things, perceived addiction to Internet games and its perceived negative social effects, particularly for minors. For example, PRC governmental authorities issued a notice in April 2007 requiring all PRC Internet games operators to adopt an “anti-fatigue system” in an effort to curb addiction to Internet games by minors, under which game operators are required to reduce the value of game benefits for minor game players as their continuous playing time reaches certain thresholds. Internet game players in the PRC are also required to register their identity numbers before they can play. In addition, PRC governmental agencies have issued a series of rules and regulations limiting the use of virtual currencies in Internet games, which may result in higher costs for the operation of our Internet games and lowers sales of virtual items in our Internet games.

We cannot assure you that the PRC government will not promulgate similar rules, regulations or policies in the future, particularly during periods when public opinion does not favor Internet games. Such rules, regulations and policies may significantly reduce our revenues and net income from Internet games and materially and adversely affect our business, financial condition, results of operations and prospects. See “Item 4 — Information on the Company — Regulation.”

The PRC government or the telecommunications operators may prevent us from distributing, and we may be subject to sanctions for, content that any of them believes is inappropriate.

The PRC government has promulgated regulations governing telecommunications service providers, Internet access, the distribution of news and other information and the operation of Internet games. In the past, the PRC government has stopped the distribution of information over the Internet that it believes violates PRC law, including content that it deems to be obscene, to incite violence, to endanger national security, to be contrary to the national interest or to be defamatory. The telecommunications operators also have their own policies that restrict the distribution by WVAS providers they deem inappropriate. For instance, they have punished certain providers for distributing content deemed by them to be obscene. These punishments have included censoring of content, delays in payments of fees by the telecommunications operators to the offending service provider, forfeiture of fees owed by the telecommunications operators to the offending service provider and suspension of the service on the telecommunications operators' networks. Accordingly, even if we comply with PRC governmental regulations relating to licensing and foreign investment restrictions, if the PRC government or the telecommunications operators were to take any action to limit or prohibit the distribution of information we provide or to limit or regulate any current or future content or services available to our users, our revenues could be materially reduced, and traffic to our reputation could be severely damaged.

Network interruptions, security breaches or computer virus attacks could have a material adverse effect on our business, financial condition and results of operations.

Any failure to maintain the satisfactory performance, reliability, security and availability of our network infrastructure may cause significant harm to our reputation and our ability to attract and maintain users. Major risks involved in such network infrastructure include, among others, any breakdowns or system failures resulting in a prolonged shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power outages, or effort to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware. In addition, certain players of our Internet games may attempt to obtain unauthorized access to our Internet games to gain unfair advantages in the games. The growth of our business may also be inhibited if the public concern over the security and privacy of confidential user information transmitted over the Internet and wireless networks is not adequately addressed.

Our network systems are vulnerable to damage from fire, flood, power loss, telecommunications failures, computer viruses, hackings and other similar events. Any network interruption or inadequacy that causes interruptions in the availability of our services or deterioration in the quality of access to our services could reduce our user satisfaction and our competitiveness. In addition, any security breach caused by hacking, which involves effort to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could have a material adverse effect on our business, financial condition and results of operations. We do not maintain insurance policies covering losses relating to our systems, and we do not have business interruption insurance.

If we are unable to respond successfully to technological or industry developments, our business and prospects may be materially and adversely affected.

The WVAS, mobile games and Internet games industries are characterized by rapid advances in technology, industry standards and customer demands. In particular, new technologies, industry standards or market demands may render our existing products, services or technologies less competitive or even obsolete. Moreover, telecommunications operators in the PRC are currently in the process of expanding 3G telecommunications services, while a number of different types of more advanced smart phone platforms have already entered the PRC market and are increasingly popular. Responding and adapting to the growing 3G telecommunications market and other technological developments and standard changes in our industry may require substantial time, effort and capital investment. In addition, updating and developing our proprietary game engines and game development platforms may also require significant expenditures in research and development. If we are unable to respond successfully to technology, industry and market developments, these developments may materially and adversely affect our business, financial condition and results of operations as well as our competitiveness.

Risks Relating to the PRC

Substantially all of our assets are located in the PRC and substantially all of our revenues are derived from our operations in the PRC. Accordingly, our financial condition and results of operations are subject, to a significant extent, to the economic, political and legal developments in the PRC.

Substantially all of our assets and end customers are located in the PRC. Accordingly, our business, financial condition, results of operations and prospects are, to a significant degree, subject to the economic, political and social conditions in the PRC. Although the PRC has been one of the world's fastest-growing economies in terms of GDP since 1978, we cannot assure you that such growth will be sustained in the future. Moreover, any negative development in the economies of the United States, the European Union and certain Asian countries may adversely affect economic growth in the PRC.

In addition, the PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. Although the PRC economy has experienced significant growth over the past decades, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures may benefit the overall PRC economy but have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. However, we cannot assure you that the PRC economy will sustain this rate of growth in the future.

Although the PRC government has implemented measures since the late 1970s emphasizing the use of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in the PRC is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over PRC economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. We cannot assure you that the PRC's economic, political or legal systems will not develop in a way that is detrimental to our business, financial condition and results of operations.

Government control of currency conversion may adversely affect our financial condition and results of operations.

We receive substantially all of our revenues in Renminbi, which currently is not a freely convertible currency. A portion of these revenues must be converted into other currencies to meet our foreign currency obligations including, among others, payment of dividends declared, if any, in respect of our ordinary shares.

Under the PRC's existing foreign exchange regulations, our subsidiaries, KongZhong Beijing, KongZhong China and Simlife Beijing, are able to pay dividends in foreign currencies without prior approval from SAFE, by complying with certain procedural requirements. However, we cannot assure you that the PRC government will not take measures in the future to restrict access to foreign currencies for current account transactions.

Foreign exchange transactions under the capital accounts of our subsidiaries, KongZhong Beijing, KongZhong China and Simlife Beijing, and of our operating companies, Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, continue to be subject to significant foreign exchange controls and require the approval of PRC governmental authorities, including the SAFE. In particular, if KongZhong Beijing, KongZhong China or Simlife Beijing borrow foreign currency loans from us or other foreign lenders, these loans must be registered with SAFE, and if we finance KongZhong Beijing, KongZhong China or Simlife Beijing by means of additional capital contributions, these capital contributions must be approved by certain government authorities including the Ministry of Commerce or its local counterparts. In addition, if we finance Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli or Dacheng by loans, we must obtain approval from SAFE. These limitations could affect the ability of KongZhong Beijing, KongZhong China, Simlife Beijing, Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli or Dacheng to obtain foreign exchange through debt or equity financing.

PRC regulations relating to offshore investment activities by PRC residents may increase the administrative burden we face and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by holders of our ordinary shares or ADSs who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose us and the PRC

resident holders of our ordinary shares or ADSs to liability under PRC law.

SAFE has promulgated regulations that require PRC residents and PRC corporate entities to register with and obtain approvals from relevant PRC government authorities in connection with their direct or indirect offshore investment activities. These regulations may apply to holders of our ordinary shares and ADSs who are PRC residents in connection with our prior and any future offshore acquisitions.

The relevant SAFE regulation required registration by March 31, 2006 of direct or indirect investments previously made by PRC residents in offshore companies prior to the implementation of the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-Raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies on November 1, 2005. If a PRC holder of our ordinary shares or ADSs with a direct or indirect stake in an offshore parent company fails to make the required SAFE registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange restrictions.

Those of our Directors and senior officers who are holders of our ordinary shares or ADSs and PRC residents have informed us that they have made the necessary applications and filings, as required under this regulation. However, there is uncertainty concerning the reconciliation of this regulation with other approval requirements, and it is unclear how the regulation, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended, implemented or enforced by the relevant government authorities. The failure or inability of any PRC resident holder of our ordinary shares or ADSs to obtain any required approvals or make any required registrations may subject us to fines and other legal sanctions, and prevent us from being able to make distributions or pay dividends.

We may be subject to fines and legal sanctions if we or our employees who are PRC citizens fail to comply with the PRC regulations relating to employee share options granted by overseas listed companies to PRC citizens.

In February 2012, SAFE promulgated the Notice Relating to Foreign Exchange Administration for Domestic Individuals Participating in the Stock Incentive Plans of Overseas-Listed Companies, or SAFE Notice 7, replacing the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Company promulgated in March 2007, or SAFE Notice 78. Under SAFE Notice 7, PRC individuals and foreign citizens who have been a resident of the PRC for one year or more, or, collectively, Domestic Individuals, participating in a stock incentive plan of an overseas-listed company, are required, through a PRC domestic agent to register with SAFE and complete certain other procedures. Such PRC domestic agent should be a PRC subsidiary of the overseas-listed company or a qualified domestic institution selected by the PRC subsidiary. As we are an overseas-listed company, we and those employees deemed to be Domestic Individuals and who have been granted share options and/or restricted share units under our equity incentive plans are subject to SAFE Notice 7. We and those employees subject to SAFE Notice 7 intend to make such application and complete all the requisite procedures. In 2009 and 2010, we registered, and registered on behalf of those employees subject to SAFE Notice 7, with the relevant local SAFE branches our previously adopted employee stock incentive plans, pursuant to regulations promulgated under SAFE Notice 78.. However, there exist significant uncertainties in practice with respect to the interpretation and implementation of SAFE Notice 7, and we cannot assure you that our registration under SAFE Notice 78 would be sufficient for compliance with SAFE Notice 7. If SAFE or other PRC governmental authorities determine that we or those of our employees subject to SAFE Notice 7 have failed to comply with the provisions of SAFE Notice 7, we or they may be subject to fines and legal sanctions, which could have a material adverse effect on the implementation of our equity incentive plans and our ability to attract and retain qualified personnel, as well as our business and prospects. See “Item 4 — Information on the Company — Regulation — Regulation of Share Options and Restricted Share Units.”

Fluctuation of the Renminbi could adversely affect the value of and dividends payable on our ADSs.

The value of the Renminbi fluctuates and is subject to changes in PRC political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the PRC government’s new policy, the Renminbi is permitted to fluctuate within a managed band against a basket of certain foreign currencies. Although daily fluctuations of the Renminbi against the basket of currencies are

currently limited to 1.0% per day, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the long term. On June 20, 2010, the People's Bank of China, or the PBOC, announced that the PRC government would further reform the Renminbi exchange rate regime and increase the flexibility of the exchange rate, and on April 14, 2012, the PBOC announced that, effective as of April 16, 2012, the Renminbi is permitted to fluctuate with a band of 1.0% per day, doubling the previous announced fluctuation limit of 0.5% per day. We cannot assure you that the Renminbi will not be permitted to enter into a free float, which also may result in a significant appreciation or depreciation of the Renminbi against the U.S. dollar. As we receive substantially all of our revenues in Renminbi and a majority of our cash and cash equivalents are denominated in Renminbi, any fluctuation in the exchange rate against the U.S. dollar will affect our balance sheet and earnings per share in U.S. dollar terms and the value of dividends, if any, payable on our ordinary shares in U.S. dollar terms and the value of any U.S. dollar-denominated investments we may make in the future. As of December 31, 2013, we had cash and cash equivalents in the amount of US\$123.4 million. A 1.0% appreciation of the Renminbi against the U.S. dollar will result in an estimated increase of approximately US\$1.0 million in our total amount of cash and cash equivalents, and a 1.0% appreciation of the U.S. dollar against the Renminbi will result in a decrease of approximately US\$1.0 million in our total amount of cash and cash equivalents. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk.

The discontinuation of any of the preferential tax treatments available to us in the PRC or the rejection of our application for preferential tax treatments could adversely affect our business, operating results and financial condition.

On March 16, 2007, the National People's Congress adopted the Enterprise Income Tax Law, or the New EIT Law, which became effective on January 1, 2008. It imposes a tax rate of 25% on all foreign-invested enterprises, and terminates many of the tax exemptions, reductions and preferential treatments available under previous tax laws and regulations. However, under the New EIT Law and its implementation rules, "high-and-new technology enterprises strongly supported by the State," or HNTE, are entitled to a preferential tax rate of 15%, and "software enterprises" are entitled to an income tax exemption for two years beginning with their first profitable year and a 50% tax reduction to a rate of 12.5% for the subsequent three years. In 2008 and 2011, KongZhong Beijing, Beijing AirInbox, BJXR and Tianjin Mammoth were granted the HNTE status by the PRC tax authority under the New EIT Law. In 2009 and 2012, KongZhong China, Beijing Chengxitong and Beijing WINT were granted the HNTE status by the PRC tax authority under the New EIT Law. As of December 31, 2013, Beijing AirInbox, KongZhong China, Dacheng, Xinreli, Brilliant Game and Tianjin Mammoth were qualified as "software enterprise" by the local industry and information technology department. However, we cannot assure you that the PRC tax authorities or local industry and information technology department will not revoke the HNTE status or "software enterprise" status of such companies or that we will be able to renew the HNTE status or "software enterprise" status for these companies in the future. The loss of preferential tax treatments by our subsidiaries and/or operating entities could materially reduce our net income and cash flows.

We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiaries may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC.

Pursuant to the New EIT Law and Enterprise Income Tax Law Implementation Rules under the New EIT Law, or the New EIT Implementation Regulation, enacted by the State Council on December 6, 2007 and which became effective on January 1, 2008, an enterprise established under the laws of a foreign country or region whose "de facto management body" is located within the PRC territory is considered a resident enterprise and will generally be subject to the enterprise income tax at the rate of 25% on its global income. According to the New EIT Implementation Regulation, "de facto management body" refers to a managing body that exercises, in substance, overall management and control over the production and business, personnel, accounting and assets of an enterprise. The PRC State Administration for Taxation, or the SAT, issued the Notice on Issues Relating to Determination of Chinese-Controlled Offshore Enterprises as PRC Resident Enterprises by Applying the "De Facto Management Body" Test, or the SAT Notice 82, on April 22, 2009. The SAT Notice 82 provides for certain specific criteria for determining whether the "de facto management body" of a Chinese-controlled offshore enterprise is located in the PRC. Although the SAT Notice 82 provides that it only applies to offshore enterprises controlled by PRC enterprises, not those controlled by PRC individuals, like our company, it is generally believed that the determining criteria set forth in the SAT Notice 82 very likely reflect the SAT's general position as to how the "de facto management body" test should be applied to determine the tax residency of all offshore enterprises, regardless of whether they are controlled by PRC enterprises or individuals. We believe that we are not a PRC resident enterprise on the basis of the fact that (i) we are a Cayman Islands company that was incorporated outside the PRC and (ii) the SAT Notice 82 does not, on its face, apply to companies that are controlled by PRC individuals. However, if we were considered a PRC resident enterprise, we

would be subject to the enterprise income tax at the rate of 25% on our global income. In such case, our profitability and cash flow would be adversely affected as a result of our global income being taxed under the New EIT Law.

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If we are considered as a non-resident enterprise under the New EIT Law, we will not be subject to the enterprise income tax at the rate of 25% on our global income. In such case, however, dividends we receive from our PRC subsidiaries will be subject to a PRC withholding tax, the standard rate for which is 10%, subject to reductions pursuant to any applicable tax treaty. To the extent we are considered as a non-resident enterprise, dividends we receive from our PRC subsidiaries will be subject to the standard rate of 10%. Such withholding tax will increase our tax burden and reduce the amount of cash available to our company.

Dividends payable by us to our non-PRC shareholders and ADS holders, and gains on the sales of our ordinary shares or ADSs, may be subject to withholding taxes under PRC tax laws, which may materially reduce the value of your investment.

Prior to January 1, 2008, dividends payable to non-PRC investors were exempted from withholding tax. The New EIT Law and the New EIT Implementation Regulation, both of which became effective on January 1, 2008, provide that an income tax rate of 10% (subject to reductions pursuant to any tax treaties between the PRC and other jurisdictions) will generally be applicable to dividends payable to non-PRC investors that are derived from sources within the PRC, provided that dividends are not subject to the 10% tax if they are paid out of distributable profits accumulated before January 1, 2008. Similarly, any gain realized on the transfer of shares by such investors is also subject to 10% tax if such gains are regarded as income derived from sources within the PRC.

We are a Cayman Islands holding company, and substantially all of our income may come from dividends we receive from our subsidiaries located in the PRC. As a result, dividends we receive from our PRC subsidiaries may be subject to withholding tax under the New EIT Law. See “Item 3 — Key Information — Risk Factors — Risks Relating to the PRC — We may be subject to PRC income tax on our global income, or dividends we receive from our PRC subsidiary may be subject to PRC withholding tax, depending on whether we are recognized as a resident enterprise in the PRC.” If we are recognized as a qualified PRC resident enterprise, the dividends we receive from our subsidiaries in the PRC will not be subject to any withholding tax. However, our dividends payable to our non-PRC shareholders and ADS holders would be subject to withholding tax under the New EIT Law.

If dividends we receive from our PRC subsidiaries or dividends payable to our non-PRC shareholders and ADS holders are subject to withholding tax under the New EIT Law, or if non-PRC foreign shareholders and ADS holders are required to pay PRC income tax on the transfer of their ordinary shares or ADSs, the value of your investment may be materially reduced.

Uncertainties in the interpretation and enforcement of PRC laws, rules and regulations could limit the legal protections available to you and us.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. Although legislation in the PRC over the past 30 years has significantly improved the protection afforded to various forms of foreign investment and contractual arrangements in the PRC, these laws, regulations and legal requirements are relatively new and their interpretation and enforcement involve uncertainties, which could limit the legal protection available to us and foreign investors, including you. In addition, the PRC government may enact new laws or amend current laws that may be detrimental to our current contractual arrangements with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, which may in turn have a material adverse effect on our business and prospects.

You may experience difficulties in effecting service of legal process and enforcing judgments against us and our management.

We are a company incorporated under the laws of the Cayman Islands, and our subsidiary and substantially all of our assets are located outside the United States. In addition, most of our Directors and officers and their assets are located outside the United States. As a result, it may not be possible to effect service of process within the United States upon our Directors or officers, including with respect to matters arising under U.S. Federal securities laws or applicable state securities laws.

Our PRC legal counsel, Commerce & Finance, has advised us that the PRC does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom or most other Western countries. As a result, recognition and enforcement in the PRC of judgments of a court obtained in those jurisdictions may be difficult or impossible.

We have been advised by Maples and Calder, our Cayman Islands legal advisers, that although there is no statutory enforcement in the Cayman Islands of judgments obtained in the United States, or any state thereof, a judgment obtained in the United States, or any state thereof, will be recognized and enforced in the courts of the Cayman Islands under common law, without any re-examination of the merits of the underlying dispute, by an action commenced on the foreign judgment debt in the Grand Court of the Cayman Islands, provided that such judgment (i) was given by a foreign court of competent jurisdiction; (ii) imposes on the debtor a liability to pay a liquidated sum for which the judgment has been given; (iii) is final; (iv) is not in respect of taxes, a fine or a penalty; and (v) was not obtained in a manner and is not of a kind of enforcement that is contrary to natural justice or the public policy of the Cayman Islands.

Proceedings instituted by the SEC against five PRC-based accounting firms, including our independent registered public accounting firm, could result in financial statements being determined to not be in compliance with the requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act.

In late 2012, the SEC commenced administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the PRC affiliates of the “big four” accounting firms (including our auditors), and also against Dahua (the former BDO affiliate in China), which we refer to hereinafter as the Rule 102(e) proceedings. The Rule 102(e) proceedings relate to the inability of these firms to produce documents, including audit work papers, in response to the request of the SEC pursuant to Section 106 of the Sarbanes-Oxley Act of 2002, as the auditors located in the PRC are not in a position to produce documents directly to the SEC due to restrictions under applicable PRC law and specific directives issued by the CSRC. The issues raised by the proceedings are not specific to our independent registered public accounting firm or to us, but affect equally all audit firms based in China and all China-based businesses with securities listed in the United States.

In an Initial Decision dated January 22, 2014 (Initial Decision Release No. 533; Administrative Proceeding File Nos. 3-14872, 3-15116), which we refer to hereinafter as the Initial Decision, the SEC administrative law judge held that the PRC affiliates of the “big four” accounting firms should be barred from practicing before the SEC for six months. However, it is currently impossible to determine the ultimate outcome of this matter as the accounting firms have filed a Petition for Review of the Initial Decision and pending that review the effect of the Initial Decision is suspended. The SEC Commissioners will review the Initial Decision, determine whether there has been any violation and, if so, determine the appropriate remedy to be placed on these audit firms. Once such an order was made, the accounting firms would have a further right to appeal to the US federal courts, and the effect of the order might be further stayed pending the outcome of that appeal, although there can be no assurance given regarding the eventual outcome.

Depending upon the final outcome, we may find it difficult or impossible to retain auditors in respect of our operations, which could result in our financial statements being determined to not be in compliance with the requirements of the Exchange Act, including possible delisting of our securities from the Nasdaq Global Select Market. Moreover, any negative news about the proceedings against the audit firms may cause uncertainty that could result in significant decrease in the market price of our ADSs.

Item 4. Information on the Company

History and Development of the Company

We were incorporated on May 6, 2002 under the laws of the Cayman Islands as Communication Over The Air Inc., an exempted limited liability company. In March 2004, we changed our name to KongZhong Corporation. We are headquartered in Beijing, the PRC.

We are one of the leading providers of WVAS to mobile phone users and have been cooperating with all major telecommunications operators in the PRC since 2002. In 2005, we began providing feature phone mobile games on the networks of China Mobile with the acquisition of Tianjin Mammoth, a feature phone mobile games developer. To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android.

We commenced our Internet games business in 2010 through our acquisition of Dacheng, a developer and operator of Internet games in the PRC. In addition to developing and operating our self-developed Internet games, such as Loong, Demon Code and Kung Fu Hero, we are the exclusive operator of the popular World of Tanks game for the PRC Internet games market.

In January 2007, we established a wholly owned subsidiary, Monkey King Search Corporation, or Monkey King, under the laws of the Cayman Islands, in an effort to develop our wireless search business. Monkey King in turn established its own wholly owned subsidiary, Wukong Shentong, under the laws of the PRC. After developing our wireless search business through Monkey King and Wukong Shentong for a period of time, in September 2008, we decided to terminate our project of developing a wireless search business and liquidate Monkey King and Wukong Shentong, which did not have significant business activities at the time. We completed the liquidation of Wukong Shentong in July 2010. As part of the winding-up of the businesses of Monkey King and Wukong Shentong, we sold certain assets of these companies to Nick Yang, the former Vice Chairman of our Board of Directors. See “Item 7 — Major Shareholders and Related Party Transactions — Related Party Transactions.” In July 2008, we liquidated Beijing Shuziyuansu Advertising Co., Ltd., a company formerly owned by two of our operating companies, Beijing Boya Wuji and Beijing WINT, because it had not had any operating activity since its incorporation in September 2005. In July 2008, BJXR, one of our operating companies, established its own subsidiary, Beijing Shiyuan Leya, which operates certain types of our WVAS business. We completed the liquidation of Anjian Xingye Technology (Beijing) Co., Ltd., or Anjian Xingye, our wholly foreign owned enterprise in the PRC, in May 2010. In July 2012, Beijing AirInbox established its own subsidiary, Brilliant Game, which operates certain types of our Internet games.

We conduct substantially all of our business in the PRC through our wholly owned subsidiaries in the PRC, KongZhong Beijing, KongZhong China and Simlife Beijing. In order to meet domestic ownership requirements under PRC laws, which restrict us and our PRC subsidiaries, as either foreign or foreign-invested companies, from operating certain value-added telecommunications, Internet services and Internet games businesses. We operate WVAS, mobile games and Internet games through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, all of which are based in the PRC and are wholly owned by PRC citizens. We do not have any equity interests in Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli or Dacheng, but enjoy the economic benefits of these companies through a series of contractual arrangements as described below.

Our principal executive office is located at 35th Floor, Tengda Plaza, No. 168, Xizhimenwai Street, Beijing, 100044, the PRC. Our telephone number is (8610) 8857-6000. The address of our primary website is www.KongZhong.com. Information contained on our website does not constitute a part of the annual report.

In July 2004, we completed the initial public offering of our ADSs representing our ordinary shares and listed the ADSs on the NASDAQ Global Market, or NASDAQ. Effective January 1, 2008, our ADSs are listed on the NASDAQ Global Select Market.

Investments and Acquisitions

We have made a number of acquisitions and received a number of outside investments during our history. Set forth below are the most significant acquisitions and investments in our history.

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In March 2009, we issued to NGP a convertible senior note due in 2014 with an aggregate principal amount of US\$6,775,400, convertible into our ordinary shares. NGP also received a warrant to purchase up to 80 million of our ordinary shares at US\$0.125 per ordinary share, exercisable within five years. The issuance of the convertible senior note and warrant was completed in March 2009. In February 2011, we prepaid 70% of the aggregate principal amount, plus any accrued but unpaid interest thereof, of the convertible senior note for US\$9.31 million in cash. Subsequently, on March 1, 2012, NGP fully converted the convertible senior note into 22.8 million of our ordinary shares, which is equivalent to 570,000 of our ADSs, at a conversion price of US\$0.08915 per ordinary share (equivalent to US\$3.6 per ADS), representing approximately 1.0% of our total shares outstanding as of March 31, 2012. In August 2012, NGP transferred a warrant to purchase up to 40 million of our ordinary shares, exercisable prior to March 18, 2014, which constituted 50% of the original warrant, to Fit Run Limited. We consented to this transfer and, in exchange for the original warrant, issued a new warrant to purchase up to 40 million of our ordinary shares, exercisable prior to March 18, 2014, to NGP.

On December 15, 2009, we entered into a definitive share purchase agreement to acquire Dacheng. We agreed to pay up to US\$80 million, in a mix of cash and our ordinary shares, to Dacheng's shareholders, based on Dacheng's 2010 net profit after tax as calculated under U.S. GAAP. Dacheng agreed to engage in a reorganization whereby an offshore holding company would be established, and Dacheng would enter into certain contractual arrangements with such holding company and/or its subsidiary that would allow the holding company to enjoy, among other things, the economic benefits of Dacheng's operations. On January 13, 2010, we amended the original share purchase agreement to permit one of our subsidiaries to enter into a series of contractual arrangements with Dacheng that allowed us to consolidate Dacheng's financial results. Subsequently, the reorganization was completed and we acquired the holding company. In March 2011, we completed the last payment due to Dacheng's shareholders under the share purchase agreement. The total consideration paid for the acquisition of Dacheng was US\$68.0 million, including US\$24.2 million in cash and 166,292,783 million of our ordinary shares. Dacheng is a leading developer of 3D massive multiplayer online role-playing games, or MMORPGs. For a further description of this transaction, see "Item 7 — Major Shareholders and Related Party Transactions — Related Party Transactions."

On February 15 and February 10, 2012, respectively, we entered into definitive agreements to acquire 100% of the equity interest in Noumena Innovations (BVI) Ltd., or Noumena, and certain assets from a related party of Noumena for a total consideration of US\$15 million in cash and 40 million of our ordinary shares. Noumena is a developer of cross-platform smartphone mobile game engines. The Handymo game engine, which Noumena developed, enables a proprietary JavaScript-based development environment and supports all major smartphone mobile game platforms, including iOS and Android, among other platforms. We completed the acquisition in March 2012.

In January 2014, we entered into a definitive agreement to acquire approximately 28.6 million series A preferred shares in Ourgame International Holdings Limited, or LianZhong, for a total consideration of approximately US\$16.4 million. The series A preferred shares may be converted into such number of ordinary shares of LianZhong as is determined by dividing the subscription price per series A preferred share by the then applicable conversion price per series A preferred share, at any time following the completion date of the acquisition, provided that all the outstanding series A preferred shares shall be converted into ordinary shares immediately preceding the occurrence of an initial public offering by LianZhong. The series A preferred shares we acquired account for 10% of LianZhong's issued share capital on a fully diluted basis upon completion of the acquisition. LianZhong is one of the leading providers of

Internet-based casual board and card games in the PRC. The acquisition was completed in February 2014.

Our Corporate Structure

The chart below sets forth our corporate and share ownership structure as of March 31, 2014.

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We do not have any ownership interest in Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, (1)Mailifang, Xinreli or Dacheng. Our wholly owned subsidiaries have entered into a series of contractual arrangements with these companies and/or their respective shareholders.

The applicable PRC regulations currently restrict foreign ownership of companies that provide value-added telecommunications services, which include WVAS, or operate Internet games. See also “— Regulation.” To comply with PRC regulations, we conduct substantially all of our wireless value-added, mobile games and Internet games operations and generate substantially all of our revenues through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, which are wholly owned by PRC citizens, and their subsidiaries. Our operations not conducted through such consolidated variable interest entities primarily consist of our smartphone games business. In 2013, our consolidated variable interest entities accounted for an aggregate of 97.4% of our total revenue. As of December 31, 2013, our consolidated variable interest entities accounted for an aggregate of 62.0% of our total assets and 88.6% of our total liabilities. The assets not associated with our consolidated variable interest entities primarily consist of cash and cash equivalents, goodwill and intangible assets.

Beijing AirInbox is 45% owned by Linguang Wu, one of our former employees; 10% owned by Guijun Wang, one of our former employees; 42% owned by Songlin Yang, uncle of Nick Yang, the former Vice Chairman of our Board of Directors; and 3% owned by Zhen Huang, wife of Nick Yang. Beijing Chengxitong is 90.1% owned by Yang Li and 9.9% owned by Xuelei Wu, both of whom are our former employees. Beijing WINT is 40% owned by Yang Yang, one of our employees, 30% owned by Jingye Sun and 30% owned by Li Ai, both of whom are our former employees. BJXR is 51% owned by Guijun Wang and 49% owned by Yang Li, both of whom are our former employees. Dacheng is 40.8% owned by Zhen Yang and 59.2% by Leilei Wang, both of whom are our employees. Xinreli is 80% owned by Tao Jia, one of our employees, and 20% owned by Junhong Chen, one of our former employees. Mailifang is 90% owned by Xu Guo and 10% owned by Yang Yang, both of whom are our employees. Zhulang is 100% owned by Beijing Chengxitong. Beijing Boya Wuji is 100% owned by Beijing AirInbox. Tianjin Mammoth is 95% owned by Beijing AirInbox and 5% owned by Beijing WINT. Shenzhen Zhida is 100% owned by Beijing WINT.] Beijing Yin’ao Fulai Culture Development Co., Ltd., or Beijing Yin’ao, is 100% owned by BJXR. Beijing Shiyuan Leya is 100% owned by BJXR. Wuxi Dacheng Network Technology Co., Ltd., or Wuxi Dacheng, is 100% owned by Dacheng. Beijing Shangshu Boer Culture Communication Co., Ltd., or Beijing Shangshu, is 100% owned by BJXR. Brilliant Game is 100% owned by Beijing AirInbox. We completed the liquidation of Shenzhen Zhida Network Technology Co., Ltd. in March 2013, and the liquidation of Wuxi Dacheng in September 2013.

We do not have any equity interests in Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli or Dacheng, or their subsidiaries, but instead have effective control over and enjoy the economic benefits of these companies through a series of contractual arrangements, which we and our subsidiaries, KongZhong China, KongZhong Beijing and Simlife Beijing, have entered into with these companies and/or their respective shareholders as described below. For a further description of each of these agreements, see “Item 7 — Major Shareholders and Related Party Transactions — Related Party Transactions.”

Each of Beijing AirInbox, Beijing WINT, Beijing Chengxitong, Mailifang and their respective shareholders also has entered into an exclusive share option agreement with KongZhong Beijing. Pursuant to these agreements, each of the shareholders of Beijing AirInbox, Beijing WINT, Beijing Chengxitong and Mailifang has granted an exclusive option to KongZhong Beijing or our designees to purchase all or part of such shareholder’s equity interest in Beijing AirInbox, Beijing WINT, Beijing Chengxitong or Mailifang, as the case may be, in accordance with PRC laws, and has agreed not to encumber such equity interest in any manner other than as permitted by KongZhong Beijing.

KongZhong Beijing has entered into business operation agreements with each of Beijing AirInbox, Beijing WINT, Beijing Chengxitong, Mailifang and their respective shareholders. Pursuant to these agreements, Beijing AirInbox, Beijing WINT, Beijing Chengxitong, Mailifang and their respective shareholders agreed to appoint individuals designated by KongZhong Beijing to the management team of Beijing AirInbox, Beijing WINT, Beijing Chengxitong and Mailifang and to refrain from taking certain actions that may materially affect these companies’ operations. Each of the shareholders of Beijing AirInbox, Beijing WINT, Beijing Chengxitong and Mailifang also has executed an irrevocable power of attorney in favor of individuals designated by KongZhong Beijing. Pursuant to these powers of attorney, those designated individuals have full power and authority to exercise all of such shareholders’ rights with respect to their equity interests in Beijing AirInbox, Beijing WINT, Beijing Chengxitong or Mailifang.

KongZhong Beijing has entered into technical and consulting services agreements with each of Beijing AirInbox, Beijing Boya Wuji, Beijing WINT, Beijing Chengxitong and Mailifang. These technical and consulting services agreements may only be terminated or renewed at KongZhong Beijing’s sole discretion. Pursuant to these technical and consulting services agreements, KongZhong Beijing provides certain technical and consulting services to Beijing AirInbox, Beijing Boya Wuji, Beijing WINT, Beijing Chengxitong and Mailifang in exchange for service fees. KongZhong Beijing has the sole discretion to determine the amounts of the technical and consulting service fees. Each of the shareholders of Beijing AirInbox, Beijing WINT, Beijing Chengxitong and Mailifang has also entered into an equity pledge agreement with KongZhong Beijing, pursuant to which these shareholders pledged their respective interests in Beijing AirInbox, Beijing WINT, Beijing Chengxitong or Mailifang, as the case may be, to guarantee the performance of such companies’ payment obligations under the respective technical and consulting services agreements.

Each of BJXR, Dacheng and their respective shareholders has entered into an exclusive share option agreement with KongZhong China. Pursuant to these agreements, each of the shareholders of BJXR and Dacheng has granted an exclusive option to KongZhong China or our designees to purchase all or part of such shareholder’s equity interest in BJXR or Dacheng, as the case may be, in accordance with PRC law and has agreed not to encumber such equity

interest in any manner other than as permitted by KongZhong China. The purchase price is equal to the respective audited net asset value of the variable interest entities or the minimum price required under applicable PRC laws at the time of such purchase. KongZhong China has also entered into a business operation agreement with each of BJXR, Dacheng and their respective shareholders. Pursuant to these agreements, BJXR, Dacheng and their respective shareholders agreed to appoint individuals designated by KongZhong China to the management team of BJXR and Dacheng and to refrain from taking certain actions that may materially affect the operations of these companies. Each of the shareholders of BJXR and Dacheng also has executed an irrevocable power of attorney in favor of individuals designated by KongZhong China. Pursuant to these powers of attorney, those designated individuals have full power and authority to exercise all of such shareholders' rights with respect to their equity interests in BJXR or Dacheng. KongZhong China has entered into a technical and consulting services agreement with each of BJXR and Dacheng. These technical and consulting services agreements are automatically renewed and may only be terminated at KongZhong China's sole discretion. Pursuant to these technical and consulting services agreements, KongZhong China provides certain technical and consulting services to BJXR and Dacheng in exchange for service fees. KongZhong China has the sole discretion to determine the amounts of the technical and consulting service fees. Each of the shareholders of BJXR and Dacheng has entered into an equity pledge agreement with KongZhong China, pursuant to which these shareholders pledged their respective interests in BJXR or Dacheng, as the case may be, to guarantee the performance by these companies of their payment obligations under the technical and consulting services agreements.

Xinreli and its shareholders have entered into an option agreement with Simlife Beijing. Pursuant to this agreement, each of the shareholders granted Simlife Beijing an option to purchase all their respective interests in Xinreli for the lowest price permitted by applicable PRC law by Simlife Beijing or its designated third party. Simlife Beijing has also entered into a business operation agreement with Xinreli and its shareholders. Pursuant to this agreement, Xinreli and its shareholders will elect designees of Simlife Beijing as the executive directors of Xinreli, and will appoint designees of Simlife Beijing as the general manager, chief financial officer and other senior officers of Xinreli. Each of the shareholders has also agreed to execute an irrevocable power of attorney to grant the designees of Simlife Beijing full power and authority to exercise all of the respective shareholders' rights in Xinreli. Pursuant to these powers of attorney, those designated individuals have full power and authority to exercise all of such shareholders' rights with respect to their equity interests in Xinreli. In addition, Simlife Beijing has entered into an exclusive technical and consulting services agreement with Xinreli. This technical and consulting services agreement may only be terminated at Simlife Beijing's sole discretion. Pursuant to this agreement, Simlife Beijing will provide certain technical and consulting services to Xinreli on an exclusive basis. Simlife Beijing has the sole discretion to determine the amounts of the technical and consulting service fees. Each of the shareholders of Xinreli has also entered into an equity pledge agreement with Simlife Beijing, pursuant to which these shareholders pledged their respective interests in Xinreli to guarantee the normal collection of technical service fees by Simlife Beijing under the exclusive technical and consulting services agreement and to ensure the performance of obligations under the business operation agreement and option agreement.

In the opinion of our PRC legal counsel, Commerce & Finance, each of the agreements constitutes a valid and legally binding obligation of each party to such contractual agreements under PRC laws. In addition, Commerce & Finance, is of the opinion that, with respect to Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, no consent, approval or license, other than those already obtained, is required under any existing PRC laws, rules and regulations for the effectiveness and enforceability of the contractual arrangements, businesses and operations of these companies. However, there are substantial uncertainties regarding the interpretation and implementation of current PRC laws, rules and regulations. See “— Regulation” and “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — If the PRC government finds that the agreements that establish the structure for operating our business do not comply with PRC government restrictions on foreign investment in the value-added telecommunications industry, we could be subject to severe penalties,” and “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — Our contractual arrangements with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.” As discussed in those risk factors, certain events may cause us to lose the benefits and control intended to be created by these arrangements.

Capital Expenditures and Divestitures

See “Item 5 — Operating and Financial Review and Prospects — Capital Expenditures” for information concerning our principal capital expenditures since our inception and those planned for 2014. We have not undertaken any significant divestitures and do not have any significant divestitures currently in progress.

Business Overview

We are one of the leading providers of digital entertainment services for consumers in the PRC. We operate three main business units, namely WVAS, mobile games and Internet games. We are one of the leading providers of WVAS to mobile phone users and have been in cooperation with all major telecommunications operators in the PRC since 2002. In 2005, we began providing feature phone mobile games on the networks of China Mobile with the acquisition of Tianjin Mammoth, a feature phone mobile games developer. To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android. We commenced our Internet games business in 2010 through our acquisition of Dacheng, a developer and operator of Internet games in the PRC. In addition to developing and operating our self-developed Internet games, such as Loong, Demon Code and Kung Fu Hero, we are the exclusive operator of the popular World of Tanks game for the PRC Internet games market. In May 2012, we entered into a strategic partnership with WarGaming, which granted us the exclusive license to all of WarGaming's future games in the PRC, including but not limited to World of Tanks, World of Warplanes and World of Warships. In addition, as of December 31, 2013, we were also the exclusive licensee in the PRC for the Guild Wars 2 game developed by ArenaNet, Hawken game developed by Meteor Entertainment, Blitzkrieg 3 game developed by ZZima International Sarl, or ZZima, Auto Club Revolution game developed by Eutechnyx Limited, or Eutechnyx, and Guozhan Online game developed by Guangzhou Sixiang Internet Technology Co., Ltd., or Guangzhou Sixiang.

Our WVAS Business

We provide interactive entertainment, media and other interactive services to mobile phone users in China through various second generation standard, or 2G, technology platforms, including SMS, IVR and color ring back tone, or CRBT, and through various "second and a half" generation standard, or 2.5G, technology and operating platforms, including WAP and MMS, which offer higher quality graphics, richer content and more interactivity than 2G wireless services. Our WVAS are tailored to the technical or other requirements of our telecommunications operator partners, through whom we deliver most of our WVAS, and to various billing systems for WVAS. Our WVAS are also delivered and marketed through various media partners, including handset manufacturers, television stations, radio stations, print media and Internet sites. Our WVAS revenues accounted for 50.2%, 41.7% and 35.6% of our total revenues in 2011, 2012 and 2013, respectively.

We offer a variety of WVAS, such as mobile games, pictures, karaoke, electronic books, mobile phone personalization features, and entertainment news, chat and message boards. Customers can access these services directly from their mobile phones: (i) by using our access code or by choosing a feature pre-loaded in select models of handsets; and (ii) from a telecommunications operator's portal or website. Substantially all of our WVAS are ordered or accessed by users directly through their mobile phones, and all services are delivered through mobile phones.

We provide our services mainly pursuant to our cooperation arrangements with the telecommunications operators and their provincial subsidiaries, the terms of which are generally for one year or less. We do not directly bill our users, and depend on the billing systems and records of the telecommunications operators to bill and collect all fees. We generally do not have the ability to independently verify the accuracy of the billing systems of the telecommunications operators. As the telecommunications operators do not provide us with a detailed revenue breakdown on a service-by-service basis, we depend on our internal data management system to monitor revenues derived from each of our services. We make our business decisions based on our internal data, taking into account our historical experience in reconciling our internal data to our actual results of operations and other factors, including strategic considerations. See “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — 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.”

Our Mobile Games Business

We are a leading developer and publisher of mobile games for mobile phone users in the PRC. Our internal development team develops mobile games based primarily on the Java™ technology, but more recently we have broadened our development of mobile games to include smartphone mobile operation systems, such as iOS and Android. The mobile games we develop include action, role-playing and leisure games.

We established a dedicated mobile games product development team, and acquired Tianjin Mammoth, a mobile games developer, in 2005. In 2009, we acquired Simlife, a leading mobile games developer in the PRC. In 2012, we acquired Noumena, a developer of cross-platform smartphone mobile game engines. For a detailed description of the acquisitions, see “—Investments and Acquisitions.” We believe the integration of the Noumena team into our existing mobile game development team will enable us to create new smartphone mobile games that can take advantage of the Handymo game engine technologies developed by Noumena. We believe these new smartphone mobile games will enable us to leverage our existing mobile game distribution channels in China and capture market share in the nascent PRC smartphone mobile games market.

Our Internet Games Business

In January 2010, we acquired Dacheng and with it our Internet games business unit. We launched our self-developed 3D MMORPGs, Loong, EMoFaZe, XiaKeXing, ShengMoZhiXue, Kung Fu Hero, Kung Fu World and Master of Meteor Blades games from December 2009 to December 2013.

In 2010, we entered into a license agreement with WarGaming for the World of Tanks game. World of Tanks is a “freemium” 3D team-based massive multiplayer online game, featuring historic fighting vehicles from the 1930s to the 1950s. The initial term of the license is three years, commencing from the commercial release of the game. We have the exclusive right to copy, distribute, operate and sell the World of Tanks game in the PRC, Hong Kong and Macau during the term of the license. Our license payments to WarGaming consist of a fixed license fee in the amount of US\$500,000 and a certain percentage of our gross revenue received from the services and merchandise related to the World of Tanks game. In 2012, we amended our license agreement with WarGaming to extend the term of the license in perpetuity. In exchange for the extension, we granted WarGaming a warrant to purchase up to 120,000,000 of our ordinary shares (equivalent to 3 million of our ADSs) and increased the percentage of our gross revenue that we pay to WarGaming if the monthly gross revenue exceeds a specified target. Since its launch, the World of Tanks game has become one of the most popular games we offer. As of December 31, 2013, the World of Tanks game had been downloaded over 13.8 million times, with over 36.7 million registered users. As a result of the successful launching of the game, revenues generated from in-game items purchased by game players who play the World of Tanks game represented over 87% and 96% of our Internet games revenues in 2012 and 2013, respectively. In May 2012, we entered into a strategic partnership with WarGaming under which we enjoy exclusive rights to license all of WarGaming’s future games in the PRC. Under this partnership, we licensed World of Warplanes and World of Battleships games from WarGaming.

In April 2012, we agreed to license on an exclusive basis in the PRC a multiplayer online game known as Offensive Combat from U4iA Games, Inc., or U4iA Games. In 2013, due to U4iA Games’ inactive status and cessation of operations, we recognized a US\$1.56 million impairment loss on intangible assets and US\$2.0 million impairment loss on long term investments related to U4iA Games. As a result, our license for Offensive Combat was terminated.

In August 2012, we agreed to license on an exclusive basis in the PRC a multiplayer online game known as Hawken from Meteor Entertainment. The initial term of the license is three years, with further extensions upon our meeting certain conditions, commencing from the commercial release of the game. We have paid US\$1.25 million to Meteor Entertainment as a license fee before the secure public testing of the game and are obligated to pay royalties calculated based on revenues generated from the game after the launch of the game.

In August 2012, we agreed to license on an exclusive basis in the PRC the Guild Wars 2 game from ArenaNet. The initial term of the license is three years, with further extensions to be agreed among the parties, commencing from the secure public testing of the game. We have agreed to pay license fees and additional royalties calculated based on revenue generated from the game. To guarantee our payment obligations to ArenaNet, we have arranged a standby letter of credit with a maximum guarantee amount of US\$35 million from the Bank of Communications in ArenaNet's favor. We also entered into a back-to-back guarantee arrangement with the Bank of Communications.

In January 2013, we agreed to license on an exclusive basis in the PRC the Blitzkrieg 3 game from ZZima. The initial term of the license is three years, with further extensions to be agreed among the parties, commencing from the open beta test of the game. We have paid a license fee in the amount of US\$1 million to ZZima before the secure public testing of the game and have agreed to pay royalties calculated based on revenues generated from the game after the launch of the game. As of April 16, 2014, the Blitzkrieg 3 game has not been commercially released.

In April 2013, we agreed to license on an exclusive basis in the PRC the Auto Club Revolution game from Eutechnyx. The initial term of the license is three years, with further extensions upon our meeting certain conditions, commencing from the commercial release of the game. We have paid a license fee in the amount of US\$1.125 million to Eutechnyx before the secure public testing of the game and have agreed to pay royalties calculated based on revenues generated from the game after the launch of the game. As of April 16, 2014, the Auto Club Revolution game has not been commercially released.

In July 2013, we agreed to license on an exclusive basis in the PRC the Guozhan Online game from Guangzhou Sixiang. The term of the license is three years commencing from July 1, 2013 and ending on June 30, 2016. We have agreed to pay royalties calculated based on net revenues generated from the game after the commercial release of the game, which occurred in the fourth quarter of 2013.

In August 2013, we obtained adaptation rights on an exclusive and worldwide basis from Beijing Qingqingshu Animation Technology Co., Ltd., or Beijing Qingqingshu, to adapt and develop the KuiBa series of animated movies into Internet games and mobile games. The term of our agreement with Beijing Qingqingshu is 10 years, commencing from August 21, 2013 and ending on August 20, 2023. We have agreed to pay a license fee in the amount of RMB5 million in the aggregate to Beijing Qingqingshu, of which 50% has been paid and the remaining RMB2.5 million will be paid after the commercial release of the first game developed by us based on adaptation of the KuiBa series of animated movies. We have also agreed to pay royalties calculated based on net revenues generated from the games. Beijing Qingqingshu agreed to pay royalties to us calculated based on the box office revenues of the Kuiba series of movies. As of April 16, 2014, the KuiBa games have not been commercially released.

In addition to licensed games, we also develop Internet games internally based mainly on our proprietary technologies, which include our proprietary game engine (Dazzler 3D), game development platforms and online game billing system, all developed by our internal team. In particular, our Dazzler 3D game engine enables us to create high-quality 3D graphics and visual effects, and provides the technical foundation for creating innovative features in our games. Furthermore, our game development platforms give us the capacity to develop Internet games within approximately six to 24 months and to update our Internet games frequently in response to players' preferences. Based on these platforms, we made publicly available our newest self-developed game, Master of Meteor Blades, in August 2013 for secured beta testing.

We use an item-based revenue model for our games, whether internally developed or licensed, under which players can play our games on the Internet free of charge, but have to pay for purchases of in-game virtual items, such as in-game currencies, performance-enhancing clothing, weapons, accessories and pets. We distribute our electronic prepaid game cards and game points, which can be used to purchase in-game virtual items, to players through multiple payment channels. Although we expect a substantial portion of our Internet games revenues to be generated in the PRC, we have licensed our games to leading game operators outside the PRC and plan to license them in additional countries and regions.

Strategic Relationships

We have established cooperation arrangements with telecommunications operators, mobile handset manufacturers, content providers and other business partners to produce, promote and market our services. We provide our WVAS and mobile games primarily pursuant to cooperation agreements with China Mobile and other telecommunications operators. In addition, we cooperate with several leading PRC mobile handset manufacturers, which make selected handset models with a WVAS icon in the handset's menu that enables users to access our services directly. We pay service fees to the telecommunications operators, mobile handset manufacturers, mobile handset distributors, content providers and other partners, where relevant.

In May 2012, we entered into a strategic partnership with WarGaming under which we enjoy exclusive rights to license all of WarGaming's future games in the PRC. Under this partnership, we licensed World of Warplanes and World of Battleships games from WarGaming.

Telecommunications Operators

China Mobile is the world's largest mobile telecommunications network operator in terms of subscribers, with more than 704 million subscribers as of December 31, 2013, according to China Mobile's website. Our working relationship with China Mobile is critical to the operation and continued development of our WVAS and mobile games businesses. See "Item 3 — Key Information — Risk Factors — 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 provide WVAS in 31 Chinese provinces or provincial-level municipalities pursuant to cooperation agreements with China Mobile and its provincial subsidiaries. Generally, these agreements have terms of one year or shorter, but may be renewed automatically unless either party objects. We were one of the first wireless service providers to work with China Mobile to develop and offer WAP, MMS and Java™ services.

We charge our customers content fees, which vary among our different services, on either a single-transaction or a monthly subscription basis. We establish the fees paid by our customers in consultation with the telecommunications operators and, in turn, pay a portion of these fees to the telecommunications operators through which our services are provided.

Pursuant to our agreements with the subsidiaries of China Mobile, we generally pay to these subsidiaries 15% to 60% of the revenues we generate from providing our services to customers through their networks, with the exception of IVR services, with respect to which we pay to these subsidiaries 30% of the revenues we generate. In addition, the subsidiaries of China Mobile deduct a net transmission charge from our portion of the fees for services provided on the MMS and SMS platforms. These transmission charges are equivalent to the transmission fee set forth in the table below multiplied by the number of messages we send through the telecommunications operator's network minus the number of messages we receive from users requesting our services.

Pursuant to our agreements with China Unicom and its subsidiaries, we generally pay each China Unicom subsidiary 20% to 70% of the revenues we generate from providing our services to customers through such subsidiary's network, with the exception of IVR services, with respect to which we pay 54% of the revenues we generate.

Pursuant to our agreements with China Telecom and China Netcom and their respective subsidiaries, we generally pay each China Telecom subsidiary and China Netcom subsidiary 15% to 60% of the revenues we generate from providing our services to customers through such subsidiary's network, with the exception of IVR services, with respect to which we pay 40% of the revenues we generate.

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The following table sets forth the principal fees that we charge our customers for our WVAS and mobile games related services and the service and transmission fees that we paid to the telecommunications operators as of December 31, 2013.

	Fees we charged customers		Fees we paid telecommunication operators	
	Transaction fee per unit (1)	Monthly subscription fee	Service fees	Transmission fee (2)
	(in RMB, except percentages)			
WAP	1.00-2.00	5.00-8.00	15%-50%	N/A
MMS	1.00-4.00	5.00-15.00	15%	0.15-0.20
Mobile Games	0.01-100.00	5.00-15.00	30%-50%	N/A
SMS	1.00-3.00	0.00-30.00	15%-50%	0.02-0.08
IVR	1.00-30.00	15.00	30%-45%	N/A
CRBT	0.50-3.00	1.00-5.00	15%-70%	N/A
E-Book	0.00-5.00	3.00-5.00	60%	N/A

- (1) Transaction fees are per download for WAP, MMS, mobile games, SMS, CRBT and e-book services and per minute for IVR services.

(2) A transmission fee is assessed for each message we send in excess of the number of messages we receive. The amount of the transmission fees for each month depends on the volume of messages sent in that month. No transmission fees are assessed for WAP, mobile games, IVR or CRBT services.

For our WVAS and mobile games, we rely primarily on the telecommunications operators to provide billing and collection services for us. Each telecommunications operator incorporates the fees for our services into the invoices that such operator sends to its customers on a monthly basis. We receive monthly statements from each of the telecommunications operators, which indicate the aggregate amount of fees that were charged to customers for services that we provided. For a description of our revenue recognition policy, see “Item 5 — Operating and Financial Review and Prospects — Critical Accounting Policies — Revenue Recognition.” Also see “Item 3 — Key Information — Risk Factors — 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.”

Material Contracts with Telecommunications Operators for WVAS and Mobile Games

The term of our contracts with the telecommunications operators is generally for one year or less. When these contracts expire, we generally execute an extension or enter into new contracts. On occasion, the extension or the execution of new contracts may be delayed by several months. Based on our experience, in the event that a contract expires and is not promptly renewed, the telecommunications operator typically continues to honor the terms of the expired contract until an extension or a new contract is signed. We cannot assure you that any telecommunications operator will in fact continue to honor the terms of an expired contract. The specific termination and other material provisions of our more significant contracts with the telecommunications operators are set forth below.

Beijing AirInbox has entered into a cooperation agreement with China Mobile’s Jiangsu subsidiary to provide IVR services on China Mobile’s nationwide network. Pursuant to this agreement, Beijing AirInbox pays China Mobile a service fee of 30% of the revenues generated from providing IVR services to customers.

Beijing AirInbox has entered into a cooperation agreement with China Unicom to provide telecommunication value-added services, such as WAP, MMS, mobile TV, mobile commercial applications, etc., on China Unicom’s nationwide network. Pursuant to this agreement, Beijing AirInbox pays China Unicom a service fee ranging from 15% to 50% of the revenues generated from providing value-added services to customers through China Unicom’s network.

Beijing AirInbox has entered into a mobile value-added service agreement with China Telecom to provide short message value-added services on China Telecom's nationwide mobile network. Pursuant to this agreement, Beijing AirInbox pays China Telecom a service fee of 15% of the revenues generated from providing mobile value-added services to customers through China Telecom's network.

Zhulang has entered into a cooperation agreement with China Mobile's Zhejiang subsidiary to provide e-book works for China Mobile's mobile phone reading platform. Zhulang receives a royalty of 40% of the revenues generated from providing e-book works to customers through China Mobile's mobile phone reading platform.

Mobile Handset Manufacturers

We have established distribution arrangements with mobile handset manufacturers, including Samsung, Ericsson and other major international and domestic handset manufacturers. Pursuant to these distribution arrangements, we pre-load into the menu of certain mobile handsets our mobile games, WAP icons and MMS, SMS and IVR short codes, which enable customers to access our WVAS quickly and easily. We pay the mobile handset manufacturers 35% to 70% of the net revenues that we receive from the telecommunications operators, generally after deducting the telecommunications operators' service fees, with respect to our mobile games and WVAS that are accessed by means of the pre-loaded icons and short codes. The terms of these agreements are generally for one year, and pertain to specific mobile handset models. In addition, we leverage our relationships with the mobile handset manufacturers to enter into joint marketing programs.

In addition to pre-loading our mobile games, icons and short codes into selected mobile handsets, we used to embed our icons and codes in selected handsets. On April 11, 2007, the MIIT issued a notice prohibiting the production of mobile handsets with embedded icons and codes that cannot be changed or deleted by customers. We have altered our arrangements with mobile handset manufacturers to comply with the notice, which took effect on June 1, 2007. In addition, on January 27, 2010, China Mobile began implementing an additional series of measures which are targeted at further improving the user experience for mobile handset embedded services. Under the guidance of China Mobile, WVAS that are embedded in handsets will be required to introduce additional notices and confirmations to users during the purchase of such services. See “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — 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.” and “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — Our effort to develop additional distribution channels for our WVAS and mobile games may not succeed or may be halted by the MIIT or the telecommunications operators.”

Content Providers for Our WVAS and Mobile Games

We have entered into licensing agreements with content providers, whereby we contract to use their content for a fixed licensing fee or for a certain percentage, generally from 10% to 80%, of the net revenues we receive from telecommunications operators with respect to products and services that contain the licensed content, generally after deducting the fees paid to our distribution partners. These arrangements are typically for one or two years and are not exclusive, except for the content specifically produced for us by our freelance writers and certain content from our third party content providers. We currently license news content from www.xunlei.com and Beijing News Media Corporation, among others, and license music content from Tianyu Brother and Peacock Porch. We use the music that we license in our CRBT, song dedication, song listening, mobile karaoke, true ringtone and music video streaming and download services. In addition, we have entered into licensing agreements with Gameloft, KONAMI and China Entertainment Television Broadcast Limited to provide their games to mobile phone users in the PRC.

Content Providers for Our Internet Games

We also license Internet games from other developers from time to time. For a description of our major licensing arrangements, see “ — Business Overview — Our Internet Games Business.”

Product Development

Product Development for Our WVAS and Mobile Games

Our product development team focuses on creating innovative products that use the latest standards and technologies with respect to our WVAS and mobile games. In particular, the 2.5G standard enables WVAS providers to send more data in a shorter period of time, thereby facilitating the transmission of more advanced data services. We were one of the first WVAS providers to work with China Mobile to develop and offer MMS and WAP services, and have continued to be a leading developer of innovative services compatible with these technology platforms. At the same time, we have increased our product development team's emphasis on developing and supporting our 2G products, including IVR and CRBT, which we distribute on the networks of China Mobile, China Unicom and China Telecom. We believe that our timely delivery of new services that meet telecommunications operators' specifications demonstrates our technical capabilities and strengthens our cooperation relationship with the telecommunications operators.

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To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android. We have launched a number of mobile games for iOS and Android markets, including Kingdom Story, Tiny War, NecroDefense and Battleland: Warrior vs. Monster, during 2013 and the first quarter of 2014.

In addition to developing a range of innovative WVAS and mobile games, we also have developed a variety of programming tools that allow us to enhance customers' enjoyment of our services. For instance, in response to the current lack of a standard operating system among mobile phones produced by different manufacturers in the PRC, which may result in inconsistent experiences for customers accessing our services through different handset models, we have developed software tools that allow our services to be readily adapted for use on most mobile phones on the market. These tools reduce the cost of adapting our services to new models of mobile phones and optimize the user experience in terms of format and presentation of our services. In 2012, we acquired Noumena, a developer of cross-platform smartphone mobile game engines. We believe the integration of the Noumena team into our existing mobile game development team will enable us to create new smartphone mobile games that can take advantage of the Handymo game engine technologies developed by Noumena.

Product Development for Internet Games

We believe that timely and quality game development and operations is critical to our Internet games business and our business as a whole, and we have formed a separate department for the development of Internet games, which had 747 employees as of December 31, 2013. Our Internet games development department mainly consists of programming, design, operations and graphics divisions.

Unlike many of our competitors that operate MMORPGs licensed from foreign game developers, we have in-house development capabilities that allow us to develop games in timely response to constantly changing market demands and trends. Our systematic game development process includes the following key steps:

Concept Generation. Our design division takes the lead in generating ideas for new games based on the latest trends in player preferences. We recruit game players for our design division to closely track popular topics among players and on the Internet. We also encourage all of our employees to provide creative ideas and concepts for game development.

Detailed Proposal. Upon our management's approval of a new game concept, the design division will prepare a detailed proposal that sets forth preliminary game storylines and characters, estimates of costs and targeted audience.

Development Plan. After the completion of the technical review of the detailed proposal, a project team consisting of our programming staff, design staff and graphics artists will work together to set the technical criteria for the development of the game and formulate a development plan with certain milestones.

Design, Style and Story Concepts. Based on the game development plan, our graphics artists will determine the style of the new game and design game characters, our game designers will develop the game story and define game environments and our program developers will develop both the server-end software and the user-end software modules.

Internal Reviews. Management reviews will take place upon the completion of each milestone of the development plan. Concurrently, our testing division will test the accuracy and completeness of the development milestones and our marketing department will initiate marketing campaigns according to the development milestones.

Closed Beta Testing and Open Beta Testing. We conduct closed beta testing to correct technical issues of a new game. Thereafter, we conduct open beta testing to test the operation of the new game under open market conditions. Finally, we introduce the new game to players online.

Anticipating the potential growth of 3D Internet games in the PRC and recognizing the importance of possessing our own game engine, we have also focused on the development of our proprietary game engine, Dazzler 3D. Our game engine enables us to create quality 3D graphics, innovative gameplay and visual effects to better capture characters' motions. Our game engine is designed to allow for effective game playing on both high-end and lower-end computers. In 2014, we plan to launch one internally-developed MMORPG.

Sales, Marketing and Customer Service

We are committed to establishing our KongZhong name as a well-recognized and reputable brand not only among our customers and users, but also among telecommunications operators, key industry players and other owners of brand names. We sell our WVAS and mobile games principally through the telecommunication operators, as well as other distribution partners. We market through our website, promotional events, direct marketing and media advertising. We also provide support and technical services to China Mobile, China Unicom and China Telecom and to our customers and users.

Sales and Marketing

In the past, we have focused our marketing activities on enhancing our KongZhong brand name, as we believed that branding was important in the wireless Internet business. In 2007, we increased our efforts in advertising in traditional media such as television, billboards, newspapers and magazines, as well as through the Internet, to promote our wireless Internet sites, including Kong.net and Ko.cn, and our corporate brand name, KongZhong. We conducted a major advertising campaign in the first half of 2007 and have been cooperating with the NBA to promote cn.NBA.com since the second half of 2007.

However, beginning in 2008 and continuing into 2009, as we adjusted our business strategy to develop our mobile games business, we began to decrease branding efforts through traditional media channels and increase our effort to promote our mobile games in cooperation with the PRC telecommunications operators. In 2012 and 2013, we made efforts to enhance our marketing to include marketing activities for the launch of our new Internet games and game expansion packs.

We utilize our leading position among providers of WVAS and our knowledge of our customers to attract joint promotion arrangements with brand owners seeking effective channels of publicity among trend-conscious consumers. Through select distribution channels, we target young and fashion-driven consumers whom we believe set trends for consumer products and services in the PRC. In addition, we market through traditional offline media venues, such as through newspapers, magazines and flyers.

A significant portion of our revenues are derived from services provided through the networks of China Mobile. Accordingly, we devote significant resources to maintaining, expanding and strengthening our relationship with China Mobile and its subsidiaries. In addition, we have strengthened our sales and marketing of 2G and 2.5G services, which we provide through the networks of China Mobile as well as other telecommunications operators.

With our acquisition of Dacheng and commencement of our Internet games business, marketing of our Internet games has become an important part of our strategy. We aim to attract new game players and increase revenues from existing game players by introducing marketing and promotion strategies that are specifically tailored to each of our Internet games. We advertise primarily in sites devoted to Internet games and game magazines, and marketing events are usually timed with the release of a new game or updates of a game's content.

As of December 31, 2013, our sales and marketing department consisted of 32 persons strategically located in 31 provinces across the PRC to work closely with telecommunications operators at the provincial and local levels, where pricing and other important decisions on marketing and operations are made. Our localized sales team helps us gain insight into developments in the local markets and the competitive landscape, as well as new market opportunities.

To motivate our sales professionals, a portion of their compensation is based on the usage of our services in their respective regions. Sales quotas are assigned to all sales personnel according to quarterly sales plans. We also continuously explore other joint marketing strategies in order to maximize our cooperation arrangements and resources.

Customer Service

We view both the telecommunications operators and end users of our services as customers. Customer service is a key to building our brand and our relationships with the telecommunications operators. We train our customer service representatives with an emphasis on customer satisfaction. Our customer service center handles calls, faxes and e-mails from our end users, as well as inquiries forwarded from the telecommunications operators. Our customer service representatives interact regularly with, and provide training materials to, customer service representatives of telecommunications operators to enhance our customers' experience with our services.

We provide high-quality customer service and are responsive to the needs of the players of our Internet games. In particular, our game players can access our customer service center through in-game chats, phone or e-mail 24 hours a day, seven days a week. In addition, we have a website for game players to submit feedback and a service center in Shanghai, which is open to walk-in game players during normal business hours. We had 82 customer service representatives dedicated to our Internet games business as of December 31, 2013, many of whom are MMORPG enthusiasts with a deep understanding of Internet games players. We also have dedicated supervisors to monitor our calls to ensure quality services. Feedback collected by our customer service team is important to the integration of our product development and game operations teams. The information collected by our customer service team forms the basis of our feedback database, which helps us track the trends in players' tastes and preferences and provide direction when we design changes, upgrades and expansion packs for our Internet games.

Competition

We face significant competition in the WVAS, mobile games and Internet games markets in the PRC. In particular, the MIIT has reported on its website that, as of December 31, 2013, more than 2,545 service providers held nationwide licenses to supply content and services on the PRC telecommunications operators' networks. Moreover, China Mobile has been developing and marketing its own MMS and WAP products, and other PRC telecommunications operators may decide to do the same. We compete with these companies primarily on the basis of brand, the type and timing of service offerings, content and business partner and channel relationships. The telecommunications operators may also decide to enter the mobile games market in the future. Other potential competitors in this market include developers of personal-computer-based Internet games, major media companies, traditional video game developers, content aggregators, mobile software providers and independent mobile games developers. In addition to competition for products, services and distribution channels, we also compete for experienced and talented employees.

Some of our competitors may have more personnel and financial resources and a longer operating history than us. For example, Internet portals providing WVAS may have an advantage over us with their longer operating history, more established brand name, larger user base and Internet distribution channels. Furthermore, some competitors may be able to develop or exploit new technologies faster than us, or offer a broader range of products and services than we are presently able to offer.

We also compete principally with the following three groups of competitors in the Internet games business in China: Internet games developers and operators in the PRC, other private companies in the PRC devoted to game development or operation, and international competitors. Our existing and potential competitors in the Internet games business compete with us for talent, game player spending, time spent on game playing, marketing activities, quality of games and distribution network. Some of our existing and potential competitors have significantly greater financial and marketing resources than we do.

See “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — We face increasing competition in the PRC from providers of WVAS, mobile games and Internet games, which could reduce our market share and materially adversely affect our financial condition and results of operations.”

WVAS Services

Competition is particularly intense in the 2G and 2.5G WVAS markets in the PRC as the barriers to entry are relatively low. Our primary competitors in this market include Internet portals, such as Sina Corporation, Sohu.com Inc. and TOM Online Inc., and providers focused on WVAS, such as Tencent Technology Limited and A8 Music Group. We also face increasing competition from China Mobile in the 2.5G WVAS market.

Mobile Games Services

Our primary competitors in the mobile games market in the PRC include Internet portals, such as Sina Corporation, Sohu.com Inc., Phoenix New Media Limited and China Wireless Arts., as well as providers focused on WVAS and mobile games, such as Tencent Technology Limited.

Internet Games Business

Our principal competitors for our Internet games business in the PRC include other Internet games developers and operators, such as Perfect World Co. Ltd, Shanda Interactive Entertainment Limited, Netease.com, Inc., Changyou.com Limited, Giant Interactive Group Inc. and Tencent Holdings Limited.

Intellectual Property and Proprietary Rights

We regard our copyrights, trademarks, trade secrets and other intellectual property rights as critical to our business. We rely on trademark and copyright law, trade secret protection, non-competition, confidentiality and licensing agreements with our senior officers, clients, partners and others to protect our intellectual property rights. Despite our effort to protect our proprietary rights, we cannot be certain that the steps we have taken will prevent misappropriation of our content or technology, particularly in foreign countries where the relevant laws may not protect our proprietary rights as fully as in the United States or other jurisdictions. For a description of the regulations applicable to our industry in the PRC, see “— Regulation.”

We have registered KongZhong Network as a commercial website with the SAIC. As a result, no one else may operate a website, whether commercial or otherwise, using the name of KongZhong Network. We also have registered our logo, the KongZhong thumb, and certain of our product names as trademarks in the PRC. Our trademarks are registered in the name of Beijing AirInbox. In addition, Beijing AirInbox is the registered owner of a number of domain names, the principal ones of which are www.kongzhong.com, www.kongzhong.com.cn, www.kongzhong.net, www.kongzhong.net.cn, www.cota.com.cn, www.cota.cn, ko.cn, Kong.net, heroandgoddess.com, pocketfort.net, and nswyapp.com. Xinreli is the registered owner of a number of domain names, the principal ones of which are Simlife.com, Simlife.com.cn, Simlife.cn, Simlife.net and Simlife.net.cn. Dacheng is also the registered owner of a number of domain names, the principal ones of which are Loong3d.com, gamall.net and dacn.com.cn.

We are unable to register the Chinese name of “KongZhong Network” as our service mark in the PRC because it is deemed a generic term under existing PRC trademark laws, rules and regulations, which prohibit registration of generic terms as trademarks or service marks. However, we do not expect to face a proliferation of counterfeit services or products without any legal remedy, as we may seek a remedy for piracy under the PRC’s Anti-Unfair Competition Law, by bringing a suit against a third party that uses the Chinese name of “KongZhong Network” if the overall design or appearance of that third party’s services is substantially the same as that of the well-known or established services provided by us. See “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — We may not be able to adequately protect our intellectual property, and we also may be exposed to infringement claims by third parties.”

Information Technology Systems and Infrastructure

We maintain most of our servers at the premises of Beijing Telecommunication Corporation, which is the administrator of the central hub of the ChinaNet backbone. We also maintain servers at other Internet data centers, including China United Network Communications Corporation Limited, Chongqing Mobile Communications Company Limited and Hangzhou Mobile Communications Company Limited. Following our acquisition of Dacheng, most of our servers used for our Internet games are hosted at the premises of 21 Vianet Data Center, one of the largest Internet infrastructure service providers in China. We also maintain online game servers at other Internet data centers, including Chengdu United Network Communications Company Limited, Shanghai Technology Network Company Limited, Shenzhen United Network Communications Company Limited, Hebei United Network Communications Company, Beijing United Network Communications Company, Beijing Telecommunications Corporation, Beijing United Network Communications Company and Beijing Capital Online Company Limited. We believe that utilizing these hosting partners provides significant operating benefits, such as protecting our systems from power loss, break-ins and other potential external causes of service interruption. In addition, we back up all of our data. We believe we will be able to increase our server capacity as needed to accommodate future growth.

Employees

General

Our senior management and many of our employees have had prior experience in the Internet portal, Internet games or telecommunications-related industries. Our employees receive a base salary and a performance-based bonus, with the amounts of such bonuses calculated based on the performance ranking of the employee. In addition, we have a broad-based equity incentive plan pursuant to which we grant share options and restricted share units, or nonvested shares, from time to time to employees who have passed their initial probation period. We also offer internal training programs tailored to different job requirements to help enhance our employees' talents and skills. We believe that these initiatives have contributed to the growth of our business.

As of December 31, 2013, we had 1,153 employees, all in the PRC. The table below sets forth the number of our employees by job function as of the dates indicated:

	As of December 31,								
	2011			2012			2013		
	Number	% of Total	%	Number	% of Total	%	Number	% of Total	%
Sales, marketing and business development	142	14.8	%	247	22.5	%	208	18.1	%
Customer service	97	10.1		91	8.3		111	9.6	

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Product development	660	68.6		698	63.5		747	64.8	
General and administrative	62	6.5		64	5.7		87	7.5	
Total	961	100.0	%	1,100	100.0	%	1,153	100.0	%

We believe that we maintain a good working relationship with our employees, and we have not experienced any significant labor disputes. Our employees are not represented through any collective bargaining agreements or by labor unions.

Employee Benefits Plan

Our full-time employees in the PRC participate in a government-mandated defined contribution plan, under which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. The PRC labor regulations require us to accrue for these benefits based on certain percentages of the employees' salaries. The total provisions for such employee benefits were approximately US\$3.6 million, US\$3.5 million and US\$5.1 million in 2011, 2012 and 2013, respectively.

We have granted share options to our employees pursuant to our KongZhong Corporation 2002 Equity Incentive Plan, or the 2002 Plan, our KongZhong Corporation 2006 Equity Incentive Plan, or the 2006 Plan, as described in “Item 6 — Directors, Senior Management and Employees — Share Options.” We have also adopted a KongZhong Corporation 2013 Equity Incentive Plan, or the 2013 Plan during 2013, but have not granted any share options to our employees pursuant to the 2013 Plan as of the date of this annual report on Form 20-F.

Properties

Our principal executive office currently occupies approximately 12,899 square meters of office space in Beijing, the PRC, primarily under leases that will expire in August 2014. We expect to be able to renew these leases upon their expiration. In addition, we lease sales offices in 11 provinces throughout the PRC.

Legal Proceedings

We are not currently a party to any material legal proceeding. From time to time, we may be subject to various claims and legal actions arising in the ordinary course of business.

Despite our effort to comply with the intellectual property rights of third parties, we cannot be certain that we have not, and will not, infringe on the intellectual property rights of others, which may subject us to legal proceedings and claims in the ordinary course of our business from time to time. Such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. In addition, we may also initiate litigation to protect our intellectual property rights. See “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — We may not be able to adequately protect our intellectual property, and we also may be exposed to infringement claims by third parties.”

Regulation

The telecommunications industry in the PRC, including computer information and Internet access services, is highly regulated by the PRC government. In particular, regulations issued or implemented by the State Council, the MIIT, and other relevant government authorities cover virtually every aspect of telecommunications network operations, including entry into the telecommunications industry, the scope of permissible business activities, interconnection and transmission line arrangements, tariff policy and foreign investment.

The MIIT, under the leadership of the State Council, is responsible for, among other things:

- formulating and enforcing telecommunications industry policy, standards and regulations;
- granting licenses to provide telecommunications and Internet services;
- formulating tariff and service charge policies for telecommunications and Internet services;
- supervising the operations of telecommunications and Internet service providers; and
- maintaining fair and orderly market competition among operators.

In addition, other governmental agencies that may have jurisdiction over our business activities include, but are not limited to, the following:

- the MOC;

the MPS;

the SAIC;

the SAPPRFT;

the State Council Information Office, or SCIO; and

SAFE.

Telecom Regulations

In September 2000, the State Council promulgated the Telecommunications Regulations, or the Telecom Regulations. The Telecom Regulations categorize all telecommunications businesses in the PRC as either infrastructure telecommunications businesses or value-added telecommunications businesses, with WVAS, mobile games and Internet games classified as value-added telecommunications businesses. Pursuant to the Telecom Regulations, a commercial operator of value-added telecommunications business must obtain an operating license. The Telecom Regulations also set forth extensive guidelines with respect to different aspects of telecommunications operations in the PRC.

In December 2001, in order to comply with the PRC's commitments with respect to its entry into the World Trade Organization, or the WTO, the State Council promulgated the Administrative Rules for Foreign Investments in Telecommunications Enterprises, or the Telecom FIE Rules. In September 2008, the State Council promulgated the Decree of the State Council No. 534 to amend certain provisions of the 2001 Telecom FIE Rules. The Telecom FIE Rules set forth detailed requirements with respect to capitalization, investor qualifications and application procedures in connection with the establishment of a foreign-invested telecommunications enterprise. Pursuant to the Telecom FIE Rules, the ultimate capital contribution ratio of the foreign investor(s) in a foreign-funded telecommunications enterprise that provides value-added telecommunications services shall not exceed 50%. In addition, the principal foreign investor in such an enterprise must have a sufficient track record in the operation of telecommunications business. Pursuant to the Foreign Investment Industrial Guidance Catalogue, as of December 24, 2011, the permitted foreign investment ratio of value-added telecommunications services is no more than 50%. To comply with these regulations, we conduct substantially all of our operations through Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli and Dacheng, which are wholly owned by PRC citizens or entities and incorporated in the PRC. We do not have any equity interests in these operating companies, but instead enjoy the economic benefits of these operating companies through a series of contractual arrangements, which we and our wholly owned subsidiaries, KongZhong Beijing, KongZhong China and Simlife Beijing, have entered into with Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang, Xinreli, Dacheng and their respective shareholders as described in "— Our Corporate Structure" and "Item 7 — Major Shareholders and Related Party Transactions — Related Party Transactions."

In July 2006, the MIIT issued the Circular on Strengthening the Administration of Foreign Investment in and Operation of Value-added Telecommunications Business. In the circular, the MIIT reiterated the existing regulations regarding foreign investment in telecommunications business, which require foreign investors to set up foreign-invested enterprises and obtain a business operating license for Internet content provision, or an ICP license, in order to conduct any value-added telecommunications business in the PRC. Under this circular, a domestic company that holds an ICP license is prohibited from leasing, transferring or selling the license to foreign investors in any form, and from providing resources, sites or facilities to foreign investors that conduct value-added telecommunications business illegally in the PRC. Furthermore, the relevant trademarks and domain names that are used in the value-added telecommunications business shall be owned by the local ICP license holder or its shareholders. This circular further requires each ICP license holder to have the necessary facilities for its approved business operations and to maintain such facilities in the regions covered by its license. In addition, all value-added telecommunications service providers are required to maintain network and information security in accordance with the standards set forth under relevant PRC regulations. Due to the lack of further interpretation from the PRC regulator, it remains unclear what impact the above circular will have on us or other PRC Internet companies that have adopted the same or similar corporate and contractual structures as ours.

In addition to the regulations promulgated by the central PRC government, some local governments have also promulgated local rules applicable to Internet or other value-added telecommunications companies operating within their respective jurisdictions. In Beijing, the Beijing Municipal Administrative Bureau of Industry and Commerce, or the Beijing AIC, has promulgated a number of Internet-related rules. In 2000, the Beijing AIC adopted the Interim Administration Rules on Filing Commercial Websites and the Detailed Rules for Implementation of Interim Administration Rules on Filing Commercial Websites, and in 2004, the Beijing AIC adopted the Administrative Rules on Filing Commercial Websites, which require owners of the domain names of commercial websites located within Beijing to file their website names and commercial websites with the Beijing AIC.

Regulation of Internet Content Services

In September 2000, the State Council promulgated the Telecom Regulations and the Internet Information Services Administrative Measures, or the Internet Information Measures. The Internet Information Measures require that commercial Internet content providers must obtain an Internet information license from the appropriate telecommunications authorities in order to carry on any commercial Internet content operations within the PRC. Internet content operators must display their operating license numbers in a conspicuous location on their home page. Internet content operators are obliged to police their websites in order to remove categories of harmful content that are broadly defined. This obligation reiterates Internet content restrictions that have been promulgated by other ministries over the past few years. In addition, the Internet Information Measures also provide that Internet content operators which operate in sensitive and strategic sectors, including news, publishing, education, health care, medicine and medical devices, must obtain additional approvals from the relevant authorities in charge of those sectors as well. Furthermore, the Internet Information Measures stipulate that Internet content operators must obtain the consent of the MIIT prior to establishing an equity or cooperative joint venture with a foreign partner. In September 2000, the MIIT and other regulatory authorities formulated and implemented a number of Internet-related regulations, including the Internet Electronic Bulletin Board Service Administrative Measures, or the BBS Measures. The BBS Measures provide that commercial Internet electronic bulletin board service providers, or commercial BBS providers, should conspicuously display their Internet information license numbers and the rules of the BBS and inform users of the possible legal liabilities for posting improper comments.

Certain local governments have promulgated local rules applicable to Internet companies operating within their respective jurisdictions. In Beijing, the Beijing AIC has promulgated a number of Internet-related rules. In October 2004, the Beijing AIC adopted the Administrative Rules on Filing Commercial Websites, which require owners of the domain names of commercial websites located within Beijing to file their website names and commercial websites with the Beijing AIC.

Each of Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR and Beijing Boya Wuji has a telecommunications and information services operating license for their Internet content businesses from the Beijing Telecommunications Administration Bureau. Each of Dacheng and Brilliant Game has a value-added telecommunications business operation permit for its Internet content business from the Shanghai Telecommunications Administration Bureau. Zhulang has a value-added telecommunications business operation

permit for its Internet content business from the Jiangsu Telecommunications Administration Bureau. These licenses are subject to standard annual review.

Regulation of WVAS

Pursuant to the Telecom Regulations, a commercial operator of Internet content services must obtain an operating license. Other than this requirement, PRC legislation on wireless telecommunications is generally aimed at regulating equipment and infrastructure rather than applications and value-added service providers.

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The Administrative Measures for Telecommunications Business Operating Licenses, or Telecom License Measures, were promulgated by the MIIT on March 5, 2009. The Telecom License Measures confirm that there are two types of telecommunications operations licenses for operators in the PRC (including foreign-invested telecommunications enterprises), namely, licenses for infrastructure services and licenses for value-added services, for which a distinction is made as to whether a license is granted for intra-provincial or nationwide activities. An appendix to the license details the permitted activities of the enterprise to which it was granted. An approved telecommunications service operator must conduct its business, for both infrastructure and value-added services types of businesses, according to the specifications recorded on its Telecom Business Operating License. The MIIT is the competent approval authority for foreign-invested telecommunications enterprises and for granting nationwide licenses to value-added telecommunications enterprises.

Other than a general classification of wireless information services as value-added telecommunications services by an appendix to the Telecom Regulations, as amended, there is currently no nationwide legislation in the PRC that specifically addresses the provision of WVAS, such as SMS, MMS, WAP, Java™, IVR or CRBT services. At this time, it is if or when national legislation may be enacted in the PRC to regulate this business.

Beijing Boya Wuji has obtained a value-added telecommunications business operation permit in order to operate wireless value-added businesses in Beijing. Each of Beijing AirInbox, Beijing WINT, Beijing Chengxitong, BJXR, Mailifang and Xinreli has obtained a nationwide value-added telecommunications license from the MIIT in order to provide services in multiple provinces, autonomous regions and municipalities. These licenses are subject to standard annual review.

Regulation of Internet Culture Activities

On February 17, 2011, the MOC promulgated the Interim Measures on Administration of Internet Culture, or the Internet Culture Measures, replacing previous interim measures promulgated in May 2003 and amended in July 2004. “Internet cultural products” are classified as cultural products developed, published and disseminated via the Internet, which mainly include: (i) products for publication via Internet, such as, among other things, online music and entertainment files, network games, online performing arts and artworks and online animation features and cartoons, and (ii) products converted from traditional music entertainment products, games, performing arts, artworks and animation features and cartoons, and published via the Internet. Pursuant to the Internet Culture Measures, entities are required to obtain Internet Culture Business Permits from a provincial counterpart of the MOC if they intend to commercially engage in any of the following types of activities: (1) production, duplication, import, sale or broadcasting of Internet cultural products; (2) publication of cultural products on the Internet or transmission thereof through information networks such as Internet and mobile network to computers, fixed-line or mobile phones, television sets, gaming consoles or Internet access service sites including Internet cafes for the purpose of browsing, reviewing, using or downloading such products by internet users; or (3) exhibitions or contests related to Internet cultural products.

On August 12, 2013, the MOC promulgated the Notice of the Ministry of Culture on the Application of the Administrative Measures for Content Self-Review by Internet Culture Business Entities, or Self-Review Notice, which took effect on December 1, 2013. The Self-Review Notice requires an Internet culture business entity to review in advance the contents of the Internet culture products and services prior to providing services to the public, and establish and improve its content management system, establish specialized content management departments, have in place staff members who could adapt to the needs of review work to be responsible for the content management of Internet cultural products and services, and safeguard the legality of the contents of Internet cultural products and services. The content management system of an Internet culture business entity should specify the responsibilities, standards and processes for content review as well as accountability measures, and should be submitted to the local provincial cultural administrative department for record-filing.

Software Products Registration

On March 5, 2009, the MIIT issued the Measures Concerning Software Products Administration, or the Software Measures. Under the Software Measures, producers of software products registered with the relevant PRC authorities may be entitled to certain preferential policies in PRC. Software developers or producers are allowed to sell or license their registered software products independently or through agents. Upon registration, the software products shall be granted registration certificates. Each registration certificate is valid for five years and may be renewed upon expiration. The MIIT and other relevant departments may carry out supervision and inspection over the development, production, operation and importing and exporting of software products in the PRC. As of December 31, 2013, we have registered the softwares for the games Kung Fu World, Loong, Doodle Dino, Blood of Sheng Mo, Deification OL, Kingdom Story, Fishing Master, Jelly Roll, Ninja Chicken, Jet Heroes, Master of Meteor Blades, Three Kingdoms in Pocket and Gudong Gudong, and have registered the softwares of AirInbox New Media Real-time Platform, AirInbox New Customer Service Query System, AirInbox Resource Management System and AirInbox Basic Data Management System, with the relevant PRC authority and have obtained the software product registration certificates for these software products.

Regulation of Information Security and Censorship

PRC legislation concerning information security and censorship specifically prohibits the use of Internet infrastructure where it results in a breach of public security, the provision of socially destabilizing content or the divulgence of state secrets.

“A breach of public security” includes a breach of national security or disclosure of state secrets; infringement on state, social or collective interests or the legal rights and interests of citizens; or illegal or criminal activities.

“Socially destabilizing content” includes any action that: (1) incites defiance or violation of PRC laws; (2) incites subversion of state power and the overturning of the socialist system; fabricates or distorts the truth, spreads rumors or disrupts social order; (3) advocates cult activities; or (4) spreads feudal superstition, involves obscenities, pornography, gambling, violence, murder or horrific acts or instigates criminal acts.

“State secrets” are defined under applicable PRC law as matters that affect the security and interest of the state. The term covers such broad areas as national defense, diplomatic affairs, policy decisions on state affairs, national economic and social development, political parties and other state secrets that the State Secrecy Bureau has determined should be safeguarded.

According to the aforementioned legislation, it is mandatory for Internet companies in the PRC to complete security filing procedures with the local public security bureau and for them to update their filings regularly with the local

public security bureau regarding information security and censorship systems for their websites.

Regulation of Pornographic Materials

Since the development of the Internet, the PRC government has carried out a series of actions targeting pornographic materials on the Internet, mobile phones and other Internet-based equipment. On May 11, 2007, the MIIT issued the Notice of Schemes of Special Campaign Against Internet-Based Pornography and, on December 15, 2009, the MIIT issued the Further Schemes of Special Campaign against Mobile Phone Pornography to regulate the dissemination of pornographic materials through mobile phones and the Internet.

The Supreme People's Court and Supreme People's Procuratorate issued the Interpretation on Issues of Application of the Laws for Production, Reproduction, Publication, Sale and Dissemination, of Pornographic Information Through Internet, Mobile Equipment and Information Service Centers on September 3, 2004, and the Interpretation on Issues of Application of the Laws for Production, Reproduction, Publication, Sale and Dissemination, of Pornography Information Through Internet, Mobile Equipment and Information Service Centers II on February 4, 2010. These interpretations define the applicable laws, crimes and penalties for the dissemination of pornographic materials on the Internet or through mobile telecommunications equipment.

Due to the uncertainty over how the above-mentioned rules and regulations will be interpreted and enforced, we cannot predict how they will affect our business operations and future strategies. Although we believe that our products and services are in compliance with these rules and regulations, we cannot assure that any of the relevant governmental authorities will not disagree and will not take legal action against us.

Regulation of Advertisements

The principal regulations governing advertisements in the PRC are the Advertising Law (1996), the Administrative Regulations of Advertisements (1987) and the Detailed Rules of Implementation of the Administrative Regulations of Advertisements (2004), pursuant to which an entity conducting advertising activities as a supplementary business must obtain a permit from the local AIC and specifically mention advertising activities as a permitted business activity in such entity's business license. The SAIC is the government agency responsible for regulating advertising activities in the PRC. The Advertising Law (1996), the Administrative Regulations of Advertisements (1987) and the Detailed Rules of Implementation of the Administrative Regulations of Advertisements (2004) do not contain, and the SAIC has not promulgated, regulations specifically aimed at mobile advertising through SMS or MMS services.

As part of our non-telecommunications operator marketing activities, we have developed integrated marketing campaigns with traditional media companies and multinational corporations through certain cross-selling efforts with these companies. Beijing AirInbox has applied to the Beijing AIC to amend its business license to specify that the mobile advertising business is a permitted business activity and Beijing AIC has informed Beijing AirInbox that this is not necessary because Beijing AirInbox's business license already permits it to undertake the mobile advertising activities that it presently conducts. We cannot assure you that the SAIC or Beijing AIC will not require Beijing AirInbox to obtain an advertising permit from the Beijing AIC and specifically mention advertising activities as a permitted business in its business license in the future. In such an event, failure to comply could result in penalties including being banned from engaging in online advertising activities, confiscation of illegal earnings and fines.

Technology of Import and Export

China imposes controls on technology import and export. The term "technology import and export" is broadly defined in the regulations to include, without limitation, the transfer or license of patents, software and know-how, and the provision of services in relation to technology. Depending on the nature of the relevant technology, the import and export of technology require either approval by, or registration with, the relevant PRC governmental authorities. If we enter into licensing agreements with third parties outside of the PRC through our PRC entities, such licenses will be required to be registered with applicable PRC governmental authorities. We intend to register the licenses we have granted to the non-PRC entities.

Regulation of Online Publications

The SAPPRFT is the government agency responsible for regulating publishing activities in the PRC. The Rules for the Administration of Electronic Publications, or Electronic Publication Rules, promulgated on February 21, 2008 and took effect on April 15, 2008, regulate the production, publishing and importation of electronic publication in the PRC

and outline a licensing system for business operations involving electronic publishing. Under the Electronic Publication Rules and other regulations issued by the SAPPRFT, Internet games are classified as a kind of electronic production, and publishing of Internet games can be done only by licensed electronic publishing entities with standard publication codes.

The Tentative Internet Publishing Administrative Measures, or the Internet Publishing Measures, which were jointly promulgated by the MIIT and the SAPPRFT on July 27, 2002 and took effect on August 1, 2002, require Internet publishers to secure approval from the SAPPRFT. The term “Internet publishing” is defined as an act of online dissemination whereby Internet information service providers select, edit and process works created by themselves or others (including content from books, newspapers, periodicals, audio and video products, electronic publications, and other sources that have already been formally published or works that have been made public in other media) and subsequently post the same on the Internet or transmit the same to users via the Internet for browsing, using or downloading by the public.

The SAPPRFT and the MIIT have not specified whether the aforementioned approval in the Internet Publishing Measures is applicable to dissemination of works through SMS, MMS, WAP, Java™, IVR, CRBT or other wireless technologies. If, in the future, the SAPPRFT and the MIIT clarify that the Internet Publishing Measures are applicable to wireless value-added telecommunications services operators or issue new regulations or rules regulating wireless publishing, we may need to apply for a license or permit from governmental agencies in charge for our WVAS business. We cannot assure you that such application would be approved by the relevant governmental agencies. As the provision of Internet games is deemed an Internet publication activity, an Internet games operator needs to obtain an Internet publishing license in order to directly make its Internet games publicly available in the PRC. As of the date of this annual report on Form 20-F, Beijing AirInbox and Dacheng have each obtained an Internet publishing license from the SAPPRFT.

Regulation of Internet-Based Audio-Video Programming Services

On December 20, 2007, the SAPPRFT and the MIIT jointly promulgated the Regulations on Administration of Internet-based Audio-Video Programming Service, or the Internet-based Audio-Video Regulations, which became effective as of January 31, 2008. The Internet-based Audio-Video Regulations are applicable to the public dissemination of Internet-based services, including audio-video programming services within the territory of the PRC. Activities covered by the Internet-based Audio-Video Regulations include producing, compiling, integrating and public dissemination over the Internet of audio or video programs, as well as aiding others to upload and disseminate such programs.

Providers of Internet-based Audio-Video programming services are required to obtain the Internet-based Audio-Video License or complete registration procedures as required in the Internet-based Audio-Video Regulations. Pursuant to the Internet-based Audio-Video Regulations, such provider must:

- be a limited liability company that is either wholly owned or majority controlled by the state, without any violation of law or regulation within three years before the application date;

- have measures that ensure the safe dissemination of audio-video programs and protect against security breaches;

- have audio-video programming resources that are appropriate for their businesses and in compliance with laws and regulations;

- possess technical competence, network resources and lawful funds that are appropriate for their businesses;

retain professionals who are appropriate for their businesses, and its major investors and operators did not violate any law or regulation within three years before the application date;

- have network technical designs that comply with laws and regulations and industry standards and guidance;

be in compliance with plans, layouts and business guidelines issued by the departments in charge of radio, film and television operations under the State Council; and

· be in compliance with laws and administrative regulations.

Pursuant to explanations of the Internet-based Audio-Video Regulations provided by the responsible persons at the SAPPRFT and the MIIT in a press conference, providers who engaged in Internet-based audio-video programming services before the promulgation of the Internet-based Audio-Video Regulations and who have not violated any other laws or regulations are eligible to register their business and continue their operations. Beijing AirInbox has obtained an Internet-based Audio-Video License. However, given the short history of the Internet-based Audio-Video Regulations and the lack of interpretations, we cannot assure you that other of our operating companies will be qualified to apply for the Internet-based Audio-Video License or complete the required registration, and we cannot assure you that we will be granted the Internet-based Audio-Video License.

Regulation of Internet Games

In addition to rules and regulations described above, the PRC authorities have promulgated other specific regulations for Internet games.

On July 12, 2005, the MOC and the MIIT promulgated the Opinions on the Development and Administration of Online Game, reflecting the PRC government's intent to foster and control the development of the Internet games industry in China. Accordingly, the MOC will censor Internet games that "threaten state security," "disturb the social order," or contain "obscenity" or "violence."

Many of our customers access our games in Internet cafes, which are also regulated by the PRC government. Internet cafes are required to obtain a license from the MOC and the SAIC, and are subject to requirements and regulations with respect to location, size, number of computers, age limit of customers and hours of operation. In 2004, the MOC, the SAIC and other PRC governmental authorities jointly issued a notice to suspend issuance of new Internet cafe licenses. Although this nationwide suspension has been generally lifted in 2005, the local authorities have the authority of controlling the number and recipients of new licenses at their discretion. In addition, local and higher-level governmental authorities may from time to time strictly enforce customer age limits and other requirements relating to Internet cafes, as a result of the occurrence of, and media attention on, gang fights, arson or other incidents in or related to Internet cafes. On February 15, 2007, the MOC and other relevant governmental authorities jointly issued the Internet Cafes Notice, which suspended nationwide the approval for the establishment of new Internet cafes in 2007 and imposed tougher penalties for Internet cafes admitting minors. In 2008 and 2010, the MOC, SAIC and other relevant governmental authorities, individually or jointly, issued several notices which provide various ways to strengthen the regulation of Internet cafes, including investigating and punishing the Internet cafes which accept minors, cracking down on Internet cafes without sufficient and valid licenses, limiting the total number of Internet cafes, screening unlawful games and websites, and improving the coordination of regulation over Internet cafes and Internet games. As many of our customers access our games from Internet cafes, any reduction in the number, or any slowdown in the growth, of Internet cafes in the PRC as a result of stricter Internet cafe regulation will limit our ability to maintain or increase our revenues and expand our customer base, which will in turn materially and adversely affect our business, financial condition and results of operations.

The SAPPRFT and several other governmental authorities have issued a circular requiring the implementation of an "anti-fatigue system" and a real-name registration (by Internet games players) system by all PRC Internet games operators, in an effort to curb addictive Internet games playing behaviors of minors. Under the anti-fatigue system, three hours or less of continuous playing by minors is considered to be "healthy," three to five hours to be "fatiguing," and five hours or more to be "unhealthy." Game operators are required to reduce the value of in-game benefits to a player by half if the player has reached "fatiguing" level, and to zero in the case of "unhealthy" level. To identify whether a player is a minor and thus subject to the anti-fatigue system, a real-name registration system is also adopted, which requires Internet games players to register their real identity information before they play Internet games. Dacheng has successfully developed such an anti-fatigue system. On July 1, 2011, the SAPPRFT and several other government authorities jointly promulgated a further notice to strengthen the implementation of the anti-fatigue system and

real-name registration, entitled the Notice on Initializing the Verification of Real-Name Registration for Anti-Fatigue System on Internet Games, or the Real-Name Registration Notice, which took effect on October 1, 2011. The Real-Name Registration Notice's main focus is to prevent minors from using adults' identification cards to play Internet games. Accordingly, the notice provides more stringent punishment for Internet game operators for not implementing the anti-fatigue and real-name registration measures properly and effectively. The most severe punishment contemplated by the Real-Name Registration Notice is termination of the operation of an Internet game if it is found to be in violation of the anti-fatigue and real-name registration requirements. On February 5, 2013, the MOC and several other governmental authorities issued the Work Plan of Comprehensive Prevention and Cure Project on Internet Games Addiction of Minors. The plan emphasizes that the cultural administrative authorities and press and publication administrative authorities must further supervise the Internet game operators to implement the anti-fatigue system and other measures.

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On September 7, 2009, the State Commission Office for Public Sector Reform issued the Notice on Interpretation of the State Commission Office for Public Sector Reform on Several Provisions relating to Animation, Online Game and Comprehensive Law Enforcement in Culture Market in the “Three Provisions” jointly promulgated by the MOC and the SAPPRFT, which became effective immediately. According to this notice, the SAPPRFT is responsible for the examination and approval of the Internet games prior to being uploaded on the Internet, after which the Internet games is to be administrated by the MOC.

On September 28, 2009, the SAPPRFT, the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications jointly published the Notice on the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games, which took effect on the same date of promulgation. This notice restates that foreign investors are not permitted to invest in Internet games operating businesses in the PRC through wholly owned, equity joint venture or cooperative joint venture investments and expressly prohibits foreign investors from gaining control over or participating in domestic Internet games operators through establishing other joint venture companies, or contractual or technical arrangements. According to this notice, where new versions, expansion packs or new content shall be updated for Internet games which have been approved by the SAPPRFT, the operation entity shall undertake the same procedures for the examination and approval by the SAPPRFT of such new versions, expansion packs or new content.

On November 13, 2009, the MOC issued the Circular on Improving and Strengthening the Administration of Content in Internet Games. This circular emphasizes that correct cultural values shall be maintained to enhance the cultural implications of Internet games. Internet games which comprise mainly of killing beasts, combat and marriage shall be further restricted. Minors should be guided in their choice of games and their playing time should be limited through technical measures. This circular also requires Internet games operators to establish and maintain committees to monitor game content. Dacheng has established such a committee.

On June 3, 2010, the MOC issued the Interim Measures for the Administration of Internet Games, or the Internet Game Measures, which took effect on August 1, 2010, to further strengthen the supervision over the Internet games industry. The Internet Game Measures regulate a broad range of operation activities relating to Internet games, including development and production of Internet games, operation of Internet games, issuance of virtual currencies used for Internet games, and virtual currency trading services. The Internet Game Measures provide that any entity that is engaged in the operation of Internet games must obtain an Internet Culture Business Permit, which is valid for three years and renewable before its expiration. The Internet Game Measures require the content of an imported Internet game to be examined and approved by the MOC prior to the game’s launch and the content of a domestic Internet game to be filed with the MOC. The Internet Game Measures also request Internet game operators to protect the interests of game players and stipulate that the service agreement between an Internet game operator and the players of its online games must include certain mandatory terms required by the MOC. On July 29, 2010, the MOC issued the Notice of the Ministry of Culture on the Implementation of the Interim Measures for the Administration of Internet Games, which took effect on the date of its issuance. This notice provides details as to the requirements and procedures relating to applications for Internet Culture Business Permits and the MOC’s review of the content of Internet games. In addition, the notice emphasizes the protection of minors who play online games and requests Internet games operators to promote real-name registration of their game players. Each of Beijing AirInbox, Dacheng, Xinreli and Brilliant Game has obtained an Internet Culture Business Permit for our Internet games business.

Regulation of Virtual Currency

The use of “virtual currency,” which is typically used to purchase in-game virtual items, is also regulated by the PRC government. Under the Internet Cafes Notice described above, the PBOC is directed to strengthen the administration of virtual currency in Internet games to avoid any adverse impact on the economy and financial system of the PRC. This notice provides that the total amount of virtual currency issued by Internet games operators and the amount purchased by individual game players should be limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase virtual items.

On June 4, 2009, the MOC and Ministry of Commerce jointly issued a circular regulating the trading of Internet games virtual currencies. The circular clearly defines for the first time the meaning of virtual currency and places a set of restrictions on the trading and issuance of virtual currency. The circular also states that Internet games operators are not allowed to give out virtual items or virtual currency through lottery-based activities, such as lucky draws, betting or random computer sampling, in exchange for user's cash or virtual money. This regulation is mainly targeted at lottery-based activities found in some Internet games.

On July 20, 2009, the MOC promulgated the Filing Guidelines on Online Game Virtual Currency Issuing Enterprise and Online Game Virtual Currency Trading Enterprise, which specifically define the meaning of "issuing enterprise" and "trading enterprise" and stipulate that both of these businesses may not be operated by the same enterprise.

According to the Internet Game Measures, a company must also obtain an Internet Culture Business Permit in order to issue and conduct transactions in virtual currency. Furthermore, the virtual currency issued by an Internet games operator can only be used to exchange for such operator's Internet games assets. As an additional requirement, the Internet games operator must register the kind, price, and total quantity of virtual currency used in its online games with the local provincial branch of the MOC.

Privacy Protection

On December 29, 2011, the MIIT promulgated the Several Provisions on Regulating the Market Order of Internet Information Services, which became effective on March 15, 2012. This regulation stipulates that Internet content providers must not, without the consent of users, collect information on such users that could be used, alone or in combination with other information, to identify a user, or corresponding personal information, and may not provide any user's personal information to third parties without prior user consent. The Internet content providers may only collect personal information necessary to provide their services and must expressly inform the users of the method, content and purpose of the collection and processing of such information. In addition, an Internet content provider may use the personal information only for the stated purposes under the Internet content providers' scope of services. The Internet content providers are also required to ensure the proper security of such personal information, and take immediate remedial measures if such information is suspected to have been disclosed. If the consequences of any such disclosure are expected to be serious, the Internet content provider must immediately report the incident to the telecommunications regulatory authorities and cooperate with the authorities in their investigations.

On December 28, 2012, the Standing Committee of the National People's Congress enacted the Decision to Enhance the Protection of Network Information, or the Information Protection Decision, to further enhance the protection of user's personal information in electronic form. The Information Protection Decision provides that the Internet content providers must expressly inform their users of the purpose, manner and scope of the Internet content providers' collection and use of personal information, publish the Internet content providers' standards for the collection and use of personal information, and collect and use personal information only with the consent of users and only within the

scope of such consent. The Information Protection Decision also mandates that Internet content providers and their employees must keep strictly confidential the personal information that they collect, and should take such technical and other measures as are necessary to safeguard the information against disclosure, damage and loss.

On July 16, 2013, the MIIT promulgated the Provisions on Protecting the Personal Information of Telecommunications and Internet Users, which became effective on September 1, 2013. This regulation stipulates that telecommunications business operators and Internet information service providers shall formulate rules on the collection and use of users' personal information, and publish the same in their business or service premises. Without the consent of users, telecommunications business operators and Internet information service providers are not allowed to collect and use the personal information of the users. Telecommunications business operators and Internet information service providers shall not collect or use information in a deceptive, misleading or compulsory manner, in violation of laws or administrative regulations, or in breach of the agreements between relevant parties. After users have terminated the use of telecommunications services or Internet information service, telecommunications business operators and Internet information service providers must stop the collection and use of the users' personal information, and provide the users with services for deregistering relevant phone numbers or account numbers.

We require the customers of our Internet games to accept a user agreement whereby they agree to provide certain personal information to us. Applicable PRC law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, the MIIT or its local bureaus may impose penalties and the Internet content provider may be liable for damages caused to its users.

Regulation of Foreign Exchange Control

The principal regulations governing foreign exchange in the PRC are the Foreign Exchange Control Regulations (Amended in 2008) and the Administration of Settlement, Sale and Payment of Foreign Exchange Regulations (1996), or together, the Exchange Regulations. Under the Exchange Regulations, the Renminbi is freely convertible into foreign exchange for current account items, including the distribution of dividends. Conversion of Renminbi for capital account items, such as direct investment, loans, security investment and repatriation of investment, however, is still subject to the approval of SAFE.

Under the Exchange Regulations, foreign-invested enterprises are required to open and maintain separate foreign exchange accounts for capital account items (but not for other items). In addition, foreign-invested enterprises may buy, sell or remit foreign currencies only at those banks authorized to conduct foreign exchange business after providing valid commercial documents and, in the case of capital account item transactions, obtaining approval from SAFE.

In October 2005, SAFE issued the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-raising and Return Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or Notice 75, which took effect on November 1, 2005. Notice 75 supersedes prior SAFE regulations promulgated in January and April of 2005. Notice 75 and relevant SAFE regulations require PRC residents to register with the relevant local SAFE branch in connection with their establishment or control of an offshore entity established for the purpose of overseas equity financing involving onshore assets or equity interests held by them and direct investment through such an offshore entity in the PRC. The term “PRC residents,” as used in Notice 75, includes not only PRC citizens but also other persons who habitually reside in the PRC for economic benefit. These PRC residents are required to register with the relevant SAFE branch before establishing or taking control of such an offshore entity and complete amended registrations with the relevant SAFE branch upon: (i) injection of equity interests or assets of an onshore enterprise into the offshore entity; (ii) subsequent overseas equity financing by such offshore entity; or (iii) any material change in the shareholding or capital of the offshore entity, such as changes in share capital, share transfers and long-term equity or debt investments, and providing security. The PRC residents who have already incorporated or gained control of offshore entities that had completed onshore investments in the PRC before Notice 75 took effect must register with the relevant local SAFE branch on or before March 31, 2006. In addition, such PRC residents are required to repatriate into the PRC all of their dividend profits or capital gains from their shareholdings in the offshore entity within 180 days of their receipt of such profits or gains.

The registration set forth by Notice 75 and relevant SAFE regulations are prerequisites for other approval and registration procedures necessary for capital inflow from the offshore entity, such as inbound investment or shareholders loans, or capital outflow to the offshore entity, such as the payment of profits or dividends, liquidating distributions, equity sale proceeds or the return of funds upon a capital reduction.

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A number of terms and provisions in Notice 75 and relevant SAFE regulations remain unclear. Due to the uncertainty regarding the interpretation and implementation of Notice 75 and relevant SAFE regulations, we cannot predict how such notice and regulations will affect our business operations or future strategies. For example, the ability of our present and prospective PRC subsidiaries to conduct foreign exchange activities, such as remitting dividends and foreign currency-denominated borrowings, may be subject to compliance with requirements of Notice 75 and relevant SAFE regulations by the PRC resident holders of our ordinary shares and ADSs. Despite our efforts to fully comply with the SAFE regulations, we cannot assure you that we will obtain, or receive waivers from, any necessary approvals or not be found in violation of the SAFE regulations or any other related foreign exchange regulations. In particular, we cannot assure you that we will be able to cause all the present or prospective PRC resident holders of our ordinary shares or ADSs to comply with all SAFE regulations. A failure by the PRC resident holders of our ordinary shares or ADSs to comply with Notice 75 and relevant SAFE regulations or our inability to secure required approvals or registrations may subject us to fines or legal sanctions, limit our subsidiaries' ability to make distributions or pay dividends, restrict our overseas or cross-border investment activities or affect our ownership structure, any of which could affect our business and prospects.

A notice issued by SAFE on May 20, 2011, or Notice 19, further provides detailed provisions and requirements regarding the foreign exchange registration under SAFE Notice 75. Under Notice 19, any PRC citizen, resident, or entity which is a direct or indirect shareholder of an offshore entity is required to update any previously filed registration with the local branch of SAFE to reflect any material change in such offshore entity. Moreover, any offshore entity which fails to comply with Notice 75 may be remedied by registering with the local branch of SAFE after fulfillment of the administrative penalties imposed by the relevant SAFE branch. On November 19, 2012, SAFE issued Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting the Foreign Exchange Administration Policies on Direct Investments, or Notice 59, which became effective on December 17, 2012. Notice 59 provides more specific requirements on the registration relating to Notice 75 than the former guidance, and supersedes Notice 19.

Regulation of Share Options and Restricted Share Units

On December 25, 2006, the PBOC issued the Administration Measures on Individual Foreign Exchange Control, and its Implementation Rules was issued by SAFE on January 5, 2007, both of which became effective on February 1, 2007. Under these regulations, all foreign exchange matters involved in employee share ownership plans, share option plans and other equity incentive plans participated by PRC individuals may be transacted upon receipt of the approval from SAFE or its authorized branch.

In February 2012, SAFE promulgated SAFE Notice 7, replacing SAFE Notice 78. SAFE Notice 7 is applicable to (i) PRC directors, supervisors, senior management and other employees of an overseas-listed PRC company, (ii) PRC subsidiaries or branches of, and any PRC entities directly or indirectly controlled by, an overseas-listed company, and (iii) the Domestic Individuals. Under SAFE Notice 7, Domestic Individuals who are granted stock options or any other stock-related rights and benefits under a stock incentive plan by an overseas publicly-listed company are required to complete certain procedures and transactional foreign exchange matters under the stock incentive plan

upon the examination by, and the approval of, SAFE or its authorized local counterparts.

In 2009 and 2010, we registered, and registered on behalf of those employees subject to SAFE Notice 7, with the relevant local SAFE branches our previously adopted employee stock incentive plans, pursuant to regulations promulgated under SAFE Notice 78. However, there exist significant uncertainties in practice with respect to the interpretation and implementation of SAFE Notice 7, and we cannot assure you that our registration under SAFE Notice 78 would be sufficient for compliance with SAFE Notice 7. If SAFE or other PRC governmental authorities determine that we or those of our employees subject to SAFE Notice 7 have failed to comply with the provisions of the SAFE Notice 7, we or they may be subject to fines and legal sanctions.

Item 4A. Unresolved Staff Comments

Not applicable.

Item 5. Operating and Financial Review and Prospects

The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and the related notes thereto included elsewhere in this annual report. Our audited consolidated financial statements have been prepared in accordance with U.S. GAAP. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information provided in “Item 3 — Key Information — Risk Factors.”

Overview

We are one of the leading providers of digital entertainment services for consumers in the PRC. We operate three main business units, namely WVAS, mobile games and Internet games. We are one of the leading providers of WVAS to mobile phone users and have been in cooperation with all major telecommunications operators in the PRC since 2002. In 2005, we began providing feature-phone mobile games on the networks of China Mobile with the acquisition of Tianjin Mammoth, a feature phone mobile games developer. To further expand our mobile games development capabilities, we acquired Noumena in 2012 in order to develop smartphone mobile games on smartphone mobile operating systems, such as iOS and Android. We commenced our Internet games business in 2010 through our acquisition of Dacheng, a developer and operator of Internet games in the PRC. In addition to developing and operating our self-developed Internet games, such as Loong, Demon Code and Kung Fu Hero, we are the exclusive operator of the popular World of Tanks game for the PRC Internet games market. In May 2012, we entered into a strategic partnership with WarGaming, which granted us the exclusive license to all of WarGaming's games in the PRC, including World of Tanks, World of Warplanes and World of Warships. In addition, as of December 31, 2013, we were also the exclusive licensee in the PRC for the Guild Wars 2 game developed by ArenaNet, Hawken game developed by Meteor Entertainment, Blitzkrieg 3 game developed by ZZima, Auto Club Revolution game developed by Eutechnyx and Guozhan Online game developed by Guangzhou Sixiang.

We were incorporated under the laws of the Cayman Islands on May 6, 2002. Our revenues were US\$179.4 million in 2013, compared to US\$186.4 million in 2012. Our net income was US\$20.7 million in 2013, compared to US\$25.7 million in 2012. As a percentage of our total revenues, revenues generated from WVAS, mobile games and Internet games accounted for 35.6%, 9.5% and 54.9% in 2013, respectively.

We have a limited operating history on which to base an evaluation of our business and prospects. Our prospects should be considered in light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in the early stages of their development, particularly in new and rapidly evolving markets such as the WVAS, mobile games and Internet games markets.

The major factors affecting our financial condition and results of operations include:

- trends in the WVAS, mobile games and Internet games markets in the PRC;
- continued growth in the number of players for, and revenues generated from, the World of Tanks game;
- our product development efforts to capitalize on market opportunities, including the successful launches of new smartphone mobile games and Internet games, which depend, in part, on our ability to anticipate and effectively

respond to the changing consumer tastes and preferences and technological advances in a timely manner;

changes in the policies or guidelines of China Mobile and other PRC telecommunications operators with respect to our WVAS and mobile games businesses;

changes in laws, rules and regulation affecting our businesses;

development of competing services from China Mobile, other PRC telecommunications operators, and increased competition in the mobile games and Internet games markets from the more established companies that develop and operate personal computer-based games, as well as the mobile platform application developers;

effectiveness of our marketing and promotional activities;

technological advancement of the mobile telecommunications market, including the adoption of 3G and subsequent standards of mobile handsets and networks, and the smartphone mobile games and Internet games market in the PRC; and

changes in the number, scope and terms of our cooperation arrangements with the telecommunications operators, content providers, mobile handset manufacturers, mobile handset distributors and other key players in the PRC's mobile telecommunications industry.

In order to reduce the risk that our financial condition and results of operations will be overly dependent upon, and disproportionately impacted by, any particular service offering, technology platform or telecommunications operator, we have sought to broaden the range of our services, expand our distribution channels, cultivate new relationships with telecommunications operators and develop our smartphone mobile games and Internet games businesses, both of which are less dependent on the telecommunications operators than either WVAS or feature-phone mobile games business. Our acquisitions of Dacheng and Noumena are also part of this diversification strategy.

Revenues

The following table sets forth the revenues attributable to services derived from the WVAS, mobile games and Internet games segments in terms of amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31, 2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)					
WVAS	US\$80,265.9	50.2	% US\$77,765.5	41.7	% US\$63,922.2	35.6 %
Mobile games	40,850.5	25.5	21,190.3	11.4	17,069.0	9.5
Internet games	38,892.0	24.3	87,423.9	46.9	98,449.2	54.9
Total	US\$160,008.4	100.0	% US\$186,379.7	100.0	% US\$179,440.4	100.0 %

The following table sets forth the revenues attributable to services derived from each of our 2G and 2.5G technology platforms in terms of amount and as a percentage of our total revenues for the periods indicated:

	For the year ended December 31, 2011		2012		2013	
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues

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(in thousands of U.S. dollars, except percentages)

2G services								
SMS	US\$37,096.5	23.2	% US\$39,178.1	21.0	% US\$32,334.6	18.0	%	
IVR	12,661.9	7.9	13,438.0	7.2	14,884.2	8.3		
CRBT and others	21,578.9	13.5	19,069.2	10.3	14,870.5	8.3		
Subtotal	71,337.3	44.6	71,685.3	38.5	62,089.3	34.6		
2.5G services								
WAP	US\$2,355.4	1.5	US\$2,688.1	1.4	US\$719.9	0.4		
MMS	6,573.2	4.1	3,392.1	1.8	1,113.0	0.6		
Subtotal	US\$8,928.6	5.6	US\$6,080.2	3.2	US\$1,832.9	1.0		
Total WVAS revenues	US\$80,265.9	50.2	% US\$77,675.5	41.7	% US\$63,922.2	35.6	%	

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WVAS Revenues

We generate our WVAS revenues from fees paid by mobile phone users who use our services through the networks of China Mobile, China Unicom and China Telecom. Our dependence on China Mobile decreased in 2013, as China Mobile continued to de-emphasize their WVAS businesses. As a percentage of our total WVAS revenues, WVAS revenues generated from China Mobile represented approximately 66% and 57% in 2012 and 2013, respectively. Due to our dependence on China Mobile for a substantial portion of our WVAS revenues, our working relationship with China Mobile is critical to the financial condition and results of operations of our WVAS business. See “Item 3 — Key Information — Risk Factors — 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 allocate our WVAS resources based on the geographic concentration of our customers. Due to our customer base being primarily concentrated in the coastal regions of the PRC, we generally allocate more of our WVAS resources to these regions, including maintaining sales offices in most of the coastal regions of the PRC.

We recognize revenues derived from our services before deducting the service fees and the net transmission charges that we pay to the telecommunications operators. Fees for our services are charged on either a single-transaction or monthly subscription basis and vary according to the type of services delivered. For a description of our fees and arrangements with the telecommunications operators, see “Item 4 — Information on the Company — Our Business — Strategic Relationships — Telecommunications Operators.” We recognize all revenues in the period in which the services are performed.

As telecommunications operators do not provide us with a detailed revenue breakdown on a service-by-service basis, we depend on our internal data management system to monitor revenues derived from each of our services. We make our business decisions, including research and development of new services and reallocation of resources to popular services, based on our internal data, taking into account other factors including strategic considerations. For a description of our revenue recognition policy, see “— Critical Accounting Policies.”

The billing policies of the PRC telecommunications operators have historically had a significant impact on our WVAS revenues. In particular, China Mobile and its provincial subsidiaries have been implementing a series of policies designed to improve customer service and satisfaction. These policies include:

- not recognizing revenues to us and other service providers for MMS messages 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 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.

Additional measures implemented by China Mobile with respect to the billing of customers of WVAS on its network that have had a significant impact on our financial condition and results of operations include:

· 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 WAP monthly subscriptions that have not been active for more than four months.

The other PRC telecommunications operators have also implemented new policies requiring double confirmation of monthly subscriptions, and China Mobile sends notices of transmission fees to be incurred by using GPRS to the handsets of its customers when those customers launched their browsers, which discouraged some customers from purchasing our WAP products.

In addition, China Mobile implemented a series of measures targeted at eliminating offensive or unauthorized content, including pornographic content, on Chinese-based WAP sites. As a result, China Mobile and other Chinese telecommunications operators suspended billing for their customers for all WAP and G+ mobile gaming platform services, including those services that do not contain offensive or unauthorized content, on behalf of third party service providers of such services. China Mobile and other operators have not yet indicated how long these new measures would last or whether they would expand their current measures.

Furthermore, China Mobile has been implementing an additional series of measures targeted at further improving the user experience for mobile handset embedded services, in addition to the introduction of a new SMS code management system. Under these measures, WVAS that are embedded in handsets will be required to introduce additional notices and confirmations to end-consumers during the purchase of such services. In addition, services related to SMS short codes will be required to be more tailored to the specific service offerings or service partners. Previously, a single SMS code could be used for multiple service offerings or partners.

For a description of risks related to significant changes in the billing and service provider policies of the telecommunications operators, see “Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — Significant changes in the policies or guidelines of China Mobile or other PRC telecommunications operators with respect to services provided by us could result in lower revenues or additional costs for us and materially and adversely affect our business, financial condition, results of operations and prospects.”

Our WVAS revenues were US\$80.3 million, US\$77.8 million and US\$63.9 million in 2011, 2012 and 2013, respectively. The continued decrease of our WVAS revenues over the past three years also reflects the decreased reliance by telecommunications operators on products of third party services providers such as our company, to generate revenues as well as their increased emphasis on data transmission to generate revenues. We believe such trends are likely to continue in the near future.

Mobile Games Revenues

We generate a majority of our mobile games revenues by distributing mobile games through the networks of China Mobile. As a percentage of our total mobile games revenues, mobile games revenues received through China Mobile accounted for 97.1%, 71.7% and 59.9% in 2011, 2012 and 2013, respectively. Due to our dependence on China Mobile for substantially all of our mobile games revenues, our working relationship with China Mobile is critical to the operation of our mobile games business. For a description of risks related to our dependence on China Mobile, see “Item 3 — Key Information — Risk Factors — 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 expect to supplement these streams of revenues in 2014 with revenues that we expect to generate from sales of our internally developed smartphone mobile games, which we distribute through digital distribution platforms, such as app stores developed by smartphone handset manufacturers.

Our mobile games revenues decreased from US\$40.8 million in 2011 to US\$21.2 million in 2012, and further decreased to US\$17.1 million in 2013. The decreases were primarily due to the adoption by China Mobile of measures similar to those that have affected our WVAS business, as described above, and China Mobile's decision to de-emphasize its subscription-based mobile games download services. In addition, as we restructured our smartphone game development team in the first half of 2013, new smartphone games were only launched during the second half of 2013, which contributed to the decrease in revenues from smartphone games in 2013. For a description of risks related to significant changes in the billing and service provider policies of the telecommunications operators, see "Item 3 — Key Information — Risk Factors — Risks Relating to Our Businesses — Significant changes in the policies or guidelines of China Mobile or other PRC telecommunications operators with respect to services provided by us could result in lower revenues or additional costs for us and materially and adversely affect our business, financial condition, results of operations and prospects." The decrease in 2013 was also attributable to impact created by the overall market shift in the tastes and preferences of consumers in China from traditional feature phone mobile games, which are mainly Java-based, to mobile games that are developed for smartphone mobile operating systems, such as iOS and Android mobile games. We believe this shift in tastes and preferences of consumers in China will continue in 2014. For a description of risks related to uncertainties in the PRC mobile games market, see "Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — Our mobile games business has a short operating history, and the mobile games market in the PRC is subject to many uncertainties."

Internet Games Revenues

The Internet games revenues are primarily derived from Internet games operation revenues and licensing revenues. We earn Internet games operation revenues through the provision of Internet games services to players under an item-based revenue model, whereby players are able to play the Internet games free of charge for an unlimited amount of time, but are charged for purchasing in-game items, such as in-game performance-enhancing items, mechanised vehicles, clothing, accessories and pets. In 2013, we derived a majority of our Internet games revenues from revenues generated through the operation of our licensed Internet games, especially the World of Tanks game, which generated over 95.5% of our Internet games revenues from the in-game items purchased for the World of Tanks game for 2013. We expect revenues generated from the World of Tanks game to continue to be a major driver for growing our Internet games revenues in 2014. Due to our dependence on the World of Tanks game for a majority of our Internet games revenues, our business relationship with WarGaming is critical to the continued operation of the World of Tanks game. For a description of risks related to our dependence on a small number of Internet games for a significant portion of our Internet games revenues, see "Item 3 — Key Information — Risk Factors — Risks Relating to Our Business — We depend on a small number of Internet games for a significant portion of our Internet games revenues. As a result, any factors that could have an adverse impact on the development, marketing and distribution of these Internet games, or on our business relationships with the licensors of these Internet games, could materially decrease our Internet games revenues, and have a material adverse effect on our business, financial condition, results of operations and prospects."

Revenues from the sales of in-game items are recognized when items are consumed by customers or over the estimated lives of the items. The revenue recognition policy for the item-based games relies on the useful lives of various items associated with each of our item-based games. The in-game items have different life patterns: one-time use items, limited life items with useful life ranging from three days to 90 days and permanent life items. To

determine whether an in-game item has a limited or permanent life, we consider whether such in-game items are offered with unlimited lasting benefit, which means that players may use such in-game items at will without any usage or time limits as long as such players are active. Limited life in-game items have usage or time limits while permanent life in-game items offer unlimited lasting benefit. Revenues from the sales of one-time use in-game items are recognized upon consumption. Revenues from the sales of limited life in-game items are recognized ratably based on the extent of time passed until expiration. Revenues from the sales of permanent life in-game items are recognized ratably based on the estimated lives of the in-game items, which is the period during which the player is expected to continue to play the game.

We consider player behavior patterns in estimating the lives of permanent life in-game items, including the average period that the typically play our games based on log-on data, which are affected by various factors such as acceptance and popularity of the game, game updates and other in-game items, promotional events launched, future operating strategies and market conditions. Based on the above considerations for all active games, we have determined the estimated life for all permanent life in-game items is six months. Given the short operating history of our Internet games, our estimates of the period that game players typically play our games may not accurately reflect the actual lives of the permanent life in-game items. We review, at least annually, the average playing periods of game players for all active games to determine if the six-month estimated life for permanent in-game items remains reasonable. Based on our latest review, such estimated life remains reasonable and has not changed over time. We may revise our estimates as we continue to collect operating data and refine our estimation process and results accordingly. All paying users' data in active games collected since the launch date of such games are used to perform the relevant assessments. Historical behavior patterns of these paying users during the period between their first log-on date and last log-on date are used to estimate the lives of the permanent life in-game items.

Under the item-based revenue model, proceeds received from sales of game points to players, which can be converted into in-game currencies to purchase in-game items, are initially recorded as advances from customers as game points are refundable. As players convert game points into in-game currencies, proceeds received from sales of those game points are transferred from advances from customers to deferred revenues. Deferred revenues are recognized as revenues when in-game items purchased with in-game currencies are consumed by players over the estimated lives of such items. In addition to game points that we sell and distribute by ourselves, a portion of our game points are sold and distributed through third party vendors. As we do not have control and generally do not know the ultimate selling price of the prepaid game cards or game points sold by the distributors, net proceeds from distributors are recorded as advances from customers. Upon activation of the game cards or the game points, these advances from customers are immediately transferred to deferred revenues. For a description of our revenue recognition policy, see “— Critical Accounting Policies.”

In addition, we entered into licensing arrangements with various licensees to operate our games in the PRC and in other countries and regions. These licensing agreements provide for two revenue streams: the initial fees and the usage-based royalty fees. In certain licensing arrangements, we provide free upgrades, maintenance support and training, which are our post-sale customer support, or PCS, for the first year. The licensees have the option to purchase PCS in subsequent years at specified renewal rates. In these arrangements, we allocate the initial fee into two parts. The first part represents the license of the game and is recognized as license revenue immediately upon the launch of the games in foreign countries or regions. The second part represents fees for the PCS and is recognized ratably over the contractual period of the PCS. In other licensing arrangements, we provide PCS over the full licensing period for no additional charge. In such cases, the total amount of the initial fee is recognized ratably over the full contractual licensing period.

According to our license agreements, we are also entitled to ongoing usage-based royalties determined based on the amount of fees charged to the players' accounts or services payable by players in a given country or region. The usage-based royalties are recognized when they are earned, provided that collection is probable.

Our Internet games revenues were US\$98.5 million in 2013, of which 97.5% was generated from game operations and 2.5% was generated from licensing our Internet games to third party licensees.

Cost of Revenues

Our cost of revenues includes WVAS cost of revenues, mobile games cost of revenues and Internet games cost of revenues.

WVAS Cost of Revenues

Our WVAS cost of revenues includes the following:

Service fees payable by us to the telecommunications operators. In the case of China Mobile and its subsidiaries, service fees are generally 15% to 60% of the revenues, while in the case of China Unicom and China Telecom, service fees are in the range of 15% to 70%, varying according to the service platform. We are not obligated to pay the service fees to the telecommunications operators if customers cannot be billed or do not pay the telecommunications operators;

Net transmission charges payable by us to the telecommunications operators, calculated as the number of messages we send to customers in any given month, minus the number of messages we receive from customers regarding our services in that month, and multiplied by a per-message transmission fee. We are obligated to pay the telecommunications operators the net transmission charges even if customers cannot be billed or do not pay the telecommunications operators;

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Payments to content providers for the use of their content, and to mobile handset manufacturers and other industry partners with whom we have cooperation arrangements, in the form of a fixed fee or a percentage of our aggregate net revenues received from the telecommunications operators with respect to services provided through the cooperation arrangements;

· Bandwidth leasing charges and depreciation and facility costs relating to equipment used to provide WVAS; and

· Depreciation and facility maintenance.

Our total WVAS cost of revenues in 2011, 2012 and 2013 was US\$50.8 million, US\$52.7 million and US\$43.1 million, respectively. As a percentage of our WVAS revenues, our WVAS cost of revenues in 2011, 2012 and 2013 was 63.2%, 67.7% and 67.4%, respectively. In 2013, as a percentage of our WVAS cost of revenues, service fees to the telecommunications operators represented approximately 21.2%, payments to handset manufacturers represented approximately 5.3%, net transmission charges to the telecommunications operators represented approximately 2.8%, payments to content providers represented approximately 5.7%, payments to other cooperation partners represented approximately 27.1% and bandwidth leasing charges, depreciation and other facility costs represented approximately 5.3%.

Our WVAS cost of revenues decreased in 2013 primarily as a result of decreases in the service fees we paid to our content providers and media partners in 2013. As our overall WVAS revenues decreased, the amount that we paid to telecommunications operators in service fees also decreased.

As part of our business strategy, we expect to continue to pursue more cooperation arrangements with business partners, such as handset manufacturers, because these arrangements make it easier for customers to access our products and services and are a cost-effective way to increase our market share as compared to traditional advertising. However, as we generally pay higher rates of service fees, in terms of percentages of revenues generated from cooperation arrangements, to such business partners than those paid to telecommunications operators, this strategy may result in a decrease in our gross profit margin.

Mobile Games Cost of Revenues

Our mobile games cost of revenues consists mainly of service fees and net transmission charges to the telecommunications operators, payments to content providers for the use of their content, bandwidth leasing charges and payments to mobile application platforms (such as iOS and Android distribution platforms) for the distribution of smartphone games.

Total mobile games cost of revenues in 2011, 2012 and 2013 was US\$25.2 million, US\$10.9 million and US\$7.8 million, respectively. The decrease in mobile games cost of revenues in 2013 resulted largely from a decrease in our overall mobile games business and associated service fees paid to telecommunications operators. In 2011, we began offering subscription-based mobile games download services through our partnership with China Mobile. Based on our agreement with China Mobile, we share approximately 50% of our subscription-based revenues with China Mobile, compared to approximately 15% for single-download games. See “Item 4 — Information on the Company — Business Overview — Material Contracts with Telecommunications Operators for WVAS and Mobile Games.” Largely as a result of the adoption by China Mobile of similar measures that have affected our WVAS business and China Mobile’s de-emphasizing of its feature phone mobile games services, our mobile games cost of revenues in 2013 has decreased by 28.9% from 2012. For a description of policies and measures adopted by China Mobile, see “— Revenues — WVAS Revenues.” To a lesser extent, the decrease was also due to a decrease in the payments to content providers and licensors and lower bandwidth leasing charges associated with our online mobile games. We expect our mobile games cost of revenues to remain stable in 2014. We further expect our mobile games cost of revenues to correspondingly increase as a result of higher sales of our internally developed smartphone mobile games, which we plan to distribute through digital distribution platforms, such as app stores developed by smartphone handset manufacturers. However, we expect such increase to be offset by continued decreases in the costs of distributing our mobile games through China Mobile as China Mobile continues to de-emphasize feature-phone mobile games.

We intend to develop internally the majority of our mobile games, which generally have lower cost of revenues. However, in order to expand our mobile games business and increase our market share, we also plan to actively identify quality mobile games to be acquired or licensed from third parties, which generally have higher cost of revenues.

Internet Games Cost of Revenues

Our Internet games cost of revenues consists mainly of revenue sharing paid to third party Internet game licensors, labor costs, warrant amortization, bandwidth leasing charges, depreciation and facility costs relating to equipment used to provide Internet games services. Total Internet games cost of revenues in 2011, 2012 and 2013 was US\$15.9 million, US\$39.5 million and US\$45.5 million, respectively. As a percentage of our Internet games cost of revenues, revenue sharing paid to third party Internet game licensors accounted for 68.8%, 76.9% and 86.2% in 2011, 2012 and 2013, respectively. The increase in Internet games cost of revenues in 2013 was primarily due to increases in our overall Internet games business and associated revenue sharing paid to third party Internet game licensors. We began acquiring licenses to operate Internet games from other Internet games developers in 2011, as part of our plan to grow our portfolio of licensed Internet games that complement our internally developed games. We expect our Internet games cost of revenues to increase in 2014 as we expect revenues generated from the World of Tanks game to continue to be a major driver for growing our Internet games revenues in 2014. To a lesser extent, we expect our Internet games cost of revenues to increase in 2014 as a result of the launch of certain new games that we licensed in 2013.

Operating Expenses

	For the year ended December 31,				2013			
	2011	2012	2012	2013	2013	2013	2013	2013
	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues	Amount	Percentage of revenues
	(in thousands of U.S. dollars, except percentages)							
Product development	US\$15,416.9	9.6 %	US\$18,382.4	9.9 %	US\$26,401.7	14.7 %		
Selling and marketing	20,891.6	13.1	24,586.0	13.2	26,674.0	14.9		
General and administrative	11,582.2	7.2	11,629.3	6.2	8,976.2	5.0		
Goodwill and intangible assets impairment loss	20,259.2	12.7	-	-	1,562.4	0.9		
Total	US\$68,149.9	42.6 %	US\$54,597.7	29.3 %	US\$63,614.3	35.5 %		

Product Development Expenses

Our product development expenses consist primarily of compensation and benefits for our product and development team. Our product development expenses in 2011, 2012 and 2013 were US\$15.4 million, US\$18.4 million and US\$26.4 million, respectively. We expect our product development expenses to increase in 2014, as we continue to expand our offerings in mobile games and Internet games.

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Sales and Marketing Expenses

Our sales and marketing expenses consist mainly of expenses associated with sponsoring promotional events and compensation and benefits for our sales, marketing and customer service teams. Our sales and marketing expenses in 2011, 2012 and 2013 were US\$20.9 million, US\$24.6 million and US\$26.7 million, respectively. We expect our sales and marketing expenses to increase in 2014, as we plan to continue to promote our Internet and mobile games and to launch several licensed Internet games in 2014.

General and Administrative Expense

Our general and administrative expenses consist primarily of compensation and benefits for general management, finance and administrative personnel, professional fees and other office expenses. Our general and administrative expenses in 2011, 2012 and 2013 were US\$11.6 million, US\$11.6 million and US\$9.0 million, respectively. We expect our general and administrative expenses to increase if our business grows in future periods as we may also incur more expenses relating to employee compensation and other administrative and professional fees.

Impairment of Goodwill and Intangibles

In 2011, we experienced significant fluctuations in the prices of our ADSs, which resulted in our market capitalization falling below our book value during certain periods of the year and made it necessary for us to perform an impairment review of our business units. In the third quarter of 2011, we performed a goodwill impairment test and found that the goodwill and our intangible assets of our WVAS unit were impaired, resulting in a total impairment charge of US\$20.3 million and US\$4,000, respectively. In the annual goodwill impairment test conducted in December 2012 and 2013, the fair value of each reporting unit exceeded its carrying value. As a result, no goodwill impairment was recorded in 2012 or 2013.

As a result of the expected cessation of one game in 2013, the carrying amount of the corresponding game license exceeded the sum of undiscounted future cash flows expected to be generated from the use and eventual disposition of such license. Accordingly, the Company recognized an impairment loss of US\$1.56 million in 2013.

Critical Accounting Policies

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Set forth below is a summary of our accounting policies that we believe are both important to the portrayal of our financial results and require us to make estimates and adjustments about the effect of matters that are inherently uncertain. Our critical accounting policies generally require us to make estimates or judgments that are difficult or subjective.

Revenue Recognition

WVAS Revenues

Our revenues are primarily derived from providing wireless interactive entertainment, media and community value-added services to customers of the PRC telecommunications operators. The fees for these services are determined by us in consultation with the telecommunications operators, are charged on a single-transaction basis or on a monthly subscription basis, and vary according to the type of services delivered.

We deliver WVAS to users through the networks of the telecommunications operators, and we rely upon the telecommunications operators to provide us with billing and collection services. We record revenues based on monthly statements from the telecommunications operators confirming the value of our services that they billed to users in the month. China Mobile and its provincial subsidiaries typically send such statements within 30 days after the end of each month.

The billing and collection cycles of China Unicom, China Telecom, China Netcom and their respective subsidiaries are generally longer than those of China Mobile. As a general matter, we receive statements from China Unicom within 120 days after the end of each month, and within 70 days after the end of each month from China Telecom and China Netcom. We cannot assure you that the length of the billing cycle will not increase further in the future.

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. Our internal estimates of revenues and cost of revenues for any period are subsequently adjusted in our financial reports when we actually receive the monthly statements for such period.

In 2012 and 2013, estimated revenues generally accounted for less than 5% of our reported quarterly revenues and less than 5% of our reported annual revenues. Our estimates are based on:

our internal data management system;

our past experience; and

our verbal communications with the telecommunications operators.

We internally tabulate the value of a WVAS that we have provided based in part on service delivery confirmations sent to us by the PRC telecommunications operators. There has historically been a discrepancy between the value that we estimate and the value that we are entitled to receive based on the monthly statements provided by the telecommunications operators. This discrepancy varies across different technology platforms and arises for various reasons, including the following:

Late notification of delinquent customers. The telecommunications operators may from time to time classify certain customers as delinquent customers for non-payment of services. The telecommunications operators would request all service providers to cease delivering services to customers once they are classified as delinquent. However, time lags often exist between when a customer is classified as delinquent and when we receive such information from the telecommunications operators. As a result, we occasionally provide services to these delinquent customers for which the telecommunications operators will not make any payments to us.

Customer database out of synchronization. Customers may cancel their subscriptions through the telecommunications operators. Although we synchronize the customer information databases of the telecommunications operators with our databases on an ongoing basis, the databases are not always completely in synchronization. As a result, until our databases are synchronized with those of the telecommunications operators, we could provide services to customers who have cancelled their subscriptions, for which we are not entitled to receive payment.

Duplicate billing. China Mobile typically generates system identification numbers to identify customers who use our WAP services, rather than using the actual mobile phone numbers. As a result, the platform operators may on occasion inadvertently generate multiple identification numbers for a mobile phone number. In such a case, the multiple bills generated need to be eliminated from the monthly statement the telecommunications operators provide to us.

Delivery failure. When telecommunications operators send us delivery confirmations within 72 hours of our delivery of value-added services, the confirmations will indicate three possible outcomes: success, failure or unknown. Our internal system recognizes successful confirmations as services provided. As a result, discrepancies may exist between our records and the monthly statement provided by the telecommunications operators for confirmations marked as “unknown” where our services were successfully delivered or where the confirmation was incorrect.

Unbillable users. Certain provincial subsidiaries of China Mobile have been offering 2.5G services since 2005 to customers who receive mobile telephone services on a pre-paid basis. These customers may subscribe to our services or download our products, and our internal databases do not distinguish between these and other customers. However, the telecommunications operators do not yet have any means to bill these pre-paying customers for the WVAS that they receive. As a result, the telecommunications operators’ monthly statements do not include fees for such users.

The telecommunications operators remit to us amounts net of an allowance they have made for the doubtful debts in respect of the amounts due to us from our customers. They also net their fees for the services they provide to us, including billing and collection services, and net transmission charges from their remittances to us. Certain telecommunications operators do not provide an itemized analysis of their remittances, and as a result we are unable to determine what allowance, if any, for doubtful or bad debts should be recorded for our services delivered through such telecommunications operators. Accordingly, recognition of revenues is based upon the amounts reported on the telecommunications operators’ monthly statements to us, which are net of doubtful debts and represent the amounts we reasonably believe will be collected.

Due to the factors set forth above, we would multiply our internal tabulation of expected revenues from telecommunications operators from whom we have not received monthly statements by a realization factor applicable to the relevant telecommunications operator and service and determined according to the average discrepancy over the previous 12 months between our internal tabulations of expected revenues and the actual revenues based on the monthly statements. In addition, we also seek to verify the estimated revenues through discussions with the billing personnel of the telecommunications operators, although we cannot assure that we would be able to reduce the discrepancy between our revenue estimates and the revenues calculated by telecommunications operators and their subsidiaries.

In 2013, the average time from our receipt of statements from the telecommunication operators until they paid us the amounts due under such statements was approximately 69 days. We cannot assure you that our period to collect accounts receivables will not increase in the future.

We evaluate our cooperation arrangements with the telecommunications operators to determine whether to recognize our revenues on a gross basis or net of the service fees and net transmission charges paid to the telecommunications operators. Our determination is based upon an assessment of whether we act as a principal or agent when providing our services. We have concluded that we act as principal in the arrangement. Factors that support our conclusion mainly include:

- we are the primary obligor in the arrangement;

we are able to establish prices within price caps prescribed by the telecommunications operators to reflect or react to changes in the market;

- we determine the service specifications of the services we will be rendering;

- we are able to control the selection of our content suppliers; and

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the telecommunications operators usually will not pay us if users cannot be billed or if users do not pay the telecommunications operators for services delivered and, as a result, we bear the delivery and billing risks for the revenues generated with respect to our services.

Based on these factors, we believe that recognizing revenues on a gross basis is appropriate. However, as noted above, our reported revenues are net of bad debt charges that have been deducted by the telecommunications operators.

Mobile Games Revenues

The mobile games revenues are primarily derived from feature phone revenues and smart phone revenues. We recognize feature phone revenues from providing mobile games services on the platforms of PRC telecommunications operators. Mobile phone users download the mobile games in the same manner as the WVAS, and we recognize revenues from such feature phone mobile games services in the same way as the WVAS revenues are recognized. We recognize smart phone revenues from providing mobile games services on platforms such as global iOS and Android platforms. Smart phone users download the mobile games on iOS and Android. We adopt the item-based revenue model. The basic game play functions are free of charge, and players are charged for purchases of in-game items. Revenues from the sales of in-game items are recognized when the items are consumed by customers.

Internet Games Revenues

We derive Internet games revenues primarily from Internet games operation revenues and licensing revenues. We earn Internet games operation revenues through providing Internet games services to players under an item-based revenue model, whereby players are able to play the Internet games free of charge for an unlimited amount of time, but are charged for purchasing in-game items, such as in-game performance-enhancing items, mechanised vehicles, clothing, accessories and pets. Revenues from the sales of in-game items are recognized when the items are consumed by customers or over the estimated lives of the items.

The revenue recognition policy for the item-based games relies on the useful lives of various items associated with each of our item-based games. The in-game items have different life patterns: one-time use items, limited life items with useful life ranging from three days to 90 days and permanent life items. To determine whether an in-game item has a limited or permanent life, we consider whether such in-game items are offered with unlimited lasting benefit, which means that players may use such in-game items at will without any usage or time limits as long as such players are active. Limited life in-game items have usage or time limits while permanent life in-game items offer unlimited lasting benefit to the players. Revenues from the sales of one-time use in-game items are recognized upon consumption. Revenues from the sales of limited life in-game items are recognized ratably based on the extent of time passed until expiration. Revenues from the sales of permanent life in-game items are recognized ratably based on the estimated lives of the in-game items, which is the period during which the player is expected to continue to play the

game.

We take into account player behavior patterns in estimating the lives of permanent life in-game items, including the average period that the typical player plays our games based on log-on data, which are affected by various factors such as acceptance and popularity of the game, game updates and other in-game items, promotional events launched, future operating strategies and market conditions. Based on the above considerations for all active games, we have determined the estimated life for all permanent life in-game items is six months. We review, at least annually, the average playing periods of game players for all active games to determine if the six-month estimated life for permanent in-game items remains reasonable. Based on our latest review, such estimated life remains reasonable and has not changed over time. We may revise our estimates as we continue to collect operating data and refine our estimation process and results accordingly. All paying users' data collected since the launch of the games are used to perform the relevant assessments. Historical behavior patterns of these paying users during the period between their first log-on date and last log-on date are used to estimate the lives of the permanent life in-game items.

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Under the item-based revenue model, proceeds received from sales of game points to players, which can be converted into in-game currencies to purchase in-game items, are initially recorded as advances from customers as game points are refundable. As players convert game points into in-game currencies, proceeds received from sales of those game points are transferred from advances from customers to deferred revenues. Deferred revenues are recognized as revenues when in-game items purchased with in-game currencies are consumed by players over the estimated lives of such items. In addition to game points that we sell and distribute, we distribute and sell a portion of our game points through third party vendors. As we do not have control over and generally do not know the ultimate selling price of game points sold by third party vendors, net proceeds from sales of game points by vendors are recorded as advances from customers. These net proceeds are converted to deferred revenues and recognized as revenues in the same way we convert and recognize revenues as discussed in this paragraph.

We evaluate our cooperation arrangements with WarGaming to determine whether to recognize our revenues of the World of Tanks on a gross or net basis. Our determination is based upon an assessment of whether we act as principal or agent when providing our services. We have concluded that we act as principal in the arrangement. Factors that support our conclusion mainly include:

- we, instead of WarGaming, are the primary obligor in the arrangement because we are responsible for the fulfillment and acceptability of the game;

- we have the sole latitude in establishing price;

- we are involved in designing the changes to the content of the game; and

- we are involved in the determination of content specifications of the game.

Based on these factors, we believe that recognizing our revenues of the World of Tanks on a gross basis is appropriate.

In addition, we enter into licensing arrangements with various licensees to operate our games in other countries and regions. These licensing agreements provide for two revenue streams: the initial fees and the usage-based royalty fees. In certain licensing arrangements, we provide free PCS such as upgrades, maintenance support and training for the first year. The licensees have the option to purchase PCS in subsequent years at specified renewal rates. In these arrangements, we allocate the initial fee into two parts. The first part represents the license of the game and is recognized as license revenue immediately upon the launch of the games in foreign countries or regions. The second part represents fees for the PCS and is recognized ratably over the contractual period of the PCS. In other licensing arrangements, we provide PCS over the full licensing period for no additional charge. In such cases, the total amount of the initial fee is recognized ratably over the full contractual licensing period.

According to our license agreements, we are also entitled to ongoing usage-based royalties determined based on the amount of fees charged to the players' accounts or services payable by players in a given country or region. The usage-based royalties are recognized when they are earned, provided that collection is probable.

Share-based Compensation Expense

Our share-based employee compensation plans are described in more detail under "Item 6 — Directors, Senior Management and Employees — Share Options." Share-based compensation to employees is measured based on the fair value of the equity instrument on its grant date. We recognize these compensation costs net of a forfeiture rate on a straight-line basis over the requisite service period of the award, which is generally the vesting period of the award. The forfeiture rate is estimated based on historical forfeiture data and will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change, which will impact the amount of share-based compensation expense to be recognized in future periods.

We adopted valuation models to determine the fair value of equity awards granted, which is generally expensed over the vesting period. Significant judgment on parameters, such as the estimated volatility of the underlying ordinary shares, is required to be made by our management in applying the models.

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