



( continued into the Cayman Islands with limited liability )

Stock Code: 03888



**KINGSOFT  
CORPORATION  
LIMITED**  
***2010 Annual Report***

Beijing Zhuhai Chengdu Dalian Shenzhen Japan Malaysia



# Kingsoft Corporation Limited

Annual Report 2010 | KINGSOFT CORPORATION LIMITED

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# MISSION

The mission of Kingsoft: committed to improving the quality of people's digital lives

## **1. For users**

The ultimate meaning of our existence is to focus on quality and to improve the quality of people's digital lives.

We provide the most tailor-made and personalized digital products and services, enabling people to have the brand-new, more colorful and freer life style. Through continuous improvement, we have been satisfying a variety of needs which are changing and increasing day by day.

Kingsoft helps everybody in need for different purposes, such as office, learning and amusement.

We respect our users' feeling and experience and thus give them extraordinary experience and better quality of life through our ubiquitous Kingsoft services.

## **2. For society**

With the extensiveness and speed of the internet, we concentrate on the businesses in connection with internet security, application software, digital entertainment and social activities. We contribute to our society's advancement with a series of products and comprehensive services provided in a creative, speedy, content-rich and centralized manner. Team members of Kingsoft always stick to their high integrity.

## **3. For staff**

The Company is committed to creating the best career path to our staff and enhancing their value. Also, we strive to develop a happy working environment, in which learning is encouraged, with a view of improving the quality of our staff's working lives.

## **4. For investors**

We aim to attract investors with excellent results while maintaining the Company's healthy and sustainable development. We expect to pursue long-term value for investors.

# CORPORATE INFORMATION

## **Legal Name of the Company**

Kingsoft Corporation Limited

## **Stock Code**

3888

## **Date of Listing**

October 9, 2007

## **Head Office and Principal Place of Business**

Kingsoft Tower

No. 33, Xiaoying West Road

Haidian District

Beijing 100085

PRC

## **Principal Place of Business in Hong Kong**

Unit 1309A, 13/F

Cable TV Tower

No. 9 Hoi Shing Road

Tsuen Wan, N.T.

Hong Kong

## **Registered Office**

Clifton House

75 Fort Street

P.O. Box 1350 GT

George Town

Grand Cayman KY1-1108

Cayman Islands

## **Executive Directors**

Mr. Pak Kwan Kau (Chairman)

Mr. Donghui Wang

Mr. Tao Zou

## **Non-executive Directors**

Mr. Jun Lei

Mr. Shuen Lung Cheung

## **Independent Non-executive Directors**

Mr. Shun Tak Wong

Mr. Guangming George Lu

Mr. Mingming Huang

## **Audit Committee**

Mr. Shun Tak Wong (Chairman)

Mr. Guangming George Lu

Mr. Shuen Lung Cheung

## **Remuneration Committee**

Mr. Shuen Lung Cheung (Chairman)

Mr. Shun Tak Wong

Mr. Mingming Huang

## **Nomination Committee**

Mr. Guangming George Lu (Chairman)

Mr. Shuen Lung Cheung

Mr. Mingming Huang

## **Board Secretary/Company Secretary**

Ms. Michelle Feng Harnett (ACCA)

## **Authorised Representatives**

Mr. Pak Kwan Kau

Ms. Michelle Feng Harnett

# CORPORATE INFORMATION (continued)

## **Principal Share Registrar and Transfer Office**

Appleby Trust (Cayman) Limited

Clifton House

75 Fort Street

P.O. Box 1350 GT

George Town

Grand Cayman KY1-1108

Cayman Islands

## **Hong Kong Branch Share Registrar and Transfer Office**

Computershare Hong Kong Investor Services Limited

Shops 1712–1716, 17/F.

Hopewell Centre

183 Queen's Road East

Hong Kong

## **Auditors**

Ernst & Young

Certified Public Accountants

18th Floor, Two International Finance Centre

8 Finance Street

Central

Hong Kong

## **Legal Advisers on Hong Kong law**

Woo Kwan Lee & Lo

26th Floor, Jardine House

1 Connaught Place

Central

Hong Kong

## **Principal Bankers**

Industrial and Commercial Bank of China (Asia) Limited

Standard Chartered Bank (Hong Kong) Limited

Standard Chartered Bank (China) Limited

Bank of Beijing — Zhongguancun Branch

China Merchants Bank Beijing — Beijing Dayuncun  
sub-branch

Bank of Communications — Zhuhai Jida Branch

DBS Bank (China) Limited — Beijing Branch

Australia and New Zealand Bank (China) Company Limited  
Beijing Branch

## **Investor and Media Relations**

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Website: [www.kingsoft.com](http://www.kingsoft.com)

# FINANCIAL HIGHLIGHTS

## Consolidated Income Statement

|   | Year ended December 31, |                 |                 |                    |
|---|-------------------------|-----------------|-----------------|--------------------|
|   | 2007<br>RMB'000         | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000    |
| <b>Revenue:</b>   |                         |                 |                 |                    |
| Entertainment software  | 396,440                 | 553,723         | 684,242         | <b>640,917</b>     |
| Application software  | 156,521                 | 261,150         | 329,196         | <b>321,003</b>     |
| Others  | 3,653                   | 6,071           | 8,974           | <b>9,477</b>       |
|   | 556,614                 | 820,944         | 1,022,412       | <b>971,397</b>     |
| Cost of revenue   | (95,484)                | (110,935)       | (128,467)       | <b>(130,998)</b>   |
| <b>Gross profit</b>   | <b>461,130</b>          | <b>710,009</b>  | <b>893,945</b>  | <b>840,399</b>     |
| Research and development costs,<br>net of government grants                         | (68,450)                | (124,926)       | (199,611)       | <b>(271,046)</b>   |
| Selling and distribution costs  | (108,723)               | (148,565)       | (171,634)       | <b>(129,216)</b>   |
| Administrative expenses   | (65,785)                | (93,772)        | (101,630)       | <b>(111,143)</b>   |
| Share-based compensation costs  | (103,764)               | (49,909)        | (41,312)        | <b>(42,119)</b>    |
| Other income and gains  | 11,531                  | 18,898          | 26,867          | <b>31,528</b>      |
| Other expenses  | (2,249)                 | (4,822)         | (2,598)         | <b>(38,203)</b>    |
| <b>Operating profit</b>   | <b>123,690</b>          | <b>306,913</b>  | <b>404,027</b>  | <b>280,200</b>     |
| Fair value gain on a financial asset<br>at fair value through profit or loss        | —                       | —               | —               | <b>13,785</b>      |
| Gain on disposal of an associate  | —                       | —               | —               | <b>105,189</b>     |
| Finance income  | 22,775                  | 31,022          | 25,523          | <b>33,162</b>      |
| Finance costs   | (1,211)                 | —               | —               | <b>(721)</b>       |
| Share of profits and losses of:   |                         |                 |                 |                    |
| Associates  | (2,460)                 | 27,263          | 25,715          | <b>14,433</b>      |
| Jointly-controlled entities   | —                       | (1,278)         | (6,952)         | <b>(6,360)</b>     |
| <b>Profit before tax</b>  | <b>142,794</b>          | <b>363,920</b>  | <b>448,313</b>  | <b>439,688</b>     |
| Income tax credit/(expense)   | 12,658                  | (59,885)        | (59,459)        | <b>(65,155)</b>    |
| <b>Profit for the year</b>  | <b>155,452</b>          | <b>304,035</b>  | <b>388,854</b>  | <b>374,533</b>     |
| <b>Attributable to:</b>   |                         |                 |                 |                    |
| Owners of the parent  | 164,678                 | 307,501         | 387,224         | <b>372,480</b>     |
| Non-controlling interests   | (9,226)                 | (3,466)         | 1,630           | <b>2,053</b>       |
|   | 155,452                 | 304,035         | 388,854         | <b>374,533</b>     |
| <b>Proposed final and special dividends</b>   | <b>95,710</b>           | <b>139,723</b>  | <b>141,575</b>  | <b>376,000</b>     |
|   | RMB                     | RMB             | RMB             | <b>RMB</b>         |
| <b>Earnings per share attributable to<br/>ordinary equity holders of the parent</b> |                         |                 |                 |                    |
| Basic   | 18.15 cents             | 28.95 cents     | 36.38 cents     | <b>34.16 cents</b> |
| Diluted   | 17.25 cents             | 27.74 cents     | 33.68 cents     | <b>32.13 cents</b> |

## FINANCIAL HIGHLIGHTS (continued)

### Consolidated Statement of Financial Position (Selected Items)

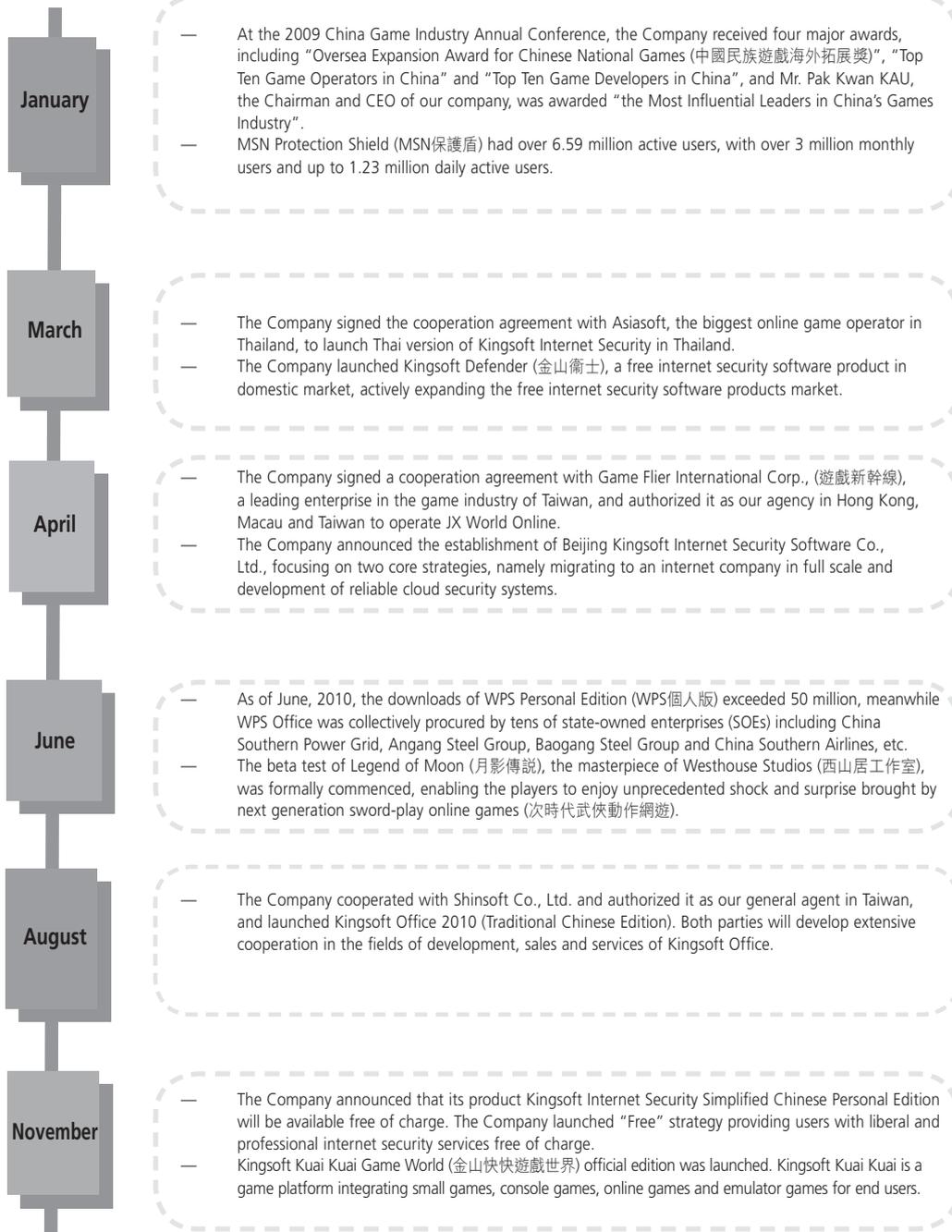
|                           | As at December 31, |                 |                 |                  |
|---------------------------|--------------------|-----------------|-----------------|------------------|
|                           | 2007<br>RMB'000    | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000  |
| Cash and cash equivalents | 1,246,077          | 1,007,115       | 1,268,098       | <b>1,656,157</b> |
| Credit-linked deposit     | —                  | 111,708         | —               | —                |
| Total assets              | 1,499,921          | 1,739,223       | 2,040,870       | <b>2,444,813</b> |
| Total equity              | 1,133,657          | 1,328,365       | 1,604,310       | <b>1,934,061</b> |

### Consolidated Statement of Cash Flows (Selected Items)

|  | Year ended December 31, |                 |                 |                 |
|--|-------------------------|-----------------|-----------------|-----------------|
|  | 2007<br>RMB'000         | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000 |
| Net cash flows from operating activities             | 345,474                 | 381,472         | 446,874         | <b>407,416</b>  |
| Net cash flows from/(used in) investing activities   | (395,659)               | (520,533)       | (503,721)       | <b>374,225</b>  |
| Net cash flows from/(used in) financing activities   | 647,412                 | (97,073)        | (153,411)       | <b>464</b>      |
| Net increase/(decrease) in cash and cash equivalents | 597,227                 | (236,134)       | (210,258)       | <b>782,105</b>  |

# MILESTONES OF THE GROUP IN 2010

## Major Group Events in 2010



# CHAIRMAN'S STATEMENT

2010 was the year of change for Kingsoft. We have recently completed restructuring of Kingsoft Internet Security and are in the midst of restructuring our online games R&D studios in order to turn ourselves into leaner and nimbler, and more self-motivated organisations. Meanwhile, we have also introduced internet-oriented top talents to our management team. All those adaptabilities allow us to keep up with challenges from the fast-changing internet sector.

## **Application Software Business Review**

In October, Kingsoft Internet Security acquired Conew Network, a top local internet security firm and announced that Kingsoft Internet Security Simplified Chinese Personal Edition would be available free of charge as from November 10, 2010. The new product is supported by our proprietary cloud-based security technology that detects internet security threats on a real time basis. West Coast Labs, an international organisation specialising in functionality testing, performance validation and the Checkmark Certification of information security products and services, has recently announced that Kingsoft Internet Security 2011 has passed seven Checkmark tests, such as anti-malware test, anti-malware test based on cloud security, anti-Trojan test, etc. Kingsoft Internet Security 2011 is the first anti-virus software that passed the Checkmark anti-malware cloud test to date. This demonstrated Kingsoft Internet Security's leading technology position in China, especially in the area of cloud-based security technology. On December 1, 2010, we announced the open source program of Kingsoft Defender (金山衛士) and opened a new chapter for security software in China. We believe this program will lead the change of security software industry by lowering the entrance barrier and gathering millions of talents to develop and improve security software products.

Kingsoft WPS Office as the premium office software in China has been benefiting from the increasing copyright protection in China and continued its success in Japan. Leveraging the increasing internet user base across devices, WPS Office is also extending to provide more value added services, such as office automation, cloud-based storage (Kingsoft Kuaipan), web-office service (Kingsoft Kuaixie) and mobile tablet office products.

The past year was also a year of transition for Kingsoft PowerWord from a client software to a learning community. We launched Kingsoft PowerWord 2011 Beta Version in October, 2010 which integrates online dictionary, mini personal portals and instant message into one package. Kingsoft PowerWord is building a converged user platform for virtual English learning and providing a variety of value-added services for English learning.

## **Entertainment Software Business Review**

Kingsoft game has been primarily engaging in research, development and operation of online games of Chinese mythology and martial arts genre. As no new game title was released in 2010, the entertainment software business recorded a decrease of 6% in revenue year-on-year. Since the introduction of a group of talents of game operation in 2009, we significantly improved game operation efficiency and recorded a reduced attenuation rate of games in 2010. To better motivate game research talents, we have announced restructuring of our Westhouse Studios by having key persons of the studios acquire 20% interest of the Westhouse Studios.

## **Prospects**

Looking ahead in 2011, Kingsoft has five new games in pipeline, compared to no new game title in 2010, which are Legend of Moon (月影傳說), Rush Team (熱血戰隊), CangQiongZhiNu (蒼穹之怒) and other two titles. In 2011, our game business will also explore opportunities into producing advanced casual games and casual games on mobile tablet devices.

The launch of our free Kingsoft Internet Security Simplified Chinese Personal Edition will help us capture a larger user base and further enhance user experience by incorporating a number of value-added-services. With increasingly better copyright protection in China and growth prospective overseas, WPS Office is well positioned for a new round of sustainable growth both in China and overseas.

Kingsoft is committed to improving its operation efficiency, enriching its customer base through product and service innovations, and ultimately bringing rewarding returns to shareholders.

To highlight all these achievements, I'am very pleased to present our 2010 annual report. I would like to thank the management and staff for their hard work, and thank all our shareholders and investors for their support and confidence in Kingsoft.

**Pak Kwan Kau**  
*Chairman*

Hong Kong, March 23, 2011

# MANAGEMENT DISCUSSION AND ANALYSIS

## For the Year Ended December 31, 2010

The following table sets forth the comparative numbers for the years ended December 31, 2009 and December 31, 2010, respectively.

|   | For the year ended              |                                 |
|---|---------------------------------|---------------------------------|
|   | December 31,<br>2010<br>RMB'000 | December 31,<br>2009<br>RMB'000 |
| <b>REVENUE:</b>   |                                 |                                 |
| Entertainment software  | 640,917                         | 684,242                         |
| Application software  | 321,003                         | 329,196                         |
| Others  | 9,477                           | 8,974                           |
|   | <b>971,397</b>                  | 1,022,412                       |
| Cost of revenue   | (130,998)                       | (128,467)                       |
| <b>GROSS PROFIT</b>   | <b>840,399</b>                  | 893,945                         |
| Research and development costs, net of government grants                        | (271,046)                       | (199,611)                       |
| Selling and distribution costs  | (129,216)                       | (171,634)                       |
| Administrative expenses   | (111,143)                       | (101,630)                       |
| Share-based compensation costs  | (42,119)                        | (41,312)                        |
| Other income and gains  | 31,528                          | 26,867                          |
| Other expenses  | (38,203)                        | (2,598)                         |
| <b>OPERATING PROFIT</b>   | <b>280,200</b>                  | 404,027                         |
| Fair value gain on a financial asset at fair value through profit or loss       | 13,785                          | —                               |
| Gain on disposal of an associate  | 105,189                         | —                               |
| Finance income  | 33,162                          | 25,523                          |
| Finance costs   | (721)                           | —                               |
| Share of profits and losses of:   |                                 |                                 |
| Associates  | 14,433                          | 25,715                          |
| Jointly-controlled entities   | (6,360)                         | (6,952)                         |
| <b>PROFIT BEFORE TAX</b>  | <b>439,688</b>                  | 448,313                         |
| Income tax expenses   | (65,155)                        | (59,459)                        |
| <b>PROFIT FOR THE YEAR</b>  | <b>374,533</b>                  | 388,854                         |
| Attributable to:  |                                 |                                 |
| Owners of the parent  | 372,480                         | 387,224                         |
| Non-controlling interests   | 2,053                           | 1,630                           |
|   | <b>374,533</b>                  | 388,854                         |
|   | <b>RMB</b>                      | <b>RMB</b>                      |
| <b>EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT</b> |                                 |                                 |
| Basic   | 0.3416                          | 0.3638                          |
| Diluted   | 0.3213                          | 0.3368                          |

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

|   | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|-----------------|-----------------|
| <b>PROFIT FOR THE YEAR</b>                                | <b>374,533</b>  | 388,854         |
| <b>OTHER COMPREHENSIVE INCOME:</b>                        |                 |                 |
| Exchange differences on translation of foreign operations | <b>(498)</b>    | (632)           |
| <b>OTHER COMPREHENSIVE LOSS FOR THE YEAR, NET OF TAX</b>  | <b>(498)</b>    | (632)           |
| <b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>            | <b>374,035</b>  | 388,222         |
| Attributable to:  |                 |                 |
| Owners of the parent                                      | <b>370,319</b>  | 386,888         |
| Non-controlling interests                                 | <b>3,716</b>    | 1,334           |
|   | <b>374,035</b>  | 388,222         |

### Revenue

Revenue decreased by 5% year-over-year to RMB971.4 million. Approximately 66% was generated from the entertainment software business segment and 33% was generated from the application software business segment.

#### — *Entertainment Software*

Revenue from the entertainment software decreased by 6% year-over-year to RMB640.9 million. The decrease was mainly due to no new game was released in 2010 and the termination of operation of the licensed online game Shui Hu Q Zhuan in November 2009.

Daily average peak concurrent users decreased by 32% to 0.8 million year-over-year for the three months ended December 31, 2010.

The monthly average revenue per paying user ("monthly ARPU") for the Group's online games increased by 8% year-over-year to RMB41 for the three months ended December 31, 2010.

#### — *Application Software*

Revenue from the application software business decreased by 2% year-over-year to RMB321.0 million. This decrease was primarily due to the decline in subscription for Kingsoft Internet Security services as we launched the free edition in November, 2010. This was partially offset by the increase of sales from Kingsoft WPS Office both in China and Japan.

Revenue from Kingsoft Internet Security was RMB239.2 million, represented 75% of the total revenue of the Group's application software and a decrease of 8% from RMB258.9 million in 2009.

The number of subscribers for online services of Kingsoft Internet Security decreased by 58% year-over-year to 3.7 million. The year-over-year decline was mainly due to the launch of the free simplified Chinese personal edition of Kingsoft Internet Security. Monthly average paying users have represented fee-based VIP security value-added service subscribers since we announced the offerings of free edition of Kingsoft Internet Security on November 10, 2010.

Monthly ARPU for online services of Kingsoft Internet Security increased by 43% year-over-year to RMB3.

### Gross Profit and Cost of Revenue

Gross profit decreased by 6% year-over-year to RMB840.4 million. The Group's gross profit margin held flat year-over-year to 87%.

Cost of revenue increased by 2% year-over-year to RMB131.0 million primarily due to an increase in staff costs.

# MANAGEMENT DISCUSSION AND ANALYSIS (continued)

## Research and Development (“R&D”) Costs

R&D costs, net of government grants, increased by 36% year-over-year to RMB271.0 million. The increase was mainly due to the increase in staff salaries and benefits.

The following table sets forth a breakdown of R&D costs for the years ended December 31, 2010 and 2009.

|  | For the years ended<br>December 31, |                 |
|--|-------------------------------------|-----------------|
|  | 2010<br>RMB'000                     | 2009<br>RMB'000 |
| Staff cost   | 215,616                             | 167,667         |
| Depreciation & Amortisation  | 29,006                              | 23,104          |
| Others   | 45,793                              | 36,335          |
|  | <b>290,415</b>                      | 227,106         |
| Less: Capitalised software costs (except share-based compensation costs) | (19,452)                            | (18,197)        |
| Add: Amortisation of capitalised software costs                          | 17,158                              | 5,481           |
| Less: Government grants for research and development activities          | (17,075)                            | (14,779)        |
| Total  | <b>271,046</b>                      | 199,611         |

## Selling and Distribution Costs

Selling and distribution expenses decreased by 25% year-over-year to RMB129.2 million. This decline was primarily due to no new game were launched in 2010 and more cost-effective campaigns for marketing and promotional activities for existing games.

## Administrative Expenses

Administrative expenses increased by 9% year-over-year to RMB111.1 million. The increase was mainly due to higher depreciation costs associated with new buildings and facilities.

## Share-based Compensation Costs

Share-based compensation costs increased by 2% year-over-year to RMB42.1 million. This increase was primarily due to newly awarded shares.

## Other Income and Gains

Other income and gains increased by 17% year-over-year to RMB31.5 million.

## Other Expenses

Other expenses recorded RMB38.2 million in 2010, compared to RMB2.6 million in 2009. The substantial year-over-year increase was largely attributable to impairment loss of investments related to online games.

## Operating Profit Excluding Share-based Compensation Costs

Operating profit excluding share-based compensation costs decreased by 28% year-over-year to RMB322.3 million as a result of the combination of above reasons. The margin of operating profit excluding share-based compensation costs decreased to 33% from 44% in 2009.

## Fair value Gain on Financial Asset at Fair Value through Profit or Loss (“Fair Value Gain”)

Fair value gain, which reflected the fair value of an option granted by Vina Game to the Group to subscribe a number of ordinary shares of Vina Game at certain price, recorded RMB13.8 million in 2010, compared to nil in 2009.

# MANAGEMENT DISCUSSION AND ANALYSIS (continued)

## Gain on Disposal of an Associate

Gain on disposal of an associate recorded RMB105.2 million, which reflected the gain from disposal of the Group's interest in Kingsoft Guangzhou, compared to nil in 2009.

In December 2010, the Group entered into an agreement, pursuant to which the Group agreed to transfer its 30% interest in Kingsoft Guangzhou for a total consideration of 126 million.

## Finance Income

Finance income increased by 30% year-over-year to RMB33.2 million. This was mainly due to the higher cash and term deposits balances in 2010 compared to 2009.

## Share of Profits of Associates

Share of profits of associates decreased by 44% year-over-year to RMB14.4 million. The decrease was mainly due to the disposal of Kingsoft Guangzhou.

## Income Tax Expense

Income tax expenses increased by 10% year-over-year to RMB65.2 million. The Group's effective tax rate (excluding the impact of share-based compensation) increased by two percentage points year-over-year to 14%. This year-over-year increase mainly resulted from the combinations of (i) a major subsidiary of the Group's online game business was entitled to enjoy a reduced tax rate of 7.5% for the years from 2009 to 2010; (ii) increased non-deductible impairment loss arising from game-related investment and; (iii) the accruals of withholding dividend tax amounting to RMB12.9 million for dividends anticipated to be remitted by PRC subsidiaries in the foreseeable future.

## Profit Attributable to Owners of the Parent

For the reasons described above, profit attributable to owners of the parent decreased by 4% year-over-year to RMB372.5 million.

## Profit Attributable to Owners of the Parent before Share-based Compensation Costs

Profit attributable to owners of the parent before share-based compensation costs decreased by 3% year-over-year to RMB414.6 million.

The profit margin excluding the effect of share-based compensation costs increased by one percentage point year-over-year to 43%.

## Liquidity and Financial Resource

The Group had a strong cash position towards the end of the reporting period. As at December 31, 2010, the Group had significant financial resources in the forms of cash and cash equivalent, time deposits with initial term of over three months amounting to RMB1,186.7 million and RMB469.4 million, respectively, which in total represented 68% of the Group's total assets.

As at December 31, 2010, the Group's gearing ratio, which represents total liabilities divided by total assets, was 21%, which remained flat as at December 31, 2009. As at December 31, 2010, the Group had HKD120.0 million (RMB102.1 million) bank loan. The loan is repayable in full before June 14, 2011 and bears interest of HIBOR plus 1.1%.

## Foreign Currency Risk Management

Certain expenses of the Group are denominated in currencies other than the RMB. The Group generates foreign currency revenue either from license sales made in other Asian countries or from its overseas subsidiaries. RMB against USD, HKD, JPY and MYR have been comparatively stable in the past. The Group adopted "natural immunity" method to match the income and payment in foreign currencies by arranging some expenses and expenditures denominated in foreign currencies.

As at December 31, 2010, RMB196.2 million of the Group's financial assets were held in deposits and investments denominated in non-RMB currencies. There is a risk that we may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with our deposits and investments.

# MANAGEMENT DISCUSSION AND ANALYSIS (continued)

## **Deferred Revenue**

Deferred revenue (including current and non-current portion) decreased by 5% year-over-year to RMB190.7 million as at December 31, 2010. This was mainly due to the decline in sales of Kingsoft Internet Security products.

## **Net Cash Generated from Operating Activities**

Cash generated by our operating activities reflects our profit for reporting year, as the case may be, as adjusted for non-cash items, such as depreciation, amortisation of capitalised software costs, and share-based compensation costs, as well as the effect of changes in certain items of statement of financial position, such as deferred revenue and accrued expenses and other payables. Our net cash generated by operating activities decreased by 9% year-over-year to RMB407.4 million for the year ended December 31, 2010.

## **Capital Expenditures**

Capital expenditures represent cash payments for acquisition of property, land use right, fixed assets and intangible assets. Cash used for capital expenditures decreased by 23% year-over-year to RMB100.6 million, as the group incurred payments for land use rights and the construction of Zhuhai Research Centers in 2009.

# DIRECTORS AND SENIOR MANAGEMENT

## Executive Directors

**Pak Kwan KAU**, aged 46, is an executive Director and the Chairman of the Board of our company. Mr. Kau has been employed by us since 1988. He graduated from National Defense University of Science and Technology in China in 1984 with a bachelor degree in Information Management Systems. Between 1984 and 1987, Mr. Kau worked at various Chinese companies as a software developer.

Mr. Kau started Kingsoft Software in 1988, and he was primarily responsible for the development of WPS 1.0 in 1988. Mr. Kau was named as one of the Top Ten Business Persons of the Year in 2000, one of the China Top Financial Figures of the Year in 2001 by CCTV, one of the Ten Most Influential Leaders in China's Games Industry at the inaugural China Game Industry Annual Conference in January 2005, and one of the Most Outstanding Entrepreneurs at 2009 China Game Industry Annual Conference held in December 2009. Mr. Kau has never held directorship in any other listed public companies. Mr. Kau was appointed as acting Chief Executive Officer of the company in December, 2007. And he was appointed as Chief Executive Officer of the Company in May, 2008.

Mr. Kau is also a director of certain subsidiaries of our Group.

**Donghui WANG**, aged 40, is currently our chief financial officer. Mr. Wang received a bachelor's degree in Engineering from Tianjin Polytechnic University in 1992 and a MBA degree from Victoria University of Technology, Australia in 1997. Mr. Wang worked at Ernst & Young Beijing from 1997 to 1999 as a senior accountant. From 1999 to 2005, Mr. Wang served as a consultant in the PricewaterhouseCoopers Sydney office and a senior manager in their Beijing office. Mr. Wang joined us at the beginning of 2005 as a vice president and was appointed as our chief financial officer in December 2005. Mr. Wang became a senior vice president of the Group in December, 2007. He has been an executive director of our company since May, 2008.

Mr. Wang is also a director of certain subsidiaries of our Group.

**Tao ZOU**, aged 35, is currently a senior vice president and the CEO of Westhouse Holdings Limited who is responsible for the overall management of Westhouse Holdings Limited and its subsidiaries of our Group, including the research and development of online games of Westhouse Studios and also participates in major decision making of our Group's gaming business sector. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our Kingsoft PowerWord. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became a senior vice president of the Group in December, 2007 and has been an executive director of our company since August, 2009.

Mr. Zou is also a director of certain subsidiaries of our Group.

## Non-executive Directors

**Jun LEI**, aged 41, is a non-executive Director, vice chairman of the Board, and co-founder of our company. Mr. Lei has been employed by us since 1992 and has played a key role in developing the operation of our Group and expanding our business operations. He had been our chief executive officer since 1998, and under his leadership, we further expanded application software businesses into utilities software, Internet security software and online games. He also played a major role in transforming our Group from a traditional software company into an on demand software company which extensively utilizes the Internet. In December, 2007, Mr. Lei relinquished his position as chief executive officer, chief technology officer and president of the Company. In August 2008, Mr. Lei was re-designated from an executive director to a non-executive director. Mr. Lei is also a director of certain subsidiaries of our Group.

Mr. Lei graduated from Wuhan University in 1991 with a bachelor degree in Computer Science. He has been a member of the board of Wuhan University since 2003. He was co-founder of Joyo.com, which was founded in April 2000 and sold to Amazon.com in 2004. Mr. Lei has held directorship in 2020 CHINACAP ACQUIRSCO, INC. — an AMEX listed company from January, 2007 to October, 2009. 2020 CHINACAP ACQUIRSCO, INC. is listed on AMEX since November 8, 2007.

## DIRECTORS AND SENIOR MANAGEMENT (continued)

Mr. Lei was named as one of the Beijing Top Ten Young Entrepreneurs in 2002, as one of the Ten Most Influential Leaders in China's Games Industry at the inaugural China Game Industry Annual Conference in January 2008.

**Shuen Lung CHEUNG**, aged 54, is one of the founders of the business of the Company and its subsidiaries. He is a director of Highland Crest Limited and Super Faith International Limited, substantial shareholders of the Company, and controlling shareholder of Highland Crest Limited. He is also a member of the audit committee and the nomination committee and the chairman of the remuneration committee of the Company. He is also an executive director of Peking University Founder Group Company Limited ("**Peking Founder**") and is one of the founders of Peking Founder. He is the executive chairman of PUC Founder (MSC) Berhad, a company listed on ACE Market of Bursa Malaysia Securities Berhad and was an executive director and the Chairman of Founder Holdings Limited, a company listed on The Stock Exchange of Hong Kong Limited, before 23 April 2007. He is a research fellow of the Enterprise Research Institute at Peking University and is a MBA alumni trainer of Peking University Guanghua School of Management. Mr. CHEUNG is famed for his prestige and has extensive experience in the China's information technology industry. Mr. Cheung has become a non-executive Director of our company since March 25, 2010.

### **Independent Non-executive Directors**

**Shun Tak WONG**, aged 50, is an independent non-executive Director of our Company. He is also the chairman of the audit committee and a member of the remuneration committee of the Company. Mr. Wong has a master degree in finance from the University of Lancaster in the United Kingdom and a master degree in accounting from Charles Stuart University in Australia. Mr. Wong is also a fellow CPA member of the Hong Kong Institute of Certified Public Accountants and a fellow CPA member of Australian Society of CPAs. In the past, Mr. Wong held key executive positions in various multi-nationals and Hong Kong listed companies, including working as the financial controller of AMF Bowling, Inc., between November 1996 and March 1998 and International Distillers China Ltd between December 1993 and October 1996. He has extensive experience in financial control, operations, strategic planning and implementation, private equity investments and exit strategies.

He served as the chief financial officer of Goodbaby Children Products Group ("Goodbaby") between August 2003 and August 2007, a leading juvenile product manufacturer in China. Before joining Goodbaby, Mr. Wong worked as the vice president for finance in IDT International Limited, a Hong Kong listed company between September 2001 and July 2003. Mr. Wong currently serves as vice president for finance & corporate controller at Alibaba Group. We appointed Mr. Wong as our independent non-executive Director in April 2007.

**Guangming George LU**, aged 46, is an independent non-executive director of our Company. He is also a member of the audit committee and the chairman of the nomination committee of the Company. Mr. Lu graduated from Huazhong Normal University in 1984 and obtained a master degree of science from the University of Memphis in 1989.

Mr. Lu founded Surfmax Corporation in November 1997, a private investment firm in the U.S. From April 2004 to December 2010, Mr. Lu served as the vice chairman of Xingda International Holdings Limited (a Surfmax portfolio investment) whose shares are listed on the Hong Kong Stock Exchange. Mr. Lu also currently serves as the Chairman of 2020 International Capital Group. From August 2006 to October 2009, Mr. Lu served as the Chairman and CEO of Exceed Company Limited (a 2020 portfolio investment), whose shares are listed on NASDAQ. Since March 2008, Mr. Lu has been the Chairman of Acquity Group (a 2020 portfolio investment). He also served as the president of Digital Li Ning Company Limited, a joint venture between Acquity Group and Li Ning Company Limited whose shares are listed on the Hong Kong Stock Exchange. Mr. Lu joined us in April 2007.

**Mingming HUANG**, aged 38, is an independent non-executive Director of our Company. He is also a member of the remuneration committee and the nomination committee of the Company. Mr. Huang is a cofounder and the chief executive officer of Trend Media Corp, which was established in August 2005, a well-known Internet company in China which owns and operates websites such as Flashget, ZCOM and Myrice. In addition, Mr. Huang also serves on boards of many well-known Internet companies in China, which operate in similar industries to ours, including 265.com (since June 2006), Baitai Media (since September 2005) and Cheshi.com (since September 2006).

## DIRECTORS AND SENIOR MANAGEMENT (continued)

During March 1996 to July 1998 at Hewlett-Packard, Mr. Huang built a channel team and developed the market in east China region for HP Unix servers. Mr. Huang did not hold directorship in any other listed public companies in the past three years. Mr. Huang received his MBA from University of Chicago and his bachelor of science majoring in Electric Engineering from Shanghai Jiao Tong University. Mr. Huang joined us in June 2007.

### Senior Management

**Pak Kwan KAU**, aged 46, is an executive Director and the Chairman of the Board of our company. Mr. Kau has been employed by us since 1988. He graduated from National Defense University of Science and Technology in China in 1984 with a bachelor degree in Information Management Systems. Between 1984 and 1987, Mr. Kau worked at various Chinese companies as a software developer.

Mr. Kau started Kingsoft Software in 1988, and he was primarily responsible for the development of WPS 1.0 in 1988. Mr. Kau was named as one of the Top Ten Business Persons of the Year in 2000, one of the China Top Financial Figures of the Year in 2001 by CCTV, one of the Ten Most Influential Leaders in China's Games Industry at the inaugural China Game Industry Annual Conference in January 2005, and one of the Most Outstanding Entrepreneurs at 2009 China Game Industry Annual Conference held in December 2009. Mr. Kau has never held directorship in any other listed public companies. Mr. Kau was appointed as acting Chief Executive Officer of the company in December, 2007. And he was appointed as Chief Executive Officer of the Company in May, 2008.

Mr. Kau is also a director of certain subsidiaries of our Group.

**Donghui WANG**, aged 40, is currently our chief financial officer. Mr. Wang received a bachelor's degree in Engineering from Tianjin Polytechnic University in 1992 and a MBA degree from Victoria University of Technology, Australia in 1997. Mr. Wang worked at Ernst & Young Beijing from 1997 to 1999 as a senior accountant. From 1999 to 2005, Mr. Wang served as a consultant in the PricewaterhouseCoopers Sydney office and a senior manager in their Beijing office. Mr. Wang joined us at the beginning of 2005 as a vice president and was appointed as our chief financial officer in December 2005. Mr. Wang became a senior vice president of the Group in December, 2007. He has been an executive director of our company since May, 2008.

Mr. Wang is also a director of certain subsidiaries of our Group.

**Tao ZOU**, aged 35, is currently a senior vice president and the CEO of Westhouse Holdings Limited who is responsible for the overall management of Westhouse Holdings Limited and its subsidiaries of our Group, including the research and development of online games of Westhouse Studios and also participates in major decision making of our Group's gaming business sector. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our Kingsoft PowerWord. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became a senior vice president of the Group in December, 2007 and has been an executive director of our company since August, 2009.

Mr. Zou is also a director of certain subsidiaries of our Group.

**Sheng FU**, aged 33, is currently a senior vice president and the CEO of Kingsoft Internet Securities Software Holdings Limited who is responsible for the overall business of Kingsoft internet security business sector. Mr. Fu joined the Company in November 2010. Mr. Fu was the product manager of 3721 Internet Real Name and 3721 Internet Assistant, as well as the general manager of 360 Security Guard. He was the vice president of Matrix Partners China from November 2008, and CEO and chairman of Conew Network Technology (Beijing) Co., Ltd from September 2009. Mr. Fu has become a senior vice president of the Group since March 7, 2011. Mr. Fu graduated from the faculty of Information Management and Information System in Shandong Institute of Business and Technology in 1999.

Mr. Fu is also a director of certain subsidiaries of our Group.

**Ke GE**, aged 37, is currently a senior vice president and has the overall responsibility for our office software business. Mr. Ge joined us in 1999 and was appointed as the assistant to our chief executive officer in 1999. He was the chief officer in our distribution department from 2000 to 2001. He was appointed the assistant president in 2001 and had overall responsibilities for our internal operations and management. He was appointed as a vice president in 2002. He became a senior vice president of the company in December, 2007, in charge of overall office software business of the company.

## DIRECTORS AND SENIOR MANAGEMENT (continued)

Mr. Ge graduated from the Electronic Science and Engineering Department of Nanjing University and worked at Founder Information System Engineering Company from 1995 to 1999, focusing on software development and software sales management.

Mr. Ge is also a director of certain subsidiaries of the Group.

**Huan YANG**, aged 38, is a senior vice president of our Group. He obtained a Bachelor's degree in Decision-Making Science from Shanghai Jiao Tong University in 1994, and a Master's degree in Management Science from the University of Science and Technology of China in 1997. Mr. Yang worked as an operation analyst at Legend Technology Limited (HK) from 1997 to 1998. From the end of 1998 to 2000, he worked at Kingsoft as General Manager of Administration Department. From 2001 to 2005, Mr. Yang worked at Lenovo Group as the Investment Management Director and Investment Project Director of Strategic Investment Department respectively, during which time he was in charge of existing investments and new business development. He assisted in the establishment of Lenovo Global Offshore Transaction Center in Singapore from 2005 to early 2007. Mr. Yang rejoined Kingsoft since 2007. Mr. Yang has been promoted from a vice president to a senior vice president of our Group since March 7, 2011.

Mr. Yang is also a director of a subsidiary of the Group.

**ShouSheng LU**, aged 40, is appointed as a vice president of our Group being in charge of HR, Administration and Kingsoft Academy since October, 2008. Before joining our company, he was the consulting director of Hay Group, a famous management consulting company in the world. He provided management consulting services for several multinational companies as well as leading Chinese companies on organizational transformation and human resources management. He once was a HR supervisor in a state-owned-company and HR director in a Sino-foreign joint venture before becoming a senior consultant.

Mr. Lu received a bachelor degree in Engineering from Hohai University (China) in 1991, a master degree in Project Management from Tianjin University (China) in 1997, and a MBA degree from University of Illinois at Chicago (USA) in 2003. He also was Certified Trainer and Coach of Leadership Development issued by McClelland Center of Hay Group.

**Yimin WU**, aged 34, is currently a vice president of the Group and is responsible for the operation of Kingsoft online games. Mr. Wu joined the Company in January 2010. He is experienced in operating online games and has worked for several reputable online games companies. From October 2002 to May 2006, he was the sales supervisor of Soft-world Electronic (Shanghai) Co. Ltd.. From May 2006 to April 2009, he joined Shenzhen Tencent Technology Co., Ltd and worked as the operating manager of a few online games. He worked for Shanghai Shanda Networking Co., Ltd from April 2009 to December 2009 as the system game manager and producer. Mr. Wu graduated from the faculty of Oil Processing in East China University of Science and Technology.

**Xin WANG**, aged 37, is currently a vice president of the Group, and is responsible for the operation and marketing & sales of Kingsoft internet security business. Ms. Wang joined the Company in 1999 and has been the product manager of Kingsoft PowerWord, Kingsoft Instant Translator and Kingsoft You Xia. She was appointed the Deputy General Manager of WPS Unit in 2002. Ms. Wang left Kingsoft in 2003 and joined MTone Wireless as General Manager of its handset game business unit. Ms. Wang rejoined Kingsoft in May 2006 and led Kingsoft's Internet Security's migration with internet.

Ms. Wang graduated in 1996 from the faculty of Computer in Qingdao University. She worked for ZTT and was the software development and project manager for large banks and is the author of The Real-life Experience of a Product Manager.

**Quanguo WANG**, aged 45, is currently a vice president of our Group and our chief information officer. Mr. Wang graduated from Wuhan Mapping and Science Technology University in 1988, specialising in Computer Science and Engineering. He worked as an engineer from 1988 to 1992 at Computer Science Department of Wuhan Mapping and Science Technology University.

Mr. Wang joined us in 1992 and served as the vice general manager of Beijing Kingsoft until 1996. From 1997 to 2003, Mr. Wang served as the vice chief editor at Sino Map Press. Mr. Wang rejoined us in 2003 and was appointed as a vice president.

## DIRECTORS AND SENIOR MANAGEMENT (continued)

**Ningning GAO**, aged 53, has been a vice president of our Group since he joined our company in 2001 and is responsible for our Zhuhai and Chengdu operations. Prior to joining our company, he was the chief officer in charge of key accounts at Nanjing Tonchu Information and Industry Group.

Mr. Gao graduated from Nanjing Employee Institute majoring in Computer Software in 1981. After graduation, he was an engineer at the Design Institute of Electronic Industry Ministry 720 Factory from 1981 to 1989, and worked at China Electronic Information Industry Group's Science and Technology Department from 1989 to 1991.

**Wenbing ZHANG**, aged 45, is currently a vice president of our Group and is responsible for overseas business development. Mr. Zhang worked at Shenzhen Yuebao Electronic General Company from 1992 to 1995 as the factory director and the manager for overseas business department. He also served as the chief operating officer at several video game franchising companies in New Zealand prior to joining us in 2006. Mr. Zhang received a bachelor degree majoring in Electronic Engineering from Xi'an Jiaotong University in 1988.

Mr. Zhang is also a director of a subsidiary of our Group.

**Fei Zhou CHEN**, aged 33, is currently a vice president of our Group and the chief technology officer of Westhouse Holdings Limited. Mr. Chen has obtained a Bachelor Degree in Computer & Application in 1998 from Huaqiao University. Mr. Chen joined the Group in 1998 and was responsible for the development of Kingsoft's anti-virus products. Mr. Chen has been responsible for the research and development of our online 3D games since 2004.

**Yueqin Wu**, aged 34, is currently our assistant president and finance controller. She joined our finance department in December 2004 and became our finance controller in July 2006. Ms. Wu has started as an assistant president of our Group since January 2011.

Ms. Wu graduated from Xi'an Jiaotong University with a bachelor degree in Accounting in 1999 and obtained a master degree in Management Science and Engineering from the same university in 2002.

### Company Secretary and Board Secretary

**Michelle Feng HARNETT**, aged 41, is our Secretary of the Board and Company Secretary, who is responsible for our secretarial and accounting management affairs. Ms. Harnett is a member of the senior management team and is employed by us on a full time basis since May 2007.

She has more than ten years of experience in accounting, including working as a Senior Treasury Officer at a property development group based in London. She also previously worked as the Company Secretary and Qualified Accountant at Zhaojin Mining Industry Company Limited from September 2006 to April 2007, shares of which are listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange"). She is a member of the Association of Chartered Certified Accountants in the United Kingdom. She obtained the BSc (Hons) in Applied Accounting degree from Oxford Brookes University, the United Kingdom.

# CORPORATE GOVERNANCE REPORT

## **OVERVIEW OF CORPORATE GOVERNANCE PRACTICES**

The board of directors (the "Board") and management of Kingsoft Corporation Limited (the "Company", or "Kingsoft") and its subsidiaries (hereinafter collectively referred to as the "Group") believe that good corporate governance is the key to the Company's success, the enhancement of its shareholders' value and the assurance of long term sustainable development. Kingsoft's seven core values, namely Care, Customer, Honesty, Innovation, Cooperation, Concentration and Happiness, represent key elements of our corporate governance framework. The Company inherited a sound and prudent management style and is committed to maintaining and upholding good corporate governance practices in order to protect the interests of shareholders, customers and staff in the long term. It abides strictly by the laws and regulations of jurisdictions where it operates, and observes the guidelines and rules issued by regulatory authorities relevant to the Company. The Board sets high standards for our employees, senior management and directors, and keeps the Company's corporate governance system under constant review to ensure that it is in line with global best practices.

Throughout the year ended December 31, 2010, save as disclosed below, the Company complied with the code provisions set out in the code on Corporate Governance Practices (the "Code") in Appendix 14 to the Rules Governing the listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

Code A.2.1 of the Code provides that the roles of the chairman (the "Chairman") and chief executive officer (the "CEO") should be separated and should not be performed by the same individual. The Chairman of the Company, Mr. Pak Kwan Kau was formally appointed as the CEO of the Company since May 2008. The Board considers that through the Company's effective internal control mechanism, and the supervision of the Board and the independent non-executive directors, the current arrangement does not impair the balance of power and authority between the Board and the management of the Company. Furthermore, the Chairman and CEO must have an intimate knowledge of the IT and internet industry and be sensitive to the fast changes in the business in order to lead the Company to react quickly to any market change.

The same person holding the positions of Chairman and CEO can improve the Company's efficiency in decision-making and execution, and effectively capture business opportunities. The Board will continue to review the current structure from time to time and shall make necessary changes when appropriate and inform the shareholders accordingly.

## **CORPORATE GOVERNANCE FRAMEWORK**

The Board is the core function of the Company's corporate governance structure. The Company's overall framework of corporate governance contains many internal guidelines, internal control policies and procedures that have been formed over the years. The Board was established under the Shareholders' Meeting, and the Audit Committee, Remuneration Committee and Nomination Committee were established under the Board. The Board of Directors is accountable to the Shareholders' Meeting. The Shareholders' Meeting is conducted according to the Articles of Association and the relevant rules of the Listing Rules. The Company takes the Shareholders' Meetings and the communication between directors and shareholders very seriously.

The Board is authorised by the Articles of Association to make major decisions regarding the Company's business and to supervise the daily operation of the senior management. The Group is controlled through its Board who is responsible for steering the success of the Group by directing and supervising the Group's affairs in line with its strategies and missions. The Board delegates the authority of the management of the Group's daily operation to the members of the senior management. The management reports to the Board on a regular basis and can communicate with the Board freely. The Board has formulated a clear written policy that stipulates the circumstances under which the management should report to and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Group. The Board regularly reviews our corporate governance practices and updates them as and when appropriate.

# CORPORATE GOVERNANCE REPORT (continued)

## **DIRECTORS' SECURITIES TRANSACTIONS**

The Company has adopted the Model Code for Securities Transactions by Director of Listed Issuers set out in Appendix 10 of the Listing Rules (the "Model Code").

The directors (the "Director", "Directors") of the Company have confirmed, following specific enquiry by the Company with each of them that they have complied with the required standards set out in the Model Code during the year. The designated senior management of the Company also has adopted the Model Code.

Details of security interests in the Company held by the Directors are set out in the Directors' Report under the subtitle of "Directors' and Chief Executive's Interests in Securities" on pages 34 to 35 of this annual report.

## **THE BOARD**

The Articles of Association of the Company provide that the Board is accountable to the shareholders' meetings. It oversees specific areas affecting the interests of all shareholders including the execution of resolutions, annual budget, formulation of major decisions for operations, financial proposals and policies, the Company's management system, recommendation/declaration of dividend or other distributions, notifiable and connected transactions under the Listing Rules, recommendation on appointment or reappointment of auditors and other significant operational and financial matters.

The Board is responsible for the effective supervision of the preparation of financial statements, so that such financial statements meet the requirements of laws and regulations and applicable accounting standards, and truly and fairly reflect the financial position, the operating results and cash flows of the Group for each reporting period. The Directors also ensured the timely publication of the Group's financial statements. In preparing the financial statements for the year ended December 31, 2010, the Directors adopted appropriate accounting policies and made fair and reasonable judgments and estimates, and the Board was not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue on a going concern basis. The external auditors' responsibilities to shareholders are set out in the Independent Auditors' Report on page 44 of this annual report.

## *Composition of the Board*

The composition of Board members maintains a balance of skills and experience appropriate for the requirements of the business of the Company. As at the date of this annual report, the Board of Directors comprises 8 Directors with 3 executive Directors (the "Executive Director", "Executive Directors"), 2 non-executive Directors (the "Non-executive Director", "Non-executive Directors") and 3 independent non-executive Directors (the "Independent Non-executive Director", "Independent Non-executive Directors"). The Company's Independent Non-executive Directors constitute more than one-third of the Board members and are professionals in the fields of accounting, finance, technology and management with extensive experience in their respective professional areas. All of the Independent Non-executive Directors of the Company act in diligent manner to uphold the interests of the Company and the shareholders by maintaining the independence of their opinions and providing professional advice on the long-term development of the Company.

The Company has received, from each of the Independent Non-executive Directors, a written confirmation of his independence to the Company pursuant to the requirements of the Listing Rules. The Company considers that all of the independent non-executive Directors are independent of the Company.

A list of all Directors is set out hereunder. A list of Directors' respective biographies and their relationship with others, if any, are set out on pages 14 to 16 of this annual report.

### *Executive Directors*

Pak Kwan KAU (*Chairman*)

Donghui WANG

Tao ZOU

### *Non-executive Directors*

Jun LEI

Shuen Lung CHEUNG

### *Independent Non-executive Directors*

Shun Tak WONG

Guangming George LU

Mingming HUANG

# CORPORATE GOVERNANCE REPORT (continued)

During the year and up to the date of this annual report, the following changes in the Board composition of the Company took place: (i) Mr. Shuen Lung CHEUNG was appointed as a non-executive Director on March 25, 2010; and (ii) Mr. Wai Ming WONG and Mr. Wing Chung Anders CHEUNG resigned as a non-executive director on March 25, 2010.

## *Supply of and access to information and resource*

All the directors have direct access to the legal counsels and the company secretary (the "Company Secretary") who are responsible for advising the Board on corporate governance and compliance issues. Written procedures are also in place for directors to seek, at the Company's expenses, independent professional advice in performing their directors' duties. The Company has arranged appropriate insurance to cover the liabilities of the directors arising from corporate activities. The insurance coverage is reviewed on an annual basis. The Management supplies the Board and its committees with adequate, complete and reliable information in a timely manner to enable them to make informed decisions. Every newly appointed Director of the Company should receive a comprehensive, formal and tailored induction on the first occasion of his appointment, and subsequently such briefing and professional development as is necessary, to ensure that he has a proper understanding of the operations and business of the Company and that he is fully aware of his responsibilities under statute and common law, the Listing Rules, applicable legal requirements and other regulatory requirements and the business and governance policies of the Company.

## *Board Meetings*

The Board meets at least four times a year at approximately quarterly intervals to review the financial performance of the Group, internal re-organisation plans, the overall group strategy and operations with active participation of majority of directors. Of such regular board meetings, Directors will receive at least 14 days' prior written notice. A regular meeting does not include the practice of obtaining board consent through the circulation of written resolutions. For any ad hoc board meetings, our directors are given as much notice as is reasonable and practicable in the circumstances. Senior vice presidents are invited as observers to attend board meetings. Other senior managements are invited to attend board meetings from time to time to report on certain matters.

Our Chairman, with the support of our Executive Directors, leads the process of setting the agenda of board meetings. Directors are invited to comment on the agenda and may request to include additional proposals into the agenda for consideration. The Company Secretary is responsible for drafting meeting agenda and obtaining comments from all Directors and approval of meeting agenda by the Chairman, preparing and circulating meeting materials that contain analysis and background information to all meeting attendees at least 3 days in advance, drafting minutes of meetings of the Board and Board committees and obtaining comments from all Directors and approval of the meetings minutes by the Chairman. The approved meetings minutes are open for inspection by the Directors within reasonable advance notice. The Directors shall abstain from voting for the approval of any proposals in which they are materially interested. If a substantial shareholder or a Director has a conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter shall not be dealt with by way of circulation or by a committee (except an appropriate board committee set up for that purpose pursuant to a resolution passed in a board meeting) but a board meeting shall be held. Independent non-executive Directors who have no material interest in the transaction should be present and vote at such board meeting.

## *Attendance record of individual directors at Board meetings held in 2010*

| Directors  | Number of meeting/<br>attendance |
|--|----------------------------------|
| <i>Executive Directors</i>                               |                                  |
| Pak Kwan KAU ( <i>Chairman</i> )                         | 11/11                            |
| Donghui WANG   | 11/11                            |
| Tao ZOU  | 11/9                             |
| <i>Non-executive Directors</i>                           |                                  |
| Jun LEI  | 11/9                             |
| Shuen Lung CHEUNG<br>(appointed on March 25, 2010)       | 9/9                              |
| Wing Chung Anders CHEUNG<br>(resigned on March 25, 2010) | 2/1                              |

# CORPORATE GOVERNANCE REPORT (continued)

| Directors                                     | Number of meeting/<br>attendance |
|---|----------------------------------|
| Wai Ming WONG<br>(resigned on March 25, 2010) | 2/0                              |
| <i>Independent Non-executive Directors</i>    |                                  |
| Shun Tak WONG                                 | 11/10                            |
| Guangming George LU                           | 11/8                             |
| Mingming HUANG                                | 11/10                            |

## **Chairman and Chief Executive Officer**

The management of the Board and the daily supervision of the business of the Company should be separated and a balance of power and authority should be ensured. The roles of the Chairman and CEO should be separated and should not be performed by the same individual. The division of responsibilities and authorities between the Chairman and CEO should be clearly established and set out in writing. Mr. Pak Kwan Kau, Chairman of the Company took up the position of acting CEO since December 20, 2007 until May 30, 2008, when Mr. Pak Kwan Kau was officially appointed to be the CEO of the Company. During the year, the roles of Chairman and CEO were not separated. The Board considers that this structure does not impair the balance of power and authority between the Board and the management of the Company. The Board also believes that Mr. Kau's appointment being both the Chairman and CEO is beneficial to the business prospect of the Company.

## **Appointment and re-election**

All the Directors including the Non-executive Directors have either service contracts or formal letters of appointments setting out the major terms and conditions of their appointment. Their terms are fixed for three years.

The Company may from time to time elect any person to be a Director either to fill a casual vacancy or as an additional Director. Any Director so appointed shall hold office only until the next general meeting of the Company and shall then be eligible for re-election at the meeting but shall not be taken into account in determining the Directors or the number of Directors who are to retire by rotation at such meeting. According to the Articles of Association of the Company, at each annual general meeting one-third of the Directors for the time being, or, if their number is not 3 or a multiple of 3, then the number nearest to but

not less than one-third, shall retire from office by rotation provided that every Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every 3 years. A retiring Director shall be eligible for re-election at the general meeting of the Company, at which a Director who retires may fill the vacated office.

## **BOARD COMMITTEES**

The Company has preserved four board committees to oversee key aspects of its affairs: audit committee (established on September 3, 2007), (the "Audit Committee"), remuneration committee (established on September 3, 2007), (the "Remuneration Committee"), nomination committee (established on September 3, 2007), (the "Nomination Committee"), and strategy committee (established on December 20, 2007), (the "Strategy Committee").

Written terms of reference of our Audit Committee, Remuneration Committee and Nomination Committee cover their respective specific role, authority and functions, which are available upon written request to the Company Secretary. The Audit Committee, Remuneration Committee, and Nomination Committee are mainly consisted of the Independent Non-executive Directors and Non-executive Directors. In order to discharge their dedicated functions, each of our board committees is provided with sufficient resources, including the provision of external advisors such as financial advisors and valuation firms, to provide professional advice as required at our cost.

The following lists out the membership, responsibilities and the summary of work that the Audit Committee, Remuneration Committee and Nomination Committee performed on behalf of the Board during the financial year:

### **Audit Committee**

#### **Membership and Responsibilities**

The Audit Committee has 3 members with a majority of independent non-executive directors. It is chaired by an independent non-executive director, Mr. Shun Tak Wong, and currently comprises one other independent non-executive director, Mr. Guangming George Lu and one non-executive director, Mr. Shuen Lung Cheung. Mr. Wing Chung Anders Cheung was a member of the Audit Committee until March 25, 2010 when he ceased to be a director of the Company and a member of the Audit Committee. Mr. Shuen Lung Cheung was appointed to be a member of the Audit Committee on March 25, 2010.

# CORPORATE GOVERNANCE REPORT (continued)

None of the Audit Committee members are members of the previous or existing auditors of the Company.

Our Audit Committee acts in accordance with the terms of reference which deals with its authority, responsibilities, membership and frequency of meetings. The Audit Committee meets regularly with the external and internal auditors, and the management to discuss the internal control and financial reporting matters, and the accounting principles and practices adopted by the Group. To this end it has unrestricted access to both our external and internal auditors. It is primarily responsible for assisting our board in supervising the truthfulness and completeness of the Company's financial statements, the effectiveness and adequacy of the Company's internal control and risk management system, and also the Company's internal audit team's work. It is also responsible for the appointment of external auditors and assessing the adequacy of resources, qualifications and experience of the accounting staff of the Company. The Audit Committee also has the authority to set up a whistleblower system to identify and prevent frauds against the Company. The Audit Committee will regularly reports on its work to the Board.

## Summary of principal work performed

Principal Work performed by the Audit Committee in 2010 includes reviewing and/or approving:

- Our Company's unaudited quarterly results, interim consolidated financial statements and audited annual consolidated financial statements, with its recommendations to the board;
- The accounting principles, policies and practices adopted by the Group;
- Annual internal audit plan of the Group and quarterly review of internal audit and business control;
- Annual audit plan of the Group and review of quarterly external audit progress report;
- The effectiveness of the internal control systems adopted by the Company;
- All connected transactions and continuing connected transactions of the Group;
- The independence, authorities and resource of the internal and external auditors; and
- The terms of engagement and fees of the Company's external auditors.

The Audit Committee has reviewed the Group's audited financial statements for the year ended December 31, 2010, and is of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosure has been made.

## Meetings attendance

|  | Number of meeting/<br>attendance |
|--|----------------------------------|
| Directors  |                                  |
| Shun Tak WONG ( <i>chairman</i> )                        | 6/6                              |
| Guangming George LU                                      | 6/6                              |
| Shuen Lung CHEUNG<br>(appointed on March 25, 2010)       | 3/3                              |
| Wing Chung Anders CHEUNG<br>(resigned on March 25, 2010) | 3/3                              |

## Remuneration Committee

### Membership and Responsibilities

The Remuneration Committee currently consists of 3 Directors. Non-executive Director Mr. Wing Chung Anders Cheung was the chairman of the Remuneration Committee until March 25, 2010 when he ceased to be a Director and a member and chairman of the Remuneration Committee. Independent Non-executive Directors Mr. Shun Tak Wong and Mr. Mingming Huang are the members of the Remuneration Committee. On March 25, 2010, Mr. Shuen Lung Cheung was appointed by the Board to be the chairman of the Remuneration Committee.

The primary duties of the Remuneration Committee mainly include assisting the Company's Board to formulate overall remuneration policy and structure for the Company's directors and senior management personnel, and establish formal and transparent procedures for developing such remuneration policy; review and determination of the terms of remuneration packages, bonuses and other compensation payable to our Directors and other senior management. The Remuneration policy is set to attract, motivate and retain highly performing individuals who are essential to the success of the Company. The emolument package for the Executive Directors, the senior managers and key personals includes basic salary, benefits in kind, pension rights, performance bonus and incentive stock options. The Non-executive Directors and Independent Non-executive Directors receive directors' fees.

# CORPORATE GOVERNANCE REPORT (continued)

The basic salary and directors' fees depend on individuals' experience, responsibilities and relevant market rate. The bonus depends on actual performance of the Company's targets and individual performance. Details for the stock option scheme and the share award scheme (the "Share Award Scheme") can be found under the subtitle of "Share Option Schemes" and "Share Award Scheme" in the Directors' Report. The awarded shares are offered to qualified employees to reward them for their high level of performance and foster loyalty with the Group. The information regarding the remuneration of the Directors for 2010 is set out in note 8 to the financial statements. When a meeting is convened to discuss certain Directors' remuneration, the Directors in discussion cannot determine his own remuneration.

## Summary of principal work performed

In the year ended December 31, 2010, the Remuneration Committee held 2 meetings in which the following activities were resolved to be undertaken:

- Reviewed and approved the remuneration packages (including year-end bonuses and awarded shares) of our executive directors and senior management;
- Reviewed and recommended compensation policy for Directors to the Board; and
- Reviewed and recommended performance bonus scheme of the Company to the Board.

## Meetings attendance

|  | Number of meeting/<br>attendance |
|--|----------------------------------|
| Directors  |                                  |
| Shuen Lung CHEUNG (chairman,<br>appointed on March 25, 2010) | 1/1                              |
| Shun Tak WONG  | 2/2                              |
| Mingming HUANG   | 2/2                              |
| Wing Chung Anders CHEUNG<br>(resigned on March 25, 2010)     | 1/1                              |

## Nomination Committee

### Membership and Responsibilities

The Nomination Committee has a total of three members, and two of them are Independent Non-executive Directors, namely Mr. Guangming George Lu (chairman) and

Mr. Mingming Huang. Non-executive Director Mr. Wing Chung Anders Cheung was a member of the Nomination Committee until March 25, 2010 when he ceased to be a director of the Company and a member of the Nomination Committee. Mr. Shuen Lung Cheung was appointed to be a member of the Nomination Committee on March 25, 2010.

The Nomination Committee is accountable to the Board and regularly reports its work. The primary duties of the Nomination Committee are mainly to lead the process for board appointments, review the structure and composition of the Board regularly, identify and nominate suitable candidates for appointment to our Board, assess the independence of our Independent Non-executive Directors, and make recommendations to the Board on matters relating to succession planning for Directors, particularly the Chairman and the CEO.

## Summary of principal work performed

Principal Work performed by the Nomination Committee in 2010 includes:

- Recommending to the Board for the appointment of Mr. Shuen Lung Cheung as a non-executive director, a member of the Audit Committee and Nomination Committee, and chairman of the Remuneration Committee
- Reviewing and assessing each independent non-executive director's annual confirmation of independence pursuant to rule 3.13 of the Listing Rules

## Meetings attendance

|  | Number of meeting/<br>attendance |
|--|----------------------------------|
| Directors  |                                  |
| Guangming George LU ( <i>chairman</i> )                  | 1/1                              |
| Mingming HUANG   | 1/1                              |
| Shuen Lung CHEUNG<br>(appointed on March 25, 2010)       | 0/0                              |
| Wing Chung Anders CHEUNG<br>(resigned on March 25, 2010) | 1/1                              |

# CORPORATE GOVERNANCE REPORT (continued)

## EXTERNAL AUDITORS

Ernst & Young, Certified Public Accountants, Hong Kong, were engaged as the Company's external auditors for the year ended December 31, 2010. External auditors may provide certain non-audit services to the Group as long as these services do not involve any management or decision making functions for and on behalf of the Group; or performing any self assessments; or acting in an advocacy role for the Group. Before any engagement with external auditor for non-audit services, external auditors must comply with the independence requirements under Code of Ethics for Professional Accountants issued by Hong Kong Institute of Certified Public Accountants. The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditors' Report on page 44 of this annual report.

During the year, Ernst & Young provided audit and non-audit services to the Group.

For the year ended December 31, 2010, the remuneration paid or payable to Ernst & Young for audit and non-audit services (together with the comparative figures for 2009) is set out as follows:

|                    | 2010<br>RMB' Mil | 2009<br>RMB' Mil |
|--------------------|------------------|------------------|
| Audit services     | 6.74             | 5.88             |
| Non-audit services | 2.71             | 3.43             |
| Total              | 9.45             | 9.31             |

## INTERNAL CONTROL

The Board acknowledges its responsibility to ensure the Company maintains a solid, complete and effective internal control system and to monitor the effective implementation of such system. A sound internal control system is designed to provide reasonable assurance in safeguarding our shareholders' investment and assets, improving corporate governance and risk management, preventing and detecting frauds and irregularities, providing reliable financial information, and ensuring compliance with applicable law and regulations.

The Company's internal control system is designed to manage, rather than eliminate, the risk of failure to achieve our business objectives, and aims at providing a reasonable, as opposed to an absolute, assurance in this respect. This is achieved through a defined management structure with specified limits of authority and defined control responsibility. The management is responsible for the design, implementation and maintenance of internal controls, and the Board and the Audit Committee oversee the actions of the management and monitor the effectiveness of the established controls. The Audit Committee reviews the Company's internal control system covering financial, operational and compliance controls and risk management procedure.

Over the past few years, the Company has formulated manuals, implemented systems and adopted rules in relation to internal control which are based on the requirements of the "Internal Control — Integrated Framework" of the Report of Committee of Sponsoring Organisations of the Treadway Committee (COSO) entitled ("the COSO internal control framework"). The COSO internal control framework leverages policies and procedures adopted at the company management, operational and financial reporting levels. The Company's internal control framework covers the setting of objectives, budgets and targets; the establishment of regular reporting of financial information, in particular, the tracking of deviations between actual performances and budgets/targets; the delegation of authority; and the establishment of clear lines of accountability.

Due to the nature of the Company's business, we have always attached great importance to improving our IT internal control capabilities, which has great impact on the efficiency and effectiveness of our operation, and the reliability, integrity and promptness of our data and information. In order to disclose our information to public in a manner of truthfulness, accuracy, completeness and promptness, we have set up an information disclosure management system since our IPO in 2007. Under this system, there are clear procedures, instructions and rules to control the flow of the Company's information which is required to be disclosed according to relevant laws and regulations. This kind of information includes but not limited to quarterly results announcements, interim and annual reports, price sensitive information, and disclosable and connected transactions. The Company's information disclosure management framework enables the Company to identify disclosable and connected transactions at their

## CORPORATE GOVERNANCE REPORT (continued)

initiation stage; review and approve news before they are released to the public; update the Group's connected parties' list on a regular basis; and inform the Board and other relevant parties monthly on findings identified by our information disclosure management system.

To assist the Audit Committee in its oversight and monitoring activities, the Company has set up an independent internal audit team (the "IA") that reports to the Audit Committee directly, and provides independent assessment as to the existence and effectiveness of the Company's internal control system, independent investigations regarding allegations of fraud and violations of our business conduct codes, and advice on managing and controlling of our risks. To achieve all these, our IA conducts an annual internal audit, quarterly financial reviews and various operational audit projects. Our IA has unrestricted access to all corporate records and data files, assets, employees and operations. Under the COSO framework, the IA undertakes a periodical risk assessment of the Company's overall activities and prepares its audit plan focusing on areas of the Company's operations with greatest perceived risk. In selecting auditing projects to perform each year, our IA uses information collected throughout the year from process owners, the risk assessment team, senior executives, external auditors and the Board of directors. The Audit Committee reviews audit plan and receives at least quarterly updates on the progress. Our IA also conducts subjective auditing projects of the operational areas which are material to the business or identified by the Audit Committee and/or senior management, results of which will be reported to the Audit Committee and senior management concerned. Our IA will follow up with the implementation of audit recommendations. Any major internal control weaknesses and findings will be firstly reported to the Audit Committee whenever necessary. In addition, our IA maintains regular communications with our external auditors so that both parties are aware of the significant factors that may affect their respective scopes of work.

In 2010, our IA initiated and carried out the assessment of internal control at company level, timely reported to the Audit Committee the outcome and executed the opinions and recommendations in areas such as revenue recognition system, source code management, advertisement, property construction management, investments, IT system maintenance and back-up plans, control of the Company's subsidiaries, marketing expenses by its nationwide branches, taxation, virtual items stock control, fixed assets, human resource and payroll, policies and procedures compliance, and cash management. Our Company pushes

all units to carry out rectification in relation to deficiencies identified through internal control assessments. The Company will have zero tolerance to any frauds committed by its staff. During the year, the Group has undergone internal reorganization which aims at optimizing the Group's structure and delegating more decision-making power to its subsidiaries. The Board foresees issues which might be caused by decentralization. In order to protect its shareholders' interest from losses caused by any willful or unintentional misconduct by its subsidiaries' management, the Board has appointed our IA to work with external professionals to update our internal control and internal audit work manuals. Such revision and improvements were not only made to cope with the changes in corporate structure and organizational structure, as well as changes in the competing market. Our IA also has had trainings and employed qualified staff to fulfill the Group's latest development requirement. The external auditors meet and report to the Audit Committee and senior management on a regular basis on matters relating to internal control and financial reporting. The Company will take appropriate actions to put into practice the external auditors' recommendations.

The Board believes that all the internal control policies and procedures have been properly designed and would enable the Company to strengthen the compliance level of the overall monitoring system and thereby reducing its operational risk. Continuous monitoring and improvement of management procedures will be carried out to ensure effective operations of those internal controls so as to be in line with the growth of the Company's business. The Company has not suffered any material liability during the period under review resulting from the deficiencies in our internal control system.

The Board, with the recommendation of the Audit Committee, has reviewed the effectiveness of the system of internal control of the Company and its subsidiaries and considers the internal control systems effective and adequate. Such review also took into consideration the adequacy of resources, qualification and experience of staff of the Company's accounting and financial reporting function, as well as their training programs and budget.

### **INVESTOR RELATIONS**

Our Board endeavors to uphold transparent communications with our shareholders for them to make informed decisions about their investments and the exercise of their rights as shareholders. We establish and maintain different communication channels with our shareholders

## CORPORATE GOVERNANCE REPORT (continued)

through the publication of annual and interim reports, quarterly results announcements, press announcements, as well as news releases to provide extensive information on the Company's activities, business strategies and developments. Our Company welcomes the views of shareholders on matters affecting us and encourages them to actively participate at shareholders' meetings to communicate any concerns that they might have directly to our directors. We regard shareholder meetings as a valuable forum for our shareholders to raise comments and exchange views with our Board. Our directors and senior management will make an effort to be present at shareholder meetings to address queries from our shareholders. All annual general meeting (the "AGM") meeting materials including but not limited to circular, notice and proxy form will be sent to shareholders in time including all adequate information according to the Listing Rules. The AGM is conducted according to the relevant rules in the Listing Rules and the Articles of Association of the Company.

During the year, the Company's senior management presented its results in Singapore, Hong Kong, Beijing and various other cities in the PRC. Through various activities such as analyst briefings, press conferences, conference calls and investor non-deal road shows, our senior management presented and answered the key issues of which investors were mainly concerned. In addition to regular one-on-one investor meetings, our senior management participated in a number of investor conferences held by major international investment banks in order to maintain active communications with global institutional investors. The Company's investor relationship website, [www.kingsoft.com](http://www.kingsoft.com), provides information of the Company such as financial, investor relations, corporate information and other latest information in a timely manner and is updated regularly.

In 2010, the Company attended many investors conferences including the following ones held by major international investment banks:

| <b>Date</b>    | <b>Name of Conference</b>   |
|----------------|---|
| January 2010   | Deutsche Bank Access China Conference 2010                            |
| March 2010     | CLSA Asia-Pacific Markets — China Internet and Media Forum            |
| March 2010     | Goldman Sachs — Investor Group Meeting                                |
| March 2010     | Citi Investment Research — None-Deal Roadshow                         |
| May 2010       | The Royal Bank of Scotland — Seventh Annual Asia Access               |
| May 2010       | Deutsche Bank — China Internet Tour                                   |
| June 2010      | Credit Suisse — China Investment Conference                           |
| June 2010      | Goldman Sachs — Investor Group Meeting                                |
| July 2010      | Credit Suisse — Investor Group Meeting                                |
| August 2010    | Credit Suisse — None-Deal Roadshow                                    |
| September 2010 | Susquehanna Financial Group — Fourth Annual Beijing Management Summit |
| November 2010  | Goldman Sachs — Investor Group Meeting                                |
| November 2010  | The Royal Bank of Scotland — None-Deal Roadshow                       |
| December 2010  | Kaufman Bros — Investor Group Meeting                                 |

On behalf of the Board  
**Pak Kwan Kau**  
*Chairman*

Hong Kong, March 23, 2011

# DIRECTORS' REPORT

The Board of the Company hereby presents its report together with the audited financial statements of the Group prepared in accordance with International Financial Reporting Standards for the year ended December 31, 2010.

## Principal Business

The principal activity of the Company is investment holding. The principal activities of the subsidiaries comprise the research, development, operation and distribution of online game, mobile game and casual game services; and the research, development, operation and distribution of internet security software, dictionary software and

office application software online and offline products. There were no significant changes in the nature of the Group's principal activities during the year. The analysis of the Group's revenues by operating segments and certain geographical information are set out in note 4 to the financial statements.

## Use of IPO Proceeds

The Company has raised the aggregate net proceeds from the Global Offering of approximately HK\$649.1 million. The Global Offering was completed in the fourth quarter of 2007 and the use of proceeds as of the end of 2010 is set out in the table below:

| <b>Area of use</b>  | <b>Planned amount<br/>(HK\$' Mil)</b> | <b>Amount remaining as<br/>at December<br/>31, 2010<br/>(HK\$' Mil)</b> |
|---|---------------------------------------|---|
| Expansion of research and development capabilities            | 170.1                                 | —   |
| Expansion in certain overseas market                          | 76.0                                  | <b>44.1</b>   |
| IT infrastructure upgrade                                     | 94.1                                  | —   |
| Strategic acquisitions and joint ventures                     | 115.8                                 | —   |
| Construction of research and development facilities in Zhuhai | 72.4                                  | —   |
| General corporate purposes                                    | 27.9                                  | —   |

## Results and Appropriations

The results of the Group for the year ended December 31, 2010 are set out in the consolidated income statement on page 45 of this annual report.

The state of affairs of the Group and the Company as at December 31, 2010 is set out in the consolidated statement of financial position on pages 47 to 48 of this annual report.

The consolidated statement of cash flows of the Group for the year is set out on page 50 to 51 of this annual report.

During the year, a final dividend for year 2009 of HK\$0.15 per ordinary share, with the total amount of approximately HK\$163.6 million, which excluded the dividend related to the shares held under the Share Award Scheme, was paid to shareholders on June 15, 2010.

The Directors recommend the payment of a final dividend of HK\$0.15 per ordinary share and a special dividend of HK\$0.25 per ordinary share totaling approximately HK\$441.9 million, which excluded the dividend related to

the shares held under the Share Award Scheme, based on the number of total issued shares of 1,121,407,633 as at December 31, 2010 in respect of the year to shareholders whose names appear on the register of members of the Company on May 25, 2011. Such proposed dividends will be subject to approval of the shareholders at the forthcoming AGM to be held on May 25, 2011. Such proposed dividends will be payable on June 10, 2011. This recommendation has been incorporated in the financial statements within the equity section of the statement of financial position.

For the year ended December 31, 2010, the Company is not aware of any arrangement under which a shareholder has waived or agreed to waive any dividends.

The register of members of the Company will be closed from Thursday, May 19, 2011 to Wednesday, May 25, 2011 both dates inclusive, during which period no transfer of shares will be effected. In order to qualify for the proposed final dividend and special dividend and the right to attend and vote at the forthcoming AGM, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's branch share registrar,

## DIRECTORS' REPORT (continued)

Computershare Hong Kong Investor Services Limited at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong for registration not later than 4:30 p.m. on Wednesday, May 18, 2011.

### **Reserves**

For the year ended December 31, 2010, the profit attributable to owners of the parent amounted to RMB372.5 million. The Company's reserves available for distribution comprise share premium and retained earnings. Under the Companies Law of the Cayman Islands, the Company's share premium account may be applied by the Company in paying distributions or dividend to shareholders of the Company provided that immediately following the date on which the distribution or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

As at December 31, 2010, the Company had distributable reserves amounting to RMB883.70 million, calculated in accordance with any statutory provisions applicable in Cayman Islands. Details of movements in the reserves of the Group and the Company during the year ended December 31, 2010 are set out in the consolidated statement of changes in equity on page 49 of this annual report, and in note 33(b) to the financial statements, respectively.

### **Donations**

During the year, the Group made charitable and other donations totaling RMB1 million (2009: RMB0.05 million).

### **Retirement Schemes**

We participate in government and other mandatory pension schemes for our employees in Mainland China and overseas. Particulars of these schemes are set out in note 2 to the financial statements.

### **Employee and Remuneration Policy**

As at December 31, 2010, the Group had approximately 2,472 full-time employees (2009: 2,735), most of whom are based at the Company's offices in Beijing and Zhuhai. The staff cost of the Group including Directors' and senior management's emoluments in 2009 and 2010 were approximately RMB315.0 million and RMB372.1 million, respectively. The Group remunerates its employees based on their performance and work experience and

the prevailing market rates. The remuneration policy and package of the Group's employees are periodically reviewed. Salaries of employees are maintained at competitive levels while bonuses are granted by reference to the performance of the Group and individual employees. Employees' remuneration includes basic salaries, benefits, allowances, bonus, share options and awarded shares. The Directors' remuneration comprises Directors' fees, basic salaries, benefits, allowances, bonus, share options and awarded shares which are determined based on their responsibilities and contribution to the Group.

Please refer to note 7 to the financial statements for the share options and awarded shares granted to certain Directors and employees of the Group, note 8 to the financial statements for Directors' and senior executives' remuneration, and note 6 to the financial statements for the employee benefit expense.

### **Subsidiaries**

Details of the Company's principal subsidiaries as at December 31, 2010 are set out in note 32 to the financial statements.

### **Material Investment and Acquisition**

No material investment and acquisition incurred during 2010.

# DIRECTORS' REPORT (continued)

## Financial Summary

A summary of the published results, assets, and liabilities of the Group for the last five financial years as extracted from the prospectus of the Company dated on September

24, 2007 and consolidated financial statements for the year ended December 31, 2007, 2008, 2009 and 2010, is set out as below. The summary does not form part of the audited financial statements.

|                     | YEAR ENDED DECEMBER 31, |                 |                 |                 |                 |
|---------------------|-------------------------|-----------------|-----------------|-----------------|-----------------|
|                     | 2006<br>RMB'000         | 2007<br>RMB'000 | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000 |
| Profit for the year | 99,110                  | 155,452         | 304,035         | 388,854         | <b>374,533</b>  |

|                   | AS AT DECEMBER 31, |                 |                 |                 |                  |
|-------------------|--------------------|-----------------|-----------------|-----------------|------------------|
|                   | 2006<br>RMB'000    | 2007<br>RMB'000 | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000  |
| Total assets      | 520,709            | 1,499,921       | 1,739,223       | 2,040,870       | <b>2,444,813</b> |
| Total liabilities | 252,882            | 366,264         | 410,858         | 436,560         | <b>510,752</b>   |

## Contract of Significance

Save as disclosed in the section of "Related Party Transactions and Connected Transactions" in Directors' Report, no other contracts of significance to which the Company, its ultimate Holding Company or its subsidiaries was a party and in which a Director or a controlling shareholder of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## Bank Borrowings

Particulars of bank loans as at December 31, 2010 are set out in note 28 to the financial statements.

## Property, Plant and Equipment

Details of the movements in the property, plant and equipment of the Group and the Company for the year ended December 31, 2010 are set out in note 13 to the financial statements. No assets of the Group are charged during the year ended December 31, 2010.

## Future Plans for Material Investments or Capital Assets

Save as those disclosed in note 36 and 42 to the financial statements, there was no specific plan for material investments and acquisition of material capital assets as at December 31, 2010.

## Principal properties

During the year, the Group has not held any properties for development and/or sale or for investment purposes which any of the percentage ratios exceeds 5%.

## Share Capital

Details of the movements in share capital of the Company for the year ended December 31, 2010 are set out in note 31 to the financial statements.

## Share Option Schemes

The Company adopted the 2004 and 2007 Pre-IPO Share Option Schemes which were approved by resolutions in writing of all the shareholders passed on June 30, 2004 and January 22, 2007. The details of these schemes and Kingsoft Japan Share Options are stated in note 7 in the financial statements.

Details of the movements in share options of the Company for the year ended December 31, 2010 are set out in note 7 to the financial statements. During the year, no share options have been granted to anybody.

# DIRECTORS' REPORT (continued)

## Summary of The Share Option Schemes

| Detail                                     | 2004 Pre-IPO Share Option Scheme   | 2007 Pre-IPO Share Option Scheme  | Kingsoft Japan Pre-IPO Share Option Scheme   |
|--|--|---|--|
| 1. Purposes                                | To retain the best available personnel, to provide additional incentive to employees, senior management and directors of the Group and to promote the success of the business of the Group   | Same as 2004 Pre-IPO Share Option Scheme  | To enhance the operational efficiency of Kingsoft Japan and to provide additional incentive for its employees and other related persons.   |
| 2. Qualifying participants                 | Any employee (whether full time or part time), chief executive or director (including executive or non-executive or independent non-executive) of any member of the Group or any associated company, in which the Company directly or indirectly holds more than 20% of its issued share capital or the voting power at general meetings or in which any equity interest is held by the Company for long term purpose and a significant influence is exercised over its management, or such other person as may be determined by the Board from time to time   | Same as 2004 Pre-IPO Share Option Scheme  | Not specified in the Scheme  |
| 3. Maximum number of shares                | The maximum number of ordinary shares in respect of which options may be granted under the 2004 Pre-IPO Share Option Scheme shall not in aggregate exceed 10% of the total number of ordinary shares in issue. On August 12, 2005, the shareholders approved that the maximum number of ordinary shares in respect of which options may be granted shall not in aggregate exceed 18% of the total number of ordinary shares in issue of 35,410,000. Pursuant to a Share Subscription and Purchase Agreement dated July 21, 2006 ("Agreement Date"), the aggregate of all options issued from the Agreement Date to an initial public offering shall not constitute more than 15% of the issued capital of the Company. | The maximum number of ordinary shares in respect of which options may be granted under the 2007 Pre-IPO Share Option Scheme shall not in aggregate exceed 13% of the total number of issued Shares on the fully diluted basis of inclusion of all of the issued and outstanding shares of the Company, as well as 6,373,800 options under the 2004 Pre-IPO Share Option Scheme. | The maximum number of the shares which may be issued upon exercise of all issued and outstanding options shall be 1,000 ordinary shares of Kingsoft Japan in aggregate.  |
| 4. Maximum entitlement of each participant | Not specified in the scheme  | Not specified in the scheme   | Not specified in the scheme  |
| 5. Option period                           | The period set out in the relevant offer letter within which the option may be exercisable provided that such period must expire on the date falling on the tenth anniversary of the offer date  | Same as 2004 Pre-IPO Share Option Scheme  | (1) the option period of options granted on January 4, 2007 is from January 5, 2009 to November 1, 2016<br>(2) the option period of options granted on March 30, 2007 is from March 30, 2007 to March 30, 2017<br>(3) the option period of options granted on July 31, 2007 is from August 1, 2009 to November 1, 2016 |
| 6. Acceptance of offer                     | The offer of a grant of share options must be accepted within 28 business days from the date of offer, upon payment of a consideration of HK\$1 in total by the grantee  | The offer of a grant of share options must be accepted within 28 business days from the date of offer   | Options shall be issued free   |

# DIRECTORS' REPORT (continued)

| Detail                          | 2004 Pre-IPO Share Option Scheme  | 2007 Pre-IPO Share Option Scheme   | Kingsoft Japan Pre-IPO Share Option Scheme   |
|---------------------------------|---|--|--|
| 7. Subscription price           | The exercise price shall be determined and notified by the Board and shall be at least a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time. | The exercise price shall be determined and notified by the Board and shall be a price US\$4.80 per share or a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time. | Note   |
| 8. Remaining life of the Scheme | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect  | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect   | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect |

Note:

The subscription price for option offered on January 4, 2007 and March 30, 2007 shall be ¥10,000 per share.

The subscription price for option offered on July 31, 2007 shall be ¥70,000 per share.

The Subscription Price shall be adjusted in accordance with the following formula, if after issuance of Options, Kingsoft Japan issues new shares at a price less than the last subscription price of its shares and it has not yet undergone initial public offering of its shares:

$$\text{Subscription price after adjustment} = \text{Subscription price before adjustment} \times \frac{\text{Number of issued shares} + \frac{\text{Number of shares to be newly issued or transferred} \times \text{Subscription amount or transfer price per share}}{\text{Last subscription price per share}}}{\text{Number of issued shares} + \text{Number of shares to be newly issued or transferred}}$$

Furthermore, in the case of any share split or consolidation of shares and reduction in paid in capital and in certain other cases, the Exercise Price may be adjusted appropriately.

## Share Award Scheme

The Share Award Scheme was adopted by the Board on March 31, 2008 (the "Adoption Date"). Unless terminated earlier by the Board, the Share Award Scheme shall be valid and effective for a term of five years commencing on the Adoption Date. On November 25, 2010, the Board approved to extend the term of the Share Award Scheme until March 30, 2017, for which the Company released an announcement on December 1, 2010. During the year, the Company granted 8,774,600 awarded shares.

The purpose of the Share Award Scheme is to recognise the contributions by certain employees (including without limitation to employees who are also directors) of the Group and to give incentive thereto in order to retain them for the continual operation and development of the Group and to attract suitable personnel for further development of the Group.

Pursuant to the terms of the Share Award Scheme, the Board may, from time to time, at its absolute discretion and subject to such terms and conditions as it may think fit (including the basis of eligibility of each employee determined by the Board from time to time) select an employee for participation in the Share Award Scheme and determine the number of shares to be awarded. The Board shall not grant any award of shares which would result in the total number of shares which are the subject of awards granted by the Board under the Share Award Scheme (but not counting any which have lapsed or have been forfeited) representing in aggregate over 10% of the issued share capital of the Company as at the date of such grant.

More details regarding the Share Award Scheme are set out in note 7 to the financial statements.

# DIRECTORS' REPORT (continued)

## Directors

The Directors of the Company during the year and up to the date of this report comprised 8 directors, of which 3

were Executive Directors, 2 were Non-executive Directors and 3 were Independent Non-executive Directors, whose names are as follows:

|  | APPOINTMENT<br>DATE | RESIGNATION<br>DATE | RE-DESIGNATION<br>DATE |
|--|---------------------|---------------------|------------------------|
| <b>EXECUTIVE DIRECTORS</b>                 |                     |                     |                        |
| Mr. Pak Kwan KAU (求伯君)                     | July 27, 1998       | N/A                 | N/A                    |
| Mr. Donghui WANG (王東暉)                     | May 30, 2008        | N/A                 | N/A                    |
| Mr. Tao ZOU (鄒濤)                           | August 25, 2009     | N/A                 | N/A                    |
| <b>NON-EXECUTIVE DIRECTORS</b>             |                     |                     |                        |
| Mr. Jun LEI (雷軍)                           | July 27, 1998       | N/A                 | August 28, 2008        |
| Mr. Shuen Lung CHEUNG (張旋龍)                | March 25, 2010      | N/A                 | N/A                    |
| Mr. Wai Ming WONG (黃偉明)                    | April 24, 2007      | March 25, 2010      | N/A                    |
| Mr. Wing Chung Anders CHEUNG (張榮宗)         | September 22, 2004  | March 25, 2010      | N/A                    |
| <b>INDEPENDENT NON-EXECUTIVE DIRECTORS</b> |                     |                     |                        |
| Mr. Shun Tak WONG (王舜德)                    | April 30, 2007      | N/A                 | N/A                    |
| Mr. Guangming George LU (魯光明)              | April 30, 2007      | N/A                 | N/A                    |
| Mr. Mingming HUANG (黃明明)                   | June 18, 2007       | N/A                 | N/A                    |

In accordance with Article 108 of the Articles of Association of the Company, Mr. Shun Tak WONG, Mr. Guangming George LU and Mr. Mingming HUANG will retire at the forthcoming AGM of the Company to be held on May 25, 2011 and, being eligible, will offer themselves for re-election.

The Company has received from each Independent Non-executive Director an annual confirmation of his independence pursuant to rule 3.13 of the Listing Rules and we consider them to be independent.

### *Directors' and Senior Management's Biographies*

Biographical details of the Directors of the Company and the senior management of the Group are set out on pages 14 to 18 of the annual report.

### *Directors' Service Contracts*

Each of the executive directors has entered into a service agreement with the Company. Each agreement is for a period of three years and shall continue thereafter until being terminated by either party giving not less than three months' prior written notice.

The emoluments of the Directors of the Company are determined by the Remuneration Committee after considering the Company's operating results, market rate and individual performance. No director can take part in deciding his own remuneration. Details of the remuneration policy for the Directors and senior management of the Group are set out in Corporate Governance Report under the heading of "Remuneration Committee".

None of the Directors who are proposed for re-election at the forthcoming AGM has a service contract with the Company or any of its subsidiaries which is not determinable within one year without payment of compensation, other than statutory compensation.

### *Interests of the Directors in Contracts*

Save as disclosed in the section of "Related Party Transactions and Connected Transactions" in Directors' Report, no Directors had any direct or indirect material interests in any contracts of significance to the business of the Group to which the Company or any of its subsidiaries was a party at the end of the year or at any time during the year ended December 31, 2010.

## DIRECTORS' REPORT (continued)

### Directors' and Chief Executive's Interests in Securities

As at December 31, 2010, the interests and short positions of the Directors and the chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance

("SFO")) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO); or (b) were required, pursuant to section 352 of the SFO, to be recorded in the register required to be kept by the Company; or (c) were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange were as follows:

*Interests in the ordinary shares of the Company:*

| NAME OF DIRECTOR  | NATURE OF INTERESTS | NUMBER OF SHARES HELD | PERCENTAGE OF ISSUED SHARE CAPITAL |
|-------------------|---------------------|-----------------------|------------------------------------|
| Pak Kwan Kau      | Corporate (Note 1)  | 219,489,800           | 19.57%                             |
|                   | Personal            | 500,000               | 0.04%                              |
| Jun Lei           | Corporate (Note 2)  | 117,230,280           | 10.45%                             |
| Tao Zou           | Personal            | 750,600               | 0.07%                              |
| Shuen Lung Cheung | Corporate (Note 3)  | 101,631,386           | 9.06%                              |

*Interests in underlying shares of the Company:*

| NAME OF DIRECTOR  | INTERESTS IN UNDERLYING SHARES | NUMBER OF INTERESTS DIRECTLY BENEFICIALLY OWNED |
|-------------------|--------------------------------|---|
| Jun Lei           | Share options (Note 4)         | 27,763,300                                      |
| Donghui Wang      | Share options (Note 5)         | 1,842,000                                       |
|                   | Awarded shares (Note 6)        | 1,184,000                                       |
| Pak Kwan Kau      | Awarded shares (Note 7)        | 1,000,000                                       |
| Tao Zou           | Share options (Note 8)         | 1,959,000                                       |
|                   | Awarded shares (Note 9)        | 402,000   |
| Shuen Lung Cheung | Share options (Note 10)        | 1,000,000                                       |

Notes:

- These shares are held by Topclick Holdings Limited, a BVI company wholly owned by Pak Kwan Kau.
- These shares are held by Color Link Management Limited, a BVI company wholly owned by Jun Lei.
- These shares are held by Super Faith International Limited. Each of Caprice Pacific Limited, Highland Crest Limited and World Conquest Limited is deemed to be interested in Super Faith International Limited's interest in the Company under the SFO because each of these entities is entitled to control the exercise of 33.3% of the voting power at general meetings of Super Faith International Limited. Caprice Pacific Limited is owned by Siu Ha Cheung and Ka Yeung Yip, who are husband and wife.

Highland Crest Limited is owned by Shuen Lung Cheung and Nien Shian Chu, who are husband and wife. World Conquest Limited is owned by Siu Lung Cheung and Tung Ping Lau, who are husband and wife. Accordingly, each of Shuen Lung Cheung, Nien Shian Chu, Siu Lung Cheung, Tung Ping Lau, Siu Ha Cheung and Ka Yeung Yip is deemed to be interested in Super Faith International Limited's interest in the Company by the SFO.

- The relevant interests include number of options of 22,451,800 which was granted on February 1, 2007 and its exercise period is from February 1, 2007 to February 1, 2017 with exercise price of US\$0.2400, and the number of options of 5,311,500 which was granted on August 1, 2004 and its exercise period is from August 1, 2004 to August 1, 2014 with exercise price of US\$0.0353.

## DIRECTORS' REPORT (continued)

5. The relevant interests include the number of options of 100,000 out of 800,000 which was granted on December 1, 2006 and its exercise period is from December 1, 2006 to December 1, 2016 with exercise price of US\$0.24, and the number of options of 1,742,000 out of 5,000,000 which was granted on February 1, 2007 and its exercise period is from February 1, 2007 to February 1, 2017 with exercise price of US\$0.24.
6. The relevant interests include: 1) number of 127,000 out of 381,000 awarded shares granted on October 13, 2008 under the Share Award Scheme adopted at the Board meeting held on March 31, 2008, which will be exercisable on October 13, 2011. The price for grant is nil; 2) number of 1,000,000 out of 1,500,000 awarded shares granted on July 13, 2009, under the Share Award Scheme, half of which will be exercisable on July 13, 2011 and July 13, 2012 respectively. The price for grant is nil; and 3) number of 57,000 awarded shares granted on March 26, 2010 under the Share Award Scheme, one third of which will be exercisable on March 26, 2011, March 26, 2012 and March 26, 2013 respectively.
7. The relevant interests include number of 1,000,000 out of 1,500,000 awarded shares granted on July 13, 2009 under the Share Award Scheme, half of which will be exercisable on July 13, 2011 and July 13, 2012 respectively. The price for grant is nil.
8. The relevant interests include number of options of 400,000 out of 1,600,000 which was granted on December 1, 2006 and its exercise period is from December 1, 2006 to December 1, 2016 with exercise price of US\$0.24, and the number of options of 1,559,000 out of 5,400,000 which was granted on February 1, 2007 and its exercise period is from February 1, 2007 to February 1, 2017 with exercise price of US\$0.2400.
9. The relevant interests include: 1) number of 324,000 awarded shares granted on October 13, 2008 under the Share Award Scheme, two third of which was matured and exercisable on October 13, 2009 and October 13, 2010 respectively, and one third of which will be exercisable on October 13, 2011. The price for grant is nil; and 2) number of 78,000 awarded shares granted on March 26, 2010 under the Share Award Scheme, one third of which will be exercisable on March 26, 2011, March 26, 2012 and March 26, 2013 respectively. The price for grant is nil.
10. The relevant interests include number of options of 1,000,000 which was granted on August 1, 2004 and its exercise period is from August 1, 2004 to August 1, 2014 with exercise price of US\$0.0353.
11. For further details on share options and awarded shares, please refer to the paragraph headed "Share Option Schemes" and "Share Award Scheme" respectively set out on page 30 to page 32 of this annual report respectively.

Save as disclosed above, none of the directors or chief executive and their associates, had interests or short positions in any shares, underlying shares or debentures of the Company and its associated corporations as at December 31, 2010.

### *Directors' Rights to Acquire Shares or Debentures*

Save as disclosed in the sections of "Directors' and Chief Executive's Interests in Securities", "Share Option Schemes" and "Share Award Scheme" in Directors' Report, at no time during the year was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries a party to any arrangement to enable the Directors of the Company, their respective spouse or minor children to acquire benefits by means of the acquisition of shares or debentures of the Company or any other body corporate.

## DIRECTORS' REPORT (continued)

### Substantial Shareholders

As at December 31, 2010, as far as the Directors are aware of, the following, other than the Directors and chief executive of the Company, had an interest in the shares or underlying shares in the Company which would fall to be

disclosed to the Company under the provision of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company under section 336 of the SFO, or who was, directly or indirectly, interested in 5% or more of the issued capital of the Company:

*Long position in the shares in the Company*

| NAME OF SHAREHOLDER                                | CAPACITY                             | NUMBER OF ORDINARY SHARES HELD IN THE COMPANY | PERCENTAGE OF ISSUED SHARE CAPITAL AS AT DECEMBER 31, 2010 |
|--|--------------------------------------|---|--|
| Topclick Holdings Limited <sup>(1)</sup>           | Beneficial owner                     | 219,489,800                                   | 19.57%   |
| Color Link Management Limited <sup>(2)</sup>       | Beneficial owner                     | 117,230,280                                   | 10.45%   |
| Super Faith International Limited                  | Beneficial owner                     | 101,631,386                                   | 9.06%  |
| Caprice Pacific Limited <sup>(3)</sup>             | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Highland Crest Limited <sup>(3)</sup>              | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| World Conquest Limited <sup>(3)</sup>              | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Shuen Lung Cheung <sup>(3)</sup>                   | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Nien Shian Chu <sup>(3)</sup>                      | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Siu Lung Cheung <sup>(3)</sup>                     | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Tung Ping Lau <sup>(3)</sup>                       | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Siu Ha Cheung <sup>(3)</sup>                       | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Ka Yeung Yip <sup>(3)</sup>                        | Interest of a controlled corporation | 101,631,386                                   | 9.06%  |
| Mirae Asset Global Investments (Hong Kong) Limited | Beneficial owner                     | 57,021,115                                    | 5.08%  |
| The Hamon Investment Group Pte Limited             | Beneficial owner                     | 56,386,000                                    | 5.03%  |

1. Pak Kwan Kau is deemed to be interested in Topclick Holdings Limited's interest in the Company by the SFO because Topclick Holdings Limited is wholly owned by Pak Kwan Kau.
2. Jun Lei is deemed to be interested in Color Link Management Limited's interest in the Company by the SFO because Color Link Management Limited is wholly owned by Jun Lei.
3. Each of Caprice Pacific Limited, Highland Crest Limited and World Conquest Limited is deemed to be interested in Super Faith International Limited's interest in the Company under the SFO because each of these entities is entitled to control the exercise of 33.3% of the voting power at general meetings of Super Faith International Limited. Caprice Pacific Limited is owned by Siu Ha Cheung and Ka Yeung Yip, who are husband and wife. Highland Crest Limited is owned by Shuen Lung Cheung and Nien Shian Chu, who are husband and wife. World Conquest Limited is owned by Siu Lung Cheung and Tung Ping

Lau, who are husband and wife. Accordingly, each of Shuen Lung Cheung, Nien Shian Chu, Siu Lung Cheung, Tung Ping Lau, Siu Ha Cheung and Ka Yeung Yip is deemed to be interested in Super Faith International Limited's interest in the Company by the SFO.

Save as disclosed above, the Directors are not aware of any other person who has beneficial interests or short positions in any of the shares or underlying shares which would be required to be disclosed to the Company and the Stock Exchange under the provisions of Division 2 and 3 of Part XV of the SFO or, directly or indirectly, be interested in 5% or more of the nominal value of the Shares carrying the right to vote in all circumstances at general meetings of the Company.

# DIRECTORS' REPORT (continued)

## **Public Float**

As at the date of this report, the Company has maintained the prescribed public float of at least 25% under the Listing Rules, based on the information that is publicly available to the Company and within the knowledge of the Directors.

## **Purchase, Sale or Redemption of Shares**

Pursuant to a resolution (the "Resolution") passed by our shareholders on May 28, 2010, a general unconditional mandate was granted to our Directors during the Relevant Period authorising the repurchase by our Company on the Stock Exchange or on any other stock exchange on which the securities of our Company may be listed and which is recognised by the Securities and Futures Commission of Hong Kong and the Stock Exchange for this purpose, such number of shares with an aggregate nominal value not exceeding 10% of the aggregate nominal value of our share capital in issue as at the date of the passing of the Resolution. For the purpose of the Resolution, Relevant Period means the period from the passing of this Resolution until whichever is the earlier of:

- (i) the conclusion of the next general meeting of the Company following the passing of the Resolution;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required to be held by the Articles of Association of the Company and any applicable laws; and
- (iii) the revocation or variation of the authority given under the Resolution by ordinary resolution of the shareholders of the Company in general meeting.

During the year ended December 31, 2010, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## **Competing Interest**

As of December 31, 2010, none of the Directors, controlling shareholders nor their respective associates (as defined in the Listing Rules) had any interest in a business which competed or might compete with the business of the Group.

## **Major Customers and Suppliers**

For the year ended December 31, 2010, the 5 largest customers of the Group accounted for 30% of the total revenue, while the largest customer accounted for 14% of the total revenue. For the year ended December 31, 2010, the 5 largest suppliers of the Group accounted for 27% of the total purchases, while the largest supplier accounted for 8% of the total purchases.

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and suppliers.

## **Related Party Transactions and Connected Transactions**

### *Non-exempt Continuing Connected Transactions*

#### **Certain Structure Contracts**

According to the Administrative Rules for Foreign Investments in Telecommunications Enterprises, which were issued on December 11, 2001 by the State Council and became effective on January 1, 2002, a foreign investor is currently prohibited from owning more than 50% of the equity interest in a Chinese entity that provides value-added telecommunications services. Internet content provision services are classified as value-added telecommunications businesses, and a commercial operator of such services must obtain an ICP license from the appropriate telecommunications authorities in order to carry on any commercial Internet content provision operations in China. In July 2006, the MII issued a notice which prohibits ICP license holders from leasing, transferring or selling a telecommunications business operating license to any foreign investors in any form, or providing any resource, sites or facilities to any foreign investors for their illegal operation of telecommunications businesses in China. The notice also requires that ICP license holders and their shareholders directly own the domain names and trademarks used by such ICP license holders in their daily operations. Therefore, in order for us to be able to carry on our business in China, the Group entered into a series of structure contracts with Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian"), its shareholders Weiqin Qiu and Peili Lei, and Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment"), which enable the Group to exercise control over Kingsoft Qijian, Beijing Kingsoft Digital Entertainment Co., Ltd. ("Beijing Digital Entertainment") and Chengdu Digital Entertainment and to consolidate these companies' financial results in our results. Beijing Digital Entertainment (which is wholly owned by Kingsoft Qijian) and Chengdu Digital Entertainment (which is owned as to 99% by Beijing Digital Entertainment and 1% by Weiqin Qiu) hold the requisite ICP licenses.

## DIRECTORS' REPORT (continued)

To streamline the corporate structure of the Group, the Group has commenced an internal reorganization exercise and a similar set of structure contracts relating to Zhuhai Qiwen Application Software Co., Ltd. ("**Zhuhai Qiwen**") was entered into on February 8, 2010. The Group also entered into a series of structure contracts with Beijing Conew Technology Development Co., Ltd. ("**Conew Technology**") on August 25, 2010.

The structure contracts which were in place during the year ended December 31, 2010 were as follows:

### *Structure Contracts relating to Kingsoft Qijian*

- (i) A loan agreement dated March 30, 2007 between Weiqin Qiu, Peili Lei and Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("**Chengdu Interactive Entertainment**") which provided for an interest free loan by Chengdu Interactive Entertainment of RMB1,200,000 to Weiqin Qiu and of RMB300,000 to Peili Lei, entirely for the purpose of repaying the loan provided by Zhuhai Kingsoft Software Co. Ltd. ("**Zhuhai Software**"). The loans have no definite maturity date and Chengdu Interactive Entertainment may request repayment at any time. Weiqin Qiu and Peili Lei shall repay the loan by transferring the equity interest they hold in Kingsoft Qijian to Chengdu Interactive Entertainment or as it may direct.
- (ii) A shareholder voting agreement dated March 30, 2007 among Chengdu Interactive Entertainment, Weiqin Qiu, Peili Lei and Kingsoft Qijian, under which Weiqin Qiu and Peili Lei irrevocably entrust all of their shareholder rights in Kingsoft Qijian to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Kingsoft Qijian.
- (iii) A call option agreement dated March 30, 2007 among Weiqin Qiu, Peili Lei, Kingsoft Qijian and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Weiqin Qiu's and Peili Lei's equity interest in Kingsoft Qijian at anytime, at a nominal amount subject to applicable PRC laws.
- (iv) An equity pledge agreement dated March 30, 2007 among Weiqin Qiu, Peili Lei, Chengdu Interactive Entertainment and Kingsoft Qijian, pursuant to which Weiqin Qiu and Peili Lei pledged all of their equity interests in Kingsoft Qijian (and any increase in their capital contributions) in favor of Chengdu Interactive Entertainment as security for their obligations and Kingsoft Qijian's performance of its obligations under the above loan agreement, shareholder voting agreement and call option agreement, and the performance by Chengdu Digital Entertainment of its obligations under the intellectual property license agreements (as described above) and the performance by Beijing Digital Entertainment of its obligations under the intellectual property license agreements (as described below).
- (v) Zhuhai Software (as the licensor) and Beijing Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on June 15, 2007 for a term of 10 years from January 1, 2007 which will be automatically renewed for one year at the end of the term of any renewed term, unless the licensor notifies otherwise. Zhuhai Software agreed to enter into agreements to license certain intellectual property rights to Beijing Digital Entertainment on a case by case basis.

### *Structure Contracts relating to Chengdu Digital Entertainment*

- (i) A loan agreement dated March 30, 2007 between Weiqin Qiu and Chengdu Interactive Entertainment which provided for an interest free loan of RMB100,000 by Chengdu Interactive Entertainment to Weiqin Qiu entirely for the purpose of capital funding of Chengdu Digital Entertainment. The loan has no definite maturity date and Chengdu Interactive Entertainment may request repayment at any time. Weiqin Qiu shall repay the loan by transferring the equity interest she holds in Chengdu Digital Entertainment to Chengdu Interactive Entertainment or as it may direct.
- (ii) A shareholder voting agreement dated March 30, 2007 among Chengdu Interactive Entertainment, Weiqin Qiu and Chengdu Digital Entertainment, under which Weiqin Qiu irrevocably entrusts all of her shareholder rights in Chengdu Digital Entertainment to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Chengdu Digital Entertainment.

## DIRECTORS' REPORT (continued)

- (iii) A call option agreement dated March 30, 2007 among Weiqin Qiu, Chengdu Digital Entertainment and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Weiqin Qiu's equity interest in Chengdu Digital Entertainment at any time, at a nominal amount subject to applicable PRC laws.
- (iv) An equity pledge agreement dated March 30, 2007 among Weiqin Qiu, Chengdu Interactive Entertainment, Chengdu Digital Entertainment and Beijing Digital Entertainment, pursuant to which Weiqin Qiu pledged her 1% equity interest in Chengdu Digital Entertainment (and any increase in her capital contribution) in favor of Chengdu Interactive Entertainment as security for the performance of her obligations under the above loan agreement, shareholder voting agreement and call option agreement as well as the performance by Chengdu Digital Entertainment of its obligations under the intellectual property license agreements (as described below).
- (v) Chengdu Interactive Entertainment (as the licensor) and Chengdu Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on June 15, 2007 for a term of 10 years from January 1, 2007 which will be automatically renewed for one year at the end of the term of any renewed term, unless the licensor notifies otherwise. Chengdu Interactive Entertainment agreed to enter into agreements to license certain intellectual property rights to Chengdu Digital Entertainment on a case by case basis.

As Weiqin Qiu is the sister of our executive Director, Pak Kwan Kau, and Peili Lei is an aunt of Jun Lei who was our executive Director when the above said structure contracts were signed and now is our non-executive Director, Weiqin Qiu and Peili Lei are associates of Pak Kwan Kau and Jun Lei, and therefore, are our connected persons. Accordingly, certain transactions under the structure contracts technically constituted connected transactions. The Company applied to the Stock Exchange for and was granted a specific waiver from strict compliance with the applicable disclosure and shareholders' approval requirements of Chapter 14A of the Listing Rules in relation to the transactions contemplated under the structure contracts for so long as the shares of the Company are listed on the Stock Exchange.

The Independent Non-executive Directors have reviewed the structure contracts relating to Kingsoft Qijian, Beijing Digital Entertainment and Chengdu Digital Entertainment and have confirmed that:

- these structure contracts remain unchanged and are consistent with their disclosure in the prospectus of the Company dated September 24, 2007;
- no dividends or other distributions were made by Kingsoft Qijian, Beijing Digital Entertainment, or Chengdu Digital Entertainment to the holders of their equity interests for the year ended December 31, 2010; and
- the terms of such structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the shareholders of the Company as a whole.

### *Structure Contracts relating to Zhuhai Qiwen*

- (i) A loan agreement dated February 8, 2010 was entered into between Weiqin Qiu, Jin Wang and Zhuhai Software which provided for an interest free loan by Zhuhai Software of RMB8,000,000 to Weiqin Qiu and Jin Wang, entirely for the purpose of repaying the liabilities incurred by Weiqin Qiu and Jin Wang in acquiring the entire equity interest in Zhuhai Qiwen. The loan has no definite maturity date and Zhuhai Software may request repayment at any time. Weiqin Qiu and Jin Wang shall, subject to the applicable laws, repay the loan by transferring the equity interest they hold in Zhuhai Qiwen to Zhuhai Software or as it may direct.

## DIRECTORS' REPORT (continued)

- (ii) A loan agreement dated August 3, 2010 among Weiqin Qiu, Jin Wang and Zhuhai Software which provided for an interest free loan by Zhuhai Software of RMB60,000,000 to Weiqin Qiu and Jin Wang, entirely for the purpose of repaying the liabilities incurred by Weiqin Qiu and Jin Wang in acquiring the 88.235% equity interest in Zhuhai Qiwen entered into following an increase of the authorized and paid-up capital of Zhuhai Qiwen. The loan has no definite maturity date and Zhuhai Software may request repayment at any time. Weiqin Qiu and Jin Wang shall, subject to the applicable laws, repay the loan by transferring the equity interest they hold in Zhuhai Qiwen to Zhuhai Software or as it may direct.
- (iii) A shareholder voting agreement dated February 8, 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, under which Weiqin Qiu and Jin Wang irrevocably entrust all of their shareholder rights in Zhuhai Qiwen to Zhuhai Software, including but not limited to the voting rights and the right to nominate directors of Zhuhai Qiwen.
- (iv) A call option agreement dated February 8, 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, under which Zhuhai Software was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Weiqin Qiu's and Jin Wang's equity interests in Zhuhai Qiwen at anytime, at a nominal amount subject to applicable PRC laws.
- (v) An equity pledge agreement dated February 8, 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, pursuant to which Weiqin Qiu and Jin Wang pledged all of their equity interests in Zhuhai Qiwen (and any increase in their capital contribution) in favor of Zhuhai Software as security for the performance of their obligations under the above loan agreement dated February 8, 2010, shareholder voting agreement and call option agreement, and the performance of the obligation by Zhuhai Kingsoft Application Software Co., Ltd. ("Zhuhai Kingsoft Application") under the intellectual property license agreement (as described below).
- (vi) An equity pledge agreement dated August 3, 2010 among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen entered into following an increase of the authorized and paid-up capital of Zhuhai Qiwen, pursuant to which Weiqin Qiu and Jin Wang pledged all of their equity interests in Zhuhai Qiwen (and any increase in their capital contribution) in favor of Zhuhai Software as security for the performance of their obligations under the above loan agreements, shareholder voting agreement and call option agreement, and the performance by Zhuhai Kingsoft Application of its obligation under the intellectual property license agreement (as described below).
- (vii) Zhuhai Software (as the licensor) and Zhuhai Kingsoft Application (as the licensee) entered into a framework intellectual property license agreement, for a term of 10 years from October 22, 2009 which will be automatically renewed for one year at the end of the term of any renewed term, unless the licensor notifies otherwise. Pursuant to the agreement, Zhuhai Software agreed to license the copyright of a software and permitted Zhuhai Kingsoft Application to develop the value-added telecommunications services and other business as permitted by its scope of business.

As Jin Wang is the husband of Weiqin Qiu, and Weiqin Qiu is the sister of our executive Director, Pak Kwan Kau, Jin Wang and Weiqin Qiu are associates of Pak Kwan Kau, and therefore are our connected persons. Accordingly, transactions under the structure contracts relating to Zhuhai Qiwen may technically constitute connected transactions.

The arrangement relating to Zhuhai Qiwen was substantially similar to the arrangement under the existing structure contracts relating to Kingsoft Qijian and Chengdu Digital Entertainment. Subject to the relevant disclosures in the annual report of the Company, cloning of structure contracts similar to those relating to Kingsoft Qijian and Chengdu Digital Entertainment will not be subject to the strict requirements of announcement and shareholders' approval under Chapter 14A of the Listing Rules.

The Independent Non-executive Directors have reviewed the structure contracts relating to Zhuhai Qiwen and have confirmed that:

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated September 24, 2007;

## DIRECTORS' REPORT (continued)

- no dividends or other distributions were made by Zhuhai Qiwen to the holders of their equity interest during the period between February 8, 2010 to December 31, 2010; and
- these structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the Company's shareholders as a whole.

### *Structure Contracts relating to Conew Technology*

- Each of Sheng Fu and Ming Xu executed a power of attorney dated August 25, 2010 in favour of Conew Network Technology (Beijing) Co., Ltd. ("**Conew Network**"), under which each of Sheng Fu and Ming Xu irrevocably entrusted all his shareholder rights in Conew Technology to Conew Network, including but not limited to the voting rights and the right to nominate directors of Conew Technology.
- A call option agreement dated August 25, 2010 between Sheng Fu and Conew Network, under which Conew Network was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Sheng Fu's equity interest in Conew Technology at anytime, at a nominal amount subject to applicable PRC laws.
- A call option agreement dated August 25, 2010 between Ming Xu and Conew Network, under which Conew Network was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Ming Xu's equity interest in Conew Technology at anytime, at a nominal amount subject to applicable PRC laws.
- An equity pledge agreement August 25, 2010 among Sheng Fu, Ming Xu and Conew Network, pursuant to which each of Sheng Fu and Ming Xu pledged all of their equity interests in Conew Technology (and any increase in their capital contributions) in favor of Conew Network as security for their obligations and Conew Technology's performance of its obligations under the above call option agreements, and the performance by Conew Technology of its obligations under the exclusive technology support and consultancy agreement (as described below) and the business operation agreement (as described below).
- Conew Network (as service provider) and Conew Technology entered into an exclusive technology support and consultancy agreement on August 25, 2010, which term commences from April 24, 2009

for an indefinite term, unless otherwise terminated by either party in accordance with the terms of the agreement.

- Conew Network, Conew Technology, Sheng Fu and Ming Xu entered into a business operation agreement on August 25, 2010 for a term of 10 years, unless otherwise terminated by Conew Network. Conew Technology, Sheng Fu and Ming Xu shall extend the term of the agreement or enter into another business operation agreement with Conew Network upon request of Conew Network.

After the entering into of the structure contracts relating to Conew Technology and as part of the consideration for the transfer of Conew Technology, Sheng Fu has become a substantial shareholder of a subsidiary of the Company and thus a connected person of the Company.

The arrangement relating to Conew Technology was substantially similar to the arrangement under the existing structure contracts relating to Kingsoft Qijian and Chengdu Digital Entertainment. Subject to the relevant disclosures in the annual report of the Company, cloning of structure contracts similar to those relating to Kingsoft Qijian and Chengdu Digital Entertainment will not be subject to the strict requirements of announcement and shareholders' approval under Chapter 14A of the Listing Rules.

The Independent Non-executive Directors have reviewed the structure contracts relating to Conew Technology and have confirmed that:

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated September 24, 2007;
- no dividends or other distributions were made by Conew Technology to the holders of their equity interest during the period between August 25, 2010 to December 31, 2010; and
- these structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the Company's shareholders as a whole.

Pursuant to Rule 14A.38 of the Listing Rules, the board of Directors engaged the auditors of the Company to perform certain agreed upon procedures in respect of the continuing connected transactions of the Group. The auditors have issued their letter on the continuing connected transactions of the Group to the board of Directors in compliance with rule 14A.38 of the Listing Rules.

# DIRECTORS' REPORT (continued)

## *Structure Contracts after December 31, 2010*

In 2011, the Group has entered into two respective sets of structure contracts with: (i) Shell Internet and its shareholders Sheng Fu, a substantial shareholder of a subsidiary of the Company, and Weiqin Qiu, the sister of our executive Director, Pak Kwan Kau; and (ii) Zhuhai Online Game and the 25 employees of Zhuhai Online Game, including Mr. Tao Zou, an executive director of the Company, which enable the Group to exercise control over Shell Internet and Zhuhai Online Game and to consolidate their financial results in our results. Such arrangement was substantially similar to the arrangement under the existing structure contracts relating to Kingsoft Qijian and Chengdu Digital Entertainment. Subject to the relevant disclosures in the annual report of the Company, cloning of structure contracts similar to those relating to Kingsoft Qijian and Chengdu Digital Entertainment will not be subject to the strict requirements of announcement and shareholders' approval under Chapter 14A of the Listing Rules.

Details of these structure contracts will be disclosed in the Company's annual report and accounts for the year ended 2011.

Such structure contracts will be subject to the review of the Independent Non-executive Directors for the financial period ending 31 December 2011.

## *Others*

### Duowan Transaction

As disclosed in the announcement of the Company of June 3, 2009, an agreement ("**Internet Advertising Services Framework Agreement**") between Chengdu Kingsoft Digital Entertainment Co., Ltd. ("**Chengdu Digital**") and Beijing Chuangshiqiji Advertisement Co., Ltd. ("**Beijing Wonder**") had been entered into on the same date, whereby Chengdu Digital agreed to allocate a total of not more than RMB10 million advertising expenses and engage Beijing Wonder to serve promotional advertisements on www.duowan.com, the online gaming portal ("**Duowan**") operated and owned by Guangzhou Huaduo Internet Technology Co., Ltd. ("**GHIT**") for a 3-year period ending 31 December 2011.

GHIT was a limited company incorporated in the PRC, which was an associate of Mr. Jun LEI, a non-executive Director of the Company, at the time when the Internet Advertising Services Framework Agreement was entered into. As Duowan was an online gaming portal owned and operated by GHIT, the transactions contemplated under the Internet Advertising Services Framework Agreement

constituted continuing connected transactions of the Company subject to the reporting and announcement requirements under Chapter 14A of the Listing Rules in the previous financial year.

As GHIT was no longer an associate of Mr. Jun LEI for the year ended December 31, 2010, the transactions under the Internet Advertising Services Framework Agreement no longer constitute continuing connected transactions during the financial year ended December 31, 2010.

### Related Party Transactions

Details of the related party transactions for the year are included in Note 37 to the financial statements. Certain related party transactions disclosed in Note 37 to the financial statements also constitute connected transactions or continuing connected transactions. The certain transactions between connected persons and the Group as shown above have been entered into and/or are ongoing during the year and the Company had made relevant disclosures to the extent required in accordance with the requirements of the Listing Rules.

### Compliance with the Code on Corporate Governance Practice

During the year, the Company complied with all code provisions of the Code on Corporate Governance Practices contained in Appendix 14 of the Listing Rules with the exception of the deviation from code provision A.2.1. Please also refer to the Corporate Governance Report in this annual report for full details.

### Auditors

The consolidated financial statements of the Company for the year ended December 31, 2010 has been audited by Ernst & Young, who will retire and, being eligible, offer themselves for reappointment at our forthcoming AGM.

### Pre-Emptive Rights

There are no provisions for pre-emptive rights under the Articles of Association of our Company or the laws of the Cayman Islands, which would oblige our Company to offer new shares on a pro-rata basis to existing shareholders.

By order of the Board

**Pak Kwan Kau**

*Chairman*

Hong Kong, March 23, 2011

# RECOGNITION & AWARDS

## Awards in 2010

- **Kingsoft** was awarded the “2010 China Top-ten Online Game Developer (2010十佳遊戲開發商)” and “2010 China Top-ten Online Game Operator (2010十佳遊戲運營商)” issued by 17173 online games portal; **Kingsoft** was ranked as “the Outstanding Enterprise in Intellectual Property Rights Development of Software Industry (軟件行業知識產權發展優秀企業)” by 2010 IP China Committee (IP China 2010組委會)



- **JX Online III** was awarded “2010 The Best 3D Online Games (2010年度最佳3D網遊)” and “2010 Top 10 Popular Online Games” of the Golden Plume Award, while **Legend of Moon** was awarded the “2010 The Best Original Online Games” of the Golden Plume Award.



- **Kingsoft Internet Security** has been certified by several international authority certification bodies in anti-virus software industry



- **Kingsoft WPS Office** was recommended by some major media organisations, including Computer News, Onlinedown.net, IT168.com, Duote.com, etc.



- **Kingsoft PowerWord** was recommended by some major media organisations, including Skycn.com, Doute.com, IT168.com, etc.



# INDEPENDENT AUDITORS' REPORT



## **TO THE SHAREHOLDERS OF KINGSOFT CORPORATION LIMITED**

*(Continued into the Cayman Islands with limited liability)*

We have audited the consolidated financial statements of Kingsoft Corporation Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 45 to 132, which comprise the consolidated and company statements of financial position as at December 31, 2010, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### **DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS**

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **AUDITORS' RESPONSIBILITY**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **OPINION**

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at December 31, 2010, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

### **Ernst & Young**

*Certified Public Accountants*

18<sup>th</sup> Floor

Two International Finance Centre

8 Finance Street, Central

Hong Kong

March 23, 2011

# CONSOLIDATED INCOME STATEMENT

Year ended December 31, 2010

|   | NOTES | 2010<br>RMB'000    | 2009<br>RMB'000 |
|---|-------|--------------------|-----------------|
| <b>REVENUE:</b>   | 5     |                    |                 |
| Entertainment software  |       | <b>640,917</b>     | 684,242         |
| Application software  |       | <b>321,003</b>     | 329,196         |
| Others  |       | <b>9,477</b>       | 8,974           |
|   |       | <b>971,397</b>     | 1,022,412       |
| Cost of revenue   |       | <b>(130,998)</b>   | (128,467)       |
| Gross profit  |       | <b>840,399</b>     | 893,945         |
| Research and development costs, net of government grants                            |       | <b>(271,046)</b>   | (199,611)       |
| Selling and distribution costs  |       | <b>(129,216)</b>   | (171,634)       |
| Administrative expenses   |       | <b>(111,143)</b>   | (101,630)       |
| Share-based compensation costs  | 6, 7  | <b>(42,119)</b>    | (41,312)        |
| Other income and gains  | 5     | <b>31,528</b>      | 26,867          |
| Other expenses  | 6     | <b>(38,203)</b>    | (2,598)         |
| Fair value gain on a financial asset at fair value through profit or loss           | 20    | <b>13,785</b>      | —               |
| Gain on disposal of an associate  | 17    | <b>105,189</b>     | —               |
| Finance income  | 6     | <b>33,162</b>      | 25,523          |
| Finance costs   | 6     | <b>(721)</b>       | —               |
| Share of profits and losses of:   |       |                    |                 |
| Associates  | 17    | <b>14,433</b>      | 25,715          |
| Jointly-controlled entities   | 18    | <b>(6,360)</b>     | (6,952)         |
| <b>PROFIT BEFORE TAX</b>  | 6     | <b>439,688</b>     | 448,313         |
| Income tax expense  | 9     | <b>(65,155)</b>    | (59,459)        |
| <b>PROFIT FOR THE YEAR</b>  |       | <b>374,533</b>     | 388,854         |
| Attributable to:  |       |                    |                 |
| Owners of the parent  |       | <b>372,480</b>     | 387,224         |
| Non-controlling interests   |       | <b>2,053</b>       | 1,630           |
|   |       | <b>374,533</b>     | 388,854         |
|   |       | <b>RMB</b>         | <b>RMB</b>      |
| <b>EARNINGS PER SHARE ATTRIBUTABLE TO<br/>ORDINARY EQUITY HOLDERS OF THE PARENT</b> | 12    |                    |                 |
| Basic   |       | <b>34.16 cents</b> | 36.38 cents     |
| Diluted   |       | <b>32.13 cents</b> | 33.68 cents     |

Details of the dividends proposed for the year are disclosed in note 11 to the financial statements.

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31, 2010

|   | <b>2010</b><br><b>RMB'000</b> | <b>2009</b><br><b>RMB'000</b> |
|---|-------------------------------|-------------------------------|
| <b>PROFIT FOR THE YEAR</b>                                | <b>374,533</b>                | 388,854                       |
| <b>OTHER COMPREHENSIVE INCOME:</b>                        |                               |                               |
| Exchange differences on translation of foreign operations | <b>(498)</b>                  | (632)                         |
| <b>OTHER COMPREHENSIVE LOSS FOR THE YEAR, NET OF TAX</b>  | <b>(498)</b>                  | (632)                         |
| <b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>            | <b>374,035</b>                | 388,222                       |
| Attributable to:  |                               |                               |
| Owners of the parent                                      | <b>370,319</b>                | 386,888                       |
| Non-controlling interests                                 | <b>3,716</b>                  | 1,334                         |
|   | <b>374,035</b>                | 388,222                       |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2010

|  | NOTES | 2010<br>RMB'000  | 2009<br>RMB'000  |
|--|-------|------------------|------------------|
| <b>NON-CURRENT ASSETS</b>                    |       |                  |                  |
| Property, plant and equipment                | 13    | 392,767          | 407,980          |
| Goodwill                                     | 14    | 11,710           | 2,377            |
| Other intangible assets                      | 15    | 69,045           | 48,489           |
| Lease prepayments                            | 16    | 45,083           | 6,972            |
| Investments in associates                    | 17    | —                | 6,378            |
| Investments in jointly-controlled entities   | 18    | 18,793           | 40,112           |
| Available-for-sale investment                | 19    | 18,675           | —                |
| Other financial asset                        | 20    | 13,785           | —                |
| Loan receivables                             | 21    | 3,542            | 2,649            |
| Deferred tax assets                          | 9     | 25,670           | 28,917           |
| Deferred cost                                |       | 461              | 1,201            |
| Long-term prepayments                        | 22    | —                | 38,738           |
| Total non-current assets                     |       | 599,531          | 583,813          |
| <b>CURRENT ASSETS</b>                        |       |                  |                  |
| Inventories                                  | 23    | 2,856            | 5,384            |
| Trade receivables                            | 24    | 98,939           | 120,378          |
| Prepayments, deposits and other receivables  | 25    | 85,125           | 60,075           |
| Deferred cost                                |       | 2,205            | 3,122            |
| Cash and cash equivalents                    | 26    | 1,656,157        | 1,268,098        |
| Total current assets                         |       | 1,845,282        | 1,457,057        |
| <b>CURRENT LIABILITIES</b>                   |       |                  |                  |
| Trade payables                               | 27    | 15,571           | 12,597           |
| Interest-bearing bank loan                   | 28    | 102,108          | —                |
| Dividend payable                             |       | 258              | 174              |
| Accrued expenses and other payables          | 29    | 163,203          | 186,896          |
| Deferred revenue                             | 30    | 161,570          | 158,643          |
| Income tax payable                           |       | 3,765            | 19,453           |
| Total current liabilities                    |       | 446,475          | 377,763          |
| <b>NET CURRENT ASSETS</b>                    |       | <b>1,398,807</b> | <b>1,079,294</b> |
| <b>TOTAL ASSETS LESS CURRENT LIABILITIES</b> |       | <b>1,998,338</b> | <b>1,663,107</b> |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)

December 31, 2010

|  | NOTES | 2010<br>RMB'000  | 2009<br>RMB'000 |
|--|-------|------------------|-----------------|
| <b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>       |       | <b>1,998,338</b> | 1,663,107       |
| <b>NON-CURRENT LIABILITIES</b>                     |       |                  |                 |
| Deferred revenue                                   | 30    | <b>29,139</b>    | 42,144          |
| Deferred tax liabilities                           | 9     | <b>35,138</b>    | 16,653          |
| Total non-current liabilities                      |       | <b>64,277</b>    | 58,797          |
| <b>Net assets</b>                                  |       | <b>1,934,061</b> | 1,604,310       |
| <b>EQUITY</b>                                      |       |                  |                 |
| <b>Equity attributable to owners of the parent</b> |       |                  |                 |
| Issued capital                                     | 31    | <b>4,527</b>     | 4,434           |
| Share premium account                              | 31    | <b>408,241</b>   | 525,349         |
| Shares held for share award scheme                 | 31    | <b>(57,773)</b>  | (72,365)        |
| Statutory reserves                                 | 33(a) | <b>140,057</b>   | 107,817         |
| Employee share-based reserve                       |       | <b>207,646</b>   | 225,011         |
| Capital reserve                                    | 33(a) | <b>16,230</b>    | —               |
| Foreign currency translation reserve               |       | <b>(68,625)</b>  | (66,464)        |
| Retained earnings                                  |       | <b>883,575</b>   | 723,335         |
| Proposed final and special dividends               | 11    | <b>376,000</b>   | 141,575         |
|  |       | <b>1,909,878</b> | 1,588,692       |
| <b>Non-controlling interests</b>                   |       | <b>24,183</b>    | 15,618          |
| <b>Total equity</b>                                |       | <b>1,934,061</b> | 1,604,310       |

**Pak Kwan Kau**  
Director

**Donghui Wang**  
Director

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended December 31, 2010

|  | ATTRIBUTABLE TO OWNERS OF THE PARENT      |   |  |  |   |   |   |                                 |   |                  |   |                            |
|--|---|---|--|--|---|---|---|---------------------------------|---|------------------|---|----------------------------|
|  | ISSUED<br>CAPITAL<br>(NOTE 31)<br>RMB'000 | SHARE<br>PREMIUM<br>ACCOUNT<br>(NOTE 31)<br>RMB'000 | SHARES<br>HELD FOR                               |  | EMPLOYEE<br>SHARE-BASED<br>RESERVE<br>RMB'000 | CAPITAL<br>RESERVE<br>(NOTE 33(a))<br>RMB'000 | FOREIGN<br>CURRENCY<br>RESERVE<br>RMB'000 | RETAINED<br>EARNINGS<br>RMB'000 | PROPOSED<br>FINAL<br>DIVIDENDS<br>RMB'000 | TOTAL            | NON-<br>CONTROLLING<br>INTERESTS<br>RMB'000 | TOTAL<br>EQUITY<br>RMB'000 |
|  |   |   | SHARE<br>AWARD<br>SCHEME<br>(NOTE 31)<br>RMB'000 | STATUTORY<br>RESERVES<br>(NOTE 33(a))<br>RMB'000 |   |   |   |                                 |   |                  |   |                            |
|  |   |   |  |  |   |   |   |                                 |   |                  |   |                            |
| <b>At January 1, 2009</b>  | 4,362                                     | 639,034   | (40,050)   | 81,481   | 194,648                                       | —   | (66,128)                                  | 362,447                         | 139,723                                   | 1,315,517        | 12,848                                      | 1,328,365                  |
| Profit for the year  | —   | —   | —  | —  | —   | —   | —   | 387,224                         | —   | 387,224          | 1,630                                       | 388,854                    |
| Other comprehensive income for the year:                         |   |   |  |  |   |   |   |                                 |   |                  |   |                            |
| Exchange differences on translation of foreign operations        | —   | —   | —  | —  | —   | —   | (336)                                     | —                               | —   | (336)            | (296)                                       | (632)                      |
| Total comprehensive income for the year                          | —   | —   | —  | —  | —   | —   | (336)                                     | 387,224                         | —   | 386,888          | 1,334                                       | 388,222                    |
| Approved and paid final dividend in respect of the previous year | —   | (1,068)   | —  | —  | —   | —   | —   | —                               | (139,723)                                 | (140,791)        | —   | (140,791)                  |
| Shares purchased for share award scheme                          | —   | —   | (43,050)   | —  | —   | —   | —   | —                               | —   | (43,050)         | —   | (43,050)                   |
| Share-based compensation costs                                   | —   | —   | —  | —  | 41,098  | —   | —   | —                               | —   | 41,098           | 36  | 41,134                     |
| Capital contribution from non-controlling interests              | —   | —   | —  | —  | —   | —   | —   | —                               | —   | —                | 1,400                                       | 1,400                      |
| Profit appropriations (note 33(a))                               | —   | —   | —  | 26,336   | —   | —   | —   | (26,336)                        | —   | —                | —   | —                          |
| Exercise of share options  | 72  | 28,958  | —  | —  | —   | —   | —   | —                               | —   | 29,030           | —   | 29,030                     |
| Vested awarded shares transferred to employees                   | —   | —   | 10,735   | —  | (10,735)                                      | —   | —   | —                               | —   | —                | —   | —                          |
| Proposed final 2009 dividend (note 11)                           | —   | (141,575)   | —  | —  | —   | —   | —   | —                               | 141,575                                   | —                | —   | —                          |
| <b>At December 31, 2009 and January 1, 2010</b>                  | <b>4,434</b>                              | <b>525,349</b>                                      | <b>(72,365)</b>                                  | <b>107,817</b>                                   | <b>225,011</b>                                | <b>—</b>                                      | <b>(66,464)</b>                           | <b>723,335</b>                  | <b>141,575</b>                            | <b>1,588,692</b> | <b>15,618</b>                               | <b>1,604,310</b>           |
| Profit for the year  | —   | —   | —  | —  | —   | —   | —   | 372,480                         | —   | 372,480          | 2,053                                       | 374,533                    |
| Other comprehensive income for the year:                         |   |   |  |  |   |   |   |                                 |   |                  |   |                            |
| Exchange differences on translation of foreign operations        | —   | —   | —  | —  | —   | —   | (2,161)                                   | —                               | —   | (2,161)          | 1,663                                       | (498)                      |
| Total comprehensive income for the year                          | —   | —   | —  | —  | —   | —   | (2,161)                                   | 372,480                         | —   | 370,319          | 3,716                                       | 374,035                    |
| Approved and paid final dividend in respect of the previous year | —   | (1,578)   | —  | —  | —   | —   | —   | —                               | (141,575)                                 | (143,153)        | —   | (143,153)                  |
| Share-based compensation costs                                   | —   | —   | —  | —  | 35,560  | —   | —   | —                               | —   | 35,560           | 1,079                                       | 36,639                     |
| Profit appropriations (note 33(a))                               | —   | —   | —  | 32,240   | —   | —   | —   | (32,240)                        | —   | —                | —   | —                          |
| Exercise of share options  | 93  | 80,470  | —  | —  | (38,333)                                      | —   | —   | —                               | —   | 42,230           | —   | 42,230                     |
| Vested awarded shares transferred to employees                   | —   | —   | 14,592   | —  | (14,592)                                      | —   | —   | —                               | —   | —                | —   | —                          |
| Proposed final 2010 and special dividends (note 11)              | —   | (196,000)   | —  | —  | —   | —   | —   | (180,000)                       | 376,000                                   | —                | —   | —                          |
| Changes in the ownership interest in a subsidiary                | —   | —   | —  | —  | —   | 16,230  | —   | —                               | —   | 16,230           | 3,770                                       | 20,000                     |
| <b>At December 31, 2010</b>                                      | <b>4,527</b>                              | <b>408,241</b>                                      | <b>(57,773)</b>                                  | <b>140,057</b>                                   | <b>207,646</b>                                | <b>16,230</b>                                 | <b>(68,625)</b>                           | <b>883,575</b>                  | <b>376,000</b>                            | <b>1,909,878</b> | <b>24,183</b>                               | <b>1,934,061</b>           |

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31, 2010

|   | NOTES | 2010<br>RMB'000  | 2009<br>RMB'000 |
|---|-------|------------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                               |       |                  |                 |
| Profit for the year   |       | <b>374,533</b>   | 388,854         |
| Adjustments for:  |       |                  |                 |
| Depreciation  | 6     | <b>57,652</b>    | 41,220          |
| Amortisation of lease prepayment  | 6     | <b>627</b>       | 166             |
| Loss on disposal of items of property, plant and equipment                | 6     | <b>299</b>       | 216             |
| Amortisation of purchased software  | 15    | <b>6,393</b>     | 9,591           |
| Amortisation of capitalised software costs                                | 15    | <b>18,071</b>    | 4,524           |
| Amortisation of other intangible assets                                   | 15    | <b>1,373</b>     | 1,065           |
| Interest income   |       | <b>—</b>         | (1,715)         |
| Finance costs   | 6     | <b>721</b>       | —               |
| Fair value gain on a financial asset at fair value through profit or loss | 20    | <b>(13,785)</b>  | —               |
| Gain on disposal of an associate  | 17    | <b>(105,189)</b> | —               |
| Deferred income tax expense   | 9     | <b>19,389</b>    | 9,135           |
| Share-based compensation costs  |       | <b>36,639</b>    | 41,134          |
| Impairment of investment in an associate                                  | 6     | <b>—</b>         | 400             |
| Impairment of goodwill  | 6     | <b>2,377</b>     | —               |
| Impairment of other intangible assets                                     | 6     | <b>5,160</b>     | —               |
| Impairment of investments in jointly-controlled entities                  | 6     | <b>13,974</b>    | —               |
| Impairment of loans to shareholders of jointly-controlled entities        | 6     | <b>10,250</b>    | —               |
| Share of profits of associates  | 17    | <b>(14,433)</b>  | (25,715)        |
| Share of losses of jointly-controlled entities                            | 18    | <b>6,360</b>     | 6,952           |
| Changes in assets and liabilities:  |       |                  |                 |
| (Increase)/decrease in trade receivables                                  |       | <b>21,439</b>    | (35,559)        |
| (Increase)/decrease in prepayments, deposits and other receivables        |       | <b>(7,798)</b>   | 12,110          |
| Decrease in income tax receivable   |       | <b>—</b>         | 182             |
| Increase in loan receivables  |       | <b>(893)</b>     | (129)           |
| (Increase)/decrease in inventories  |       | <b>2,528</b>     | (698)           |
| Decrease in deferred cost   |       | <b>1,657</b>     | 1,839           |
| Increase in trade payables  |       | <b>2,974</b>     | 4,948           |
| Decrease in deferred revenue  |       | <b>(10,078)</b>  | (13,837)        |
| Increase/(decrease) in accrued expenses and other payables                |       | <b>(7,136)</b>   | 2,354           |
| Decrease in income tax payable  |       | <b>(15,688)</b>  | (163)           |
| Net cash flows from operating activities                                  |       | <b>407,416</b>   | 446,874         |

# CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

Year ended December 31, 2010

|   | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|---|-------|-----------------|-----------------|
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |       |                 |                 |
| Proceeds from disposal of items of property, plant and equipment                                  |       | 467             | 101             |
| Purchases of items of property, plant and equipment   |       | (58,394)        | (78,655)        |
| Purchases of software   | 15    | (2,139)         | (4,491)         |
| Addition of capitalised software costs  | 15    | (20,177)        | (18,883)        |
| Addition of capitalised television program production cost  | 15    | (19,865)        | —               |
| Maturity of credit-linked financial instrument  |       | —               | 108,807         |
| Interest received from credit-linked deposit  |       | —               | 2,901           |
| (Increase)/decrease in time deposits with original maturity of<br>over three months when acquired | 26    | 393,057         | (472,343)       |
| Dividend and proceeds from disposal of an associate   | 17    | 86,500          | 46,414          |
| Acquisition of a subsidiary   | 34    | 1,026           | —               |
| Increase in long-term prepayments   |       | —               | (28,738)        |
| Advance of loans to shareholders of a subsidiary  |       | —               | (13,912)        |
| Advance of loans to shareholders of jointly-controlled entities                                   |       | (6,250)         | (4,000)         |
| Investment in an associate  |       | —               | (200)           |
| Investments in jointly-controlled entities  |       | —               | (40,722)        |
| Net cash flows from/(used in) investing activities  |       | 374,225         | (503,721)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |       |                 |                 |
| Purchase of shares held for share award scheme  |       | —               | (43,050)        |
| Exercise of share options   | 31    | 42,230          | 29,030          |
| Capital contribution from non-controlling interests   |       | —               | 1,400           |
| Dividends paid to owners of the parent  |       | (143,153)       | (140,791)       |
| New bank loan   | 28    | 102,108         | —               |
| Interest paid   |       | (721)           | —               |
| Net cash flows from/(used in) financing activities  |       | 464             | (153,411)       |
| <b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                       |       |                 |                 |
|   |       | 782,105         | (210,258)       |
| Cash and cash equivalents at beginning of year  |       | 405,595         | 616,955         |
| Effect of foreign exchange rate changes, net  |       | (989)           | (1,102)         |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>   |       |                 |                 |
|   |       | 1,186,711       | 405,595         |
| <b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>  |       |                 |                 |
| Cash and bank balances  | 26    | 259,995         | 258,975         |
| Time deposits with original maturity of three months or less when acquired                        | 26    | 926,716         | 146,620         |
|   |       | 1,186,711       | 405,595         |

# STATEMENT OF FINANCIAL POSITION

December 31, 2010

|  | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|--|-------|-----------------|-----------------|
| <b>NON-CURRENT ASSETS</b>                    |       |                 |                 |
| Property, plant and equipment                | 13    | 2               | 3               |
| Other intangible assets                      | 15    | —               | 763             |
| Investments in subsidiaries                  | 32    | 216,725         | 195,060         |
| Investment in a jointly-controlled entity    | 18    | 18,793          | 35,370          |
| Total non-current assets                     |       | 235,520         | 231,196         |
| <b>CURRENT ASSETS</b>                        |       |                 |                 |
| Prepayments, deposits and other receivables  | 25    | 13,867          | 14,305          |
| Due from subsidiaries                        | 32    | 791,402         | 327,470         |
| Cash and cash equivalents                    | 26    | 97,015          | 85,554          |
| Total current assets                         |       | 902,284         | 427,329         |
| <b>CURRENT LIABILITIES</b>                   |       |                 |                 |
| Interest-bearing bank loan                   | 28    | 102,108         | —               |
| Accrued expenses and other payables          | 29    | 1,075           | 2,897           |
| Dividend payable                             |       | 258             | 174             |
| Due to subsidiaries                          | 32    | 84,309          | 52,738          |
| Total current liabilities                    |       | 187,750         | 55,809          |
| <b>NET CURRENT ASSETS</b>                    |       | <b>714,534</b>  | 371,520         |
| <b>TOTAL ASSETS LESS CURRENT LIABILITIES</b> |       | <b>950,054</b>  | 602,716         |
| <b>NET ASSETS</b>                            |       | <b>950,054</b>  | 602,716         |
| <b>EQUITY</b>                                |       |                 |                 |
| Issued capital                               | 31    | 4,527           | 4,434           |
| Share premium account                        | 31    | 408,241         | 525,349         |
| Shares held for share award scheme           | 31    | (57,773)        | (72,365)        |
| Employee share-based reserve                 | 33(b) | 208,062         | 224,348         |
| Foreign currency translation reserve         | 33(b) | (88,428)        | (71,368)        |
| Retained earnings/(accumulated losses)       | 33(b) | 99,425          | (149,257)       |
| Proposed final and special dividends         | 11    | 376,000         | 141,575         |
| <b>TOTAL EQUITY</b>                          |       | <b>950,054</b>  | 602,716         |

**Pak Kwan Kau**  
Director

**Donghui Wang**  
Director

# NOTES TO FINANCIAL STATEMENTS

December 31, 2010

## 1. CORPORATE INFORMATION

Kingsoft Corporation Limited (the "Company") was incorporated under the Companies Act of the British Virgin Islands on March 20, 1998 as a tax exempted company with limited liability. On November 15, 2005, the Company was redomiciled to Cayman Islands under the Company Law (2004 revision) of the Cayman Islands. The registered office of the Company is located at Clifton House, 75 Fort Street, George Town, Grand Cayman, Cayman Islands.

The principal place of business of the Company is located at Kingsoft Tower, No. 33, Xiaoying West Road, Haidian District, Beijing, the People's Republic of China ("PRC").

During the year, the Company and its subsidiaries (collectively, the "Group") were involved in the following principal activities:

- research, development, operation and distribution of online games, mobile games and casual game services; and
- research, development, operation and distribution of internet security, dictionary and office application software products.

## 2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), which comprise standards and interpretations approved by the International Accounting Standards Board ("IASB"), and International Accounting Standards ("IASs") and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee that remain in effect and the disclosure requirements of the Hong Kong Companies Ordinance.

These financial statements have been prepared under the historical cost convention, except for available-for-sale investment and other financial asset, which have been measured at fair value. These consolidated financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

### **Basis of consolidation**

*Basis of consolidation from January 1, 2010*

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended December 31, 2010. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated on consolidation in full.

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.1 BASIS OF PREPARATION (continued)

### Basis of consolidation (continued)

*Basis of consolidation prior to January 1, 2010*

Certain of the above-mentioned requirements have been applied on a prospective basis. The following differences, however, are carried forward in certain instances from the previous basis of consolidation:

- Acquisition of non-controlling interests (formerly known as minority interests), prior to January 1, 2010, were accounted for using the parent entity extension method, whereby the difference between the consideration and the book value of the share of the net assets acquired were recognised in goodwill.
- Losses incurred by the Group were attributed to the non-controlling interest until the balance was reduced to nil. Any further excess losses were attributable to the parent, unless the non-controlling interest had a binding obligation to cover these. Losses prior to January 1, 2010 were not reallocated between non-controlling interest and the parent shareholders.

On March 31, 2008 (the "Adoption Date"), the board of directors of the Company approved and adopted a share award scheme (the "Share Award Scheme") in which selected employees of the Group are entitled to participate. The Group has set up a trust (the "Share Award Scheme Trust") for the purpose of administering the Share Award Scheme and holding shares awarded to the employees (the "Awarded Shares") before they vest. As the Group has the power to govern the financial and operating policies of the Share Award Scheme Trust and derives benefits from the contributions of the employees who have been awarded the Awarded Shares through their continued employment with the Group, the Group consolidates the Share Award Scheme Trust.

## 2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES

The Group has adopted the following new and revised IFRSs for the first time for the current year's financial statements.

|                                   |   |
|-----------------------------------|---|
| IFRS 2 Amendments                 | <i>Amendments to IFRS 2 Share-based Payment —<br/>Group Cash-settled Share-based Payment Transactions</i> |
| IFRS 3 (Revised)                  | <i>Business Combinations</i>  |
| IAS 27 (Revised)                  | <i>Consolidated and Separate Financial Statements</i>   |
| <i>Improvements to IFRSs 2009</i> | <i>Amendments to a number of IFRSs issued in April 2009</i>   |

Other than as further explained below regarding the impact of IFRS 3 (Revised) and IAS 27 (Revised), the adoption of the new and revised IFRSs has had no significant financial effect on these financial statements.

The principal effects of adopting these new and revised IFRSs are as follows:

IFRS 3 (Revised) introduces a number of changes in the accounting for business combinations that affect the initial measurement of non-controlling interests, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

IAS 27 (Revised) requires that a change in the ownership interest of a subsidiary without loss of control is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Consequential amendments were made to various standards, including, but not limited to IAS 7 *Statement of Cash Flows*, IAS 12 *Income Taxes*, IAS 21 *The Effects of Changes in Foreign Exchange Rates*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

The changes introduced by these revised standards are applied prospectively and affect the accounting of acquisitions, loss of control and transactions with non-controlling interests after January 1, 2010.

## 2.3 ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised IFRSs, that have been issued but are not yet effective, in these financial statements.

|                     |   |
|---------------------|---|
| IFRS 7 Amendments   | Amendments to IFRS 7 <i>Financial Instruments: Disclosures — Transfers of Financial Assets</i> <sup>4</sup>   |
| IFRS 9              | <i>Financial Instruments</i> <sup>5</sup>   |
| IAS 32 Amendment    | Amendment to IAS 32 <i>Financial Instruments: Presentation — Classification of Rights Issues</i> <sup>1</sup> |
| IFRIC 14 Amendments | Amendments to IFRIC 14 <i>Prepayments of a Minimum Funding Requirement</i> <sup>3</sup>                       |
| IFRIC 19            | <i>Extinguishing Financial Liabilities with Equity Instruments</i> <sup>2</sup>                               |

Apart from the above, the IASB has issued *Improvements to IFRSs 2010* which sets out amendments to a number of IFRSs primarily with a view to removing inconsistencies and clarifying wording. The amendments to IFRS 3 and IAS 27 are effective for annual periods beginning on or after July 1, 2010, whereas the amendments to IFRS 1, IFRS 7, IAS 1, IAS 34 and IFRIC 13 are effective for annual periods beginning on or after January 1, 2011 although there are separate transitional provisions for each standard.

<sup>1</sup> Effective for annual periods beginning on or after February 1, 2010

<sup>2</sup> Effective for annual periods beginning on or after July 1, 2010

<sup>3</sup> Effective for annual periods beginning on or after January 1, 2011

<sup>4</sup> Effective for annual periods beginning on or after July 1, 2011

<sup>5</sup> Effective for annual periods beginning on or after January 1, 2013

Further information about those changes that are expected to significantly affect the Group is as follows:

IFRS 9 issued in November 2009 is the first part of phase 1 of a comprehensive project to entirely replace IAS 39 *Financial Instruments: Recognition and Measurement*. This phase focuses on the classification and measurement of financial assets. Instead of classifying financial assets into four categories, an entity shall classify financial assets as subsequently measured at either amortised cost or fair value, on the basis of both the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. This aims to improve and simplify the approach for the classification and measurement of financial assets compared with the requirements of IAS 39.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.3 ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

IAS 39 is aimed to be replaced by IFRS 9 in its entirety. Before this entire replacement, the guidance in IAS 39 on hedge accounting and impairment of financial assets continues to apply. The Group expects to adopt IFRS 9 from January 1, 2013.

*Improvements to IFRSs 2010* issued in May 2010 sets out amendments to a number of IFRSs. The Group expects to adopt the amendments from January 1, 2011. There are separate transitional provisions for each standard. While the adoption of some of the amendments may result in changes in accounting policies, none of these amendments are expected to have a significant financial impact on the Group. Further information about these amendments is as follows:

- (a) *IFRS 3 Business Combinations*: Clarifies that the amendments to IFRS 7, IAS 32 and IAS 39 that eliminate the exemption for contingent consideration do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of IFRS 3 (as revised in 2008).

In addition, the amendments limit the measurement choice of non-controlling interests at fair value or at the proportionate share of the acquiree's identifiable net assets to components of non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. Other components of non-controlling interests are measured at their acquisition date fair value, unless another measurement basis is required by another IFRS.

The amendments also added explicit guidance to clarify the accounting treatment for non-replaced and voluntarily replaced share-based payment awards.

- (b) *IAS 1 Presentation of Financial Statements*: Clarifies that an analysis of other comprehensive income for each component of equity can be presented either in the statement of changes in equity or in the notes to the financial statements.
- (c) *IAS 27 Consolidated and Separate Financial Statements*: Clarifies that the consequential amendments from IAS 27 (as revised in 2008) made to IAS 21, IAS 28 and IAS 31 shall be applied prospectively for annual periods beginning on or after July 1, 2009 or earlier if IAS 27 is applied earlier.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Subsidiaries

A subsidiary is an entity (including a special purpose entity) whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated at cost less any impairment losses.

### Joint ventures

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Joint ventures (continued)

A joint venture is treated as:

- (a) a subsidiary, if the Group/Company has unilateral control, directly or indirectly, over the joint venture;
- (b) a jointly-controlled entity, if the Group/Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;
- (c) an associate, if the Group/Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or
- (d) an equity investment accounted for in accordance with IAS 39, if the Group/Company holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

### Jointly-controlled operations

A jointly-controlled operation is a joint venture that is set up by joint venture agreements which involve the use of the assets and other resources of the venturers, without the establishment of a separate entity. Under these agreements, assets remain under the ownership and controls of each party. Revenue and expenses derived/incurred in common are shared by the parties according to the contractual arrangement.

Assets that the Group controls and liabilities that it incurs in relation to a jointly-controlled operation are recognised in the Group's consolidated financial position on an accrual basis and are classified according to the nature of the item. The Group's share of the income that it earns from a jointly-controlled operation, together with the expenses that it incurs, is included in the Group's consolidated income statement when it is probable that the economic benefits associated with the transactions will flow to/from the Group.

### Jointly-controlled entities

A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's investments in jointly-controlled entities are stated in the consolidated statement of financial position at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post-acquisition results and reserves of jointly-controlled entities is included in the consolidated income statement and consolidated reserves, respectively. Goodwill arising from the acquisition of jointly-controlled entities is included as part of the Group's investments in jointly-controlled entities.

The results of the jointly-controlled entities are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in the jointly-controlled entities are treated as non-current asset and are stated at cost less any impairment losses.

### Associates

An associate is an entity, not being a subsidiary or a jointly-controlled entity, in which the Group has a long-term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Associates** (continued)

The Group's investments in associates are stated in the consolidated statement of financial position at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post-acquisition results and reserves of associates is included in the consolidated income statement and consolidated reserves, respectively. Goodwill arising from the acquisition of associates is included as part of the Group's investments in associates and is not individually tested for impairment.

### **Business combinations and goodwill**

#### *Business combinations from January 1, 2010*

Business combinations are accounted for using the acquisition method. The consideration transferred is measured at the acquisition date fair value which is the sum of the acquisition date fair values of assets transferred by the Group, liabilities assumed by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs are expensed as incurred.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred, the amount recognised for non-controlling interests and any fair value of the Group's previously held equity interests in the acquiree over the net identifiable assets acquired and liabilities assumed. If the sum of this consideration and other items is lower than the fair value of the net assets of the subsidiary acquired, the difference is, after reassessment, recognised in profit or loss as a gain on bargain purchase.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. The Group performs its annual impairment test of goodwill as at December 31. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Business combinations and goodwill** (continued)

Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

*Business combinations prior to January 1, 2010 but after January 1, 2005*

In comparison to the above-mentioned requirements which were applied on a prospective basis, the following differences applied to business combinations prior to January 1, 2010:

Business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs. The non-controlling interest was measured at the proportionate share of the acquiree's identifiable net assets.

Business combinations achieved in stages were accounted for as separate steps. Any additional acquired share of interest did not affect previously recognised goodwill.

When the Group acquired a business, embedded derivatives separated from the host contract by the acquiree were not reassessed on acquisition unless the business combination resulted in a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

Contingent consideration was recognised if, and only if, the Group had a present obligation, the economic outflow was more likely than not and a reliable estimate was determinable. Subsequent adjustments to the contingent consideration were recognised as part of goodwill.

### **Impairment of non-financial assets**

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, financial assets, investment properties, goodwill), the asset's recoverable amount is estimated. An asset's recoverable amount is the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises in those expense categories consistent with the function of the impaired asset.

An assessment is made at the end of each reporting period as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation) had no impairment loss been recognised for the asset in prior years. A reversal of such an impairment loss is credited to the income statement in the period in which it arises (only if there are revalued assets in the financial statements), unless the asset is carried at a revalued amount, in which case the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Related parties

A party is considered to be related to the Group if:

- (a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a jointly-controlled entity;
- (d) the party is a member of the key management personnel of the Group or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d); or
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

### Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where the recognition criteria are satisfied, the expenditure for a major inspection is capitalised in the carrying amount of the asset as a replacement. Where significant parts of property, plant and equipment are required to be replaced at intervals, the Group recognises such parts as individual assets with specific useful lives and depreciation.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful lives. The principal annual rates used for this purpose are as follows:

|                               |  |
|-------------------------------|--|
| Leasehold land and buildings  | Over the shorter of the lease term and 50 years  |
| Electronic equipment          | 33%  |
| Office equipment and fixtures | 19%  |
| Motor vehicles                | 19%  |
| Leasehold improvements        | Over the shorter of the expected life of the leasehold improvements and the lease term |

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at least at each financial year end.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Property, plant and equipment and depreciation** (continued)

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents a building under construction or equipment under installation, which is stated at cost less any impairment losses and is not depreciated. Cost comprises the direct costs of purchase, construction and installation during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

### **Intangible assets (other than goodwill)**

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are subsequently amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end.

#### *Purchased software*

Purchased software (including upfront licensing fees) is stated at cost less any impairment losses and is amortised on the straight-line basis over the shorter of the estimated economic life or the license period, which ranges from 2 to 10 years.

#### *Research and development costs*

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

The capitalised software development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the estimated economic life of the underlying product, which is determined to range from one to two years, commencing from the period in which the product is commercially released.

#### *Website and internally used software development costs*

The Group expenses all development costs of website and internally used software that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the development phase and satisfied the criteria for development cost capitalisation listed above are capitalised and amortised over the estimated product life of the underlying products not exceeding one to two years, commencing from the date when the products are put into commercial production.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Intangible assets (other than goodwill) (continued)

#### *Television program production costs*

Expenditure incurred for the production of television program is capitalised only when it is probable that the expected future economic benefits that are attributable to the television program will flow to the Group and the cost can be measured reliably. Television program production costs include capitalisable production costs, production overhead and development costs. Marketing, distribution, and general and administrative costs are expensed as incurred.

The capitalised television program production costs are stated at cost less any impairment losses and are amortised against revenue generated from the sales or distribution of the television program, commencing from the period in which the television program is broadcasted to audience. As of December 31, 2010, there has been no revenue derived from the television program.

### Leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Rentals payable under operating leases net of any incentives received from the lessor are charged to the income statement on the straight-line basis over the lease terms.

Prepaid land lease payments under operating leases are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

### Investments and other financial assets

#### *Initial recognition and measurement*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial investments, as appropriate. The Group determines the classification of its financial assets at initial recognition. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

The Group's financial assets include cash and bank balances, time deposits, trade and other receivables, loan receivables, available-for-sale investment and other financial asset.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Investments and other financial assets (continued)

#### *Subsequent measurement*

The subsequent measurement of financial assets depends on their classification as follows:

#### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with changes in fair value recognised in the income statement. These net fair value changes do not include any dividends or interest earned on these financial assets, which are recognised in accordance with the policies set out for "Revenue recognition" below.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such assets are subsequently measured at amortised cost using the effective interest rate method less any allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and includes fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance income in the income statement. The loss arising from impairment is recognised in the income statement in other expenses.

#### *Available-for-sale financial investments*

Available-for-sale financial investments are non-derivative financial assets in unlisted equity securities. Equity investments classified as available for sale are those which are neither classified as held for trading nor designated at fair value through profit or loss.

After initial recognition, available-for-sale financial investments are subsequently measured at fair value, with unrealised gains or losses recognised as other comprehensive income in the available-for-sale investment valuation reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in the income statement, or until the investment is determined to be impaired, at which time the cumulative gain or loss is recognised in the income statement in other expenses and removed from the available-for-sale investment valuation reserve. Interest and dividends earned are reported as interest income and dividend income, respectively and are recognised in the income statement as other income in accordance with the policies set out for "Revenue recognition" below.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Derecognition of financial assets**

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

### **Impairment of financial assets**

The Group assesses at the end of each reporting period whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that a debtor or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

#### *Financial assets carried at amortised cost*

For financial assets carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred). The present value of the estimated future cash flow is discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Impairment of financial assets** (continued)

#### *Financial assets carried at amortised cost* (continued)

The carrying amount of the asset is reduced either directly or through use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flow for the purpose of measuring the impairment loss. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the income statement.

#### *Available-for-sale financial investments*

For available-for-sale financial investments, the Group assesses at the end of each reporting period whether there is objective evidence that an investment or a group of investments is impaired.

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

In the case of equity investments classified as available for sale, objective evidence would include a significant or prolonged decline in the fair value of an investment below its cost. The determination of what is "significant" or "prolonged" requires judgement. "Significant" is evaluated against the original cost of the investment and "prolonged" against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the cumulative loss — measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement — is removed from other comprehensive income and recognised in the income statement. Impairment losses on equity instruments classified as available for sale are not reversed through the income statement. Increases in their fair value after impairment are recognised directly in other comprehensive income.

### **Financial liabilities**

#### *Initial recognition and measurement*

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loan and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, interest-bearing bank loan.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Financial liabilities (continued)

#### *Loans and borrowings*

After initial recognition, interest-bearing bank loan are subsequently measured at amortised cost, using the effective interest rate method unless the effect of discounting would be immaterial, in which case they are stated at cost. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the effective interest rate method amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance costs in the income statement.

#### *Derecognition of financial liabilities*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in the income statement.

### Fair value of financial instruments

The fair value of financial instruments that are traded in active markets is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. For financial instruments where there is no active market, the fair value is determined using appropriate valuation techniques. Such techniques include using recent arm's length market transactions; a discounted cash flow analysis; and option pricing models.

### Shares held for share award scheme

Where shares of the Company are purchased from the market for share award scheme, the consideration paid, including any directly attributable incremental costs, is presented as "Shares held for share award scheme" and deducted from equity.

### Inventories

Inventories are stated at the lower of cost (calculated on the weighted average basis) and net realisable value. Cost includes materials and production costs related to the purchase and production of inventories outsourced to third party manufacturers. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Cash and cash equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise cash on hand and demand deposits, and short-term highly liquid investments that are readily convertible into known amounts of cash, are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the statement of financial position, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

### Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event, and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the end of the reporting period of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

### Defined contribution plan for PRC employees

Full-time employees of the Group in the PRC participate in a government mandated multi-employer defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labour regulations require that the Group makes contributions to the government for these benefits based on certain percentages of the employees' salaries. The Group has no legal obligation for the benefits beyond the contributions made.

### Share-based payment transactions

Employees (including senior executives) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair values of the Company's ordinary shares on the dates of share option grants before the listing of the Company were assessed by an external appraiser. The fair values of share options are determined by management using the Black-Scholes valuation model (the "BS Model").

The cost of equity-settled transactions with employees is recognised as expense, together with a corresponding increase in equity, presented as "Employee share-based reserve", over the period in which the performance and/or service conditions are fulfilled. The cumulative expense recognised for equity-settled transactions at the end of each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the income statement for a period represents the movement in the cumulative expense recognised as at the beginning and end of that period.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Share-based payment transactions (continued)

No expense is recognised for awards that do not ultimately vest, except for equity-settled transactions where vested is conditional upon a market or non-vesting condition, which are treated as vested irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified, if the original terms of the award are met. In addition, an expense is recognised for any modification that increases the total fair value of the share-based payment transaction, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. This includes any award where non-vesting conditions within the control of either the Group or the employee are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph. All cancellations of equity-settled transaction awards are treated equally.

The Group has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after November 7, 2002 that had not vested by January 1, 2005 and to those granted on or after January 1, 2005.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

### Revenue recognition

The Group recognises revenue when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably.

Revenue from the sale of software products often includes a combination of software sale, the provision of training and post contract support services ("PCS"). When the selling price of a product includes an identifiable amount for subsequent servicing, the amount is deferred and recognised as revenue over the period during which the service is performed. The amount deferred is the amount which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services. If an acceptance period is required, revenue is recognised upon the earlier of customer acceptance or the expiration of the acceptance period.

Revenue is recognised net of value-added tax ("VAT") payable to, but includes the benefit of the refund of VAT on the sale of software products received or receivable from, the Chinese tax authorities as part of the PRC government's policy of encouraging software development in the PRC. The sales of software products in the PRC are subject to a 17% VAT. Companies that fulfil certain criteria set by the relevant authorities and companies that develop their own software products and have the software products registered with the relevant authorities in the PRC are entitled to a refund of VAT equivalent to the excess over 3% of contract amount paid in the month when output VAT exceeds input VAT (excluding export sales). The excess portion of the VAT is refundable and is recorded on an accrual basis.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Revenue recognition (continued)

The Group offers contractual cash rebates and rights of returns of its products under various policies and programs with its distributors and resellers. Revenue is deferred and recognised when the price can be measured reliably and the amount of future rebates and returns can be reasonably estimated, provided that all other basic criteria for revenue recognition have been met. The Group accounts for reserves on cash rebates and returns as an offset to revenue. The Group accounts for the cash rebates which are offset against revenue in the income statement, together with an accrual in the statement of financial position. Besides, the Group estimates the amount of returns, which is offset against revenue in the income statement, together with deferred revenue in the statement of financial position.

In addition to these basic criteria, there are specific revenue recognition policies for each of the major streams, namely, the sale of software products, including security and utilities software and office application software, the provision of online game services, and other revenue which mainly comprises the provision of software consultancy services.

#### (a) *Application software products*

- Sales of perpetual software licenses

The Group sells perpetual information security and utilities software licenses to original equipment manufacturers ("OEMs") for them to install into their own products, or to non-OEM customers, most of which are for individual usage through distributors. Revenue from the licensing agreements is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold. For those licenses to OEMs which involve virus definition updates to end users of OEM's products, revenue of this element is recognised over the period during which the virus definition update service is provided.

- Multi-year licensing arrangements

The Group enters into multi-year licensing arrangements with OEMs to allow OEMs to install unlimited copies of the Group's information security and utilities software over a period of one to three years in the OEMs' products for a fixed cash consideration. During the licensing period, the Group is required to provide when-and-if-available upgrades, training and virus definition update subscriptions to OEMs' products. Revenue from multi-year licensing arrangements is recognised as revenue ratably over the licensing period upon the delivery of the software master copy.

- Subscription of online downloads

Online subscription model is applied on the Group's individual information security products, of which revenue is recognised upon activation of the prepaid service cards or online downloads based on the actual usage of subscribed time by end customers. Upon expiry of prepaid service cards, any remaining amount is recognised immediately as revenue. The costs related to the production of prepaid services cards are also deferred until revenue for the prepaid amounts is recognised.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Revenue recognition (continued)

#### (b) Entertainment software — Online game services

The Group sells either its prepaid game cards for its online game products to the distributors which in turn sell them to end users, or prepaid online points to end customers at the Group's website.

The Group applies a pay-to-play subscription-based model and an item-billing revenue model on its online game services.

For the pay-to-play subscription-based model, both prepaid cards and prepaid online points provide customers with a pre-specified length of game playing time within a specified period of time. All prepaid fees received from distributors and end customers are initially recognised as deferred revenue. Revenue is recognised upon activation of the prepaid game cards or online points based on the actual usage of the game playing time by end customers.

For the item-billing revenue model, the customers can play the game for free with limited basic functions. There are also in-game items and premium features sold in the game by consuming online game points, commonly known as "Virtual Items", which are regarded as value-added services and are rendered over a pre-specified period or throughout the whole game life. The revenue from these Virtual Items are recognised ratably over the estimated practical usage period or throughout the whole game life as appropriate. Future usage patterns may differ from the historical usage patterns on which the item-billing revenue model revenue recognition is based. The Group monitors the operational statistics and usage patterns of Virtual Items.

Upon expiry of online points, any remaining amount is recognised as revenue. The costs related to the production of prepaid game cards are also deferred until revenue for those prepaid amounts are recognised.

The sale of prepaid game cards to distributors and retailers includes certain discounts from the face value of the cards. The Group recognises revenue from these transactions net of the discounts provided to the distributors.

#### (c) Licensing revenue

The Group enters into licensing arrangements with licensees to operate the Group's games in other countries and regions.

According to the licensing arrangements, the Group is entitled to ongoing usage-based royalties which are determined based on the amount of money charged to the players' accounts in a given country or region. The usage-based royalties are recognised when they are earned, provided that the collection is probable.

In certain licensing arrangements, the Group provides PCS over the licensing period at no additional charge except for the initial fees. In those cases, the total amount of the initial fee is recognised ratably over the contractual licensing period.

#### (d) Software consultancy services

The Group engages in the provision of the consultancy services to assist its clients in the design and development of software or applications. These consulting services are usually fixed on prices, completed within one year, and subject to the successful completion in performing deliverables within a time frame specified by clients on a project by project basis. The Group recognises software consultancy service revenue when the services have been completed or upon written acceptance from customers, if applicable. Revenue from software consultancy services was reported as either application software revenue or other revenue, depending on the nature of project.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Revenue recognition (continued)

#### (e) Advertising services

Advertising revenues are derived principally from online advertising arrangements. The Group enters into advertising arrangements with advertisers to allow them to place advertisements on particular areas of the Group's websites over a particular period of time, or embedded hyperlinks to advertisements in the Group's software. Advertising revenues from advertising arrangements with a particular period of time are recognised ratably over the displayed period of the contract when the collectability is reasonably assured. For the hyperlinks embedded in the Group's software, the advertisers pay the Group based on number of clicks on the hyperlinks by end users of the software. The Group recognises revenue when the revenue can be measured reliably and the collectability is reasonably assured.

#### (f) Interest income

Interest income is recognised on an accrual basis using the effective interest method by applying the rate that exactly discounts the estimated future cash receipts through the expected life of the financial instrument or a shorter period, when appropriate, to the net carrying amount of the financial asset.

### Cost of revenue

Cost of revenue consists primarily of manufacturing costs for software and prepaid game cards, data centre and transportation costs and other overhead expenses directly attributable to the production of software and provision of online game services.

### Deferred revenue

Deferred revenue represents cash received or receivables from the sale of software products, subscription received for online information security services, payment for online game services in advance of services being rendered and government grants received in advance of fulfilling the grant requirements.

### Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as a reduction of the related expense when the expense is incurred. Where the grant relates to capitalised software costs, the fair value is deducted from the carrying amount of the capitalised software costs and released to the income statement by way of a reduced depreciation charge.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Income tax

Income tax comprises current and deferred tax. Income tax relating to items recognised outside profit or loss is recognised outside profit or loss, either in other comprehensive income or directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period, taking into consideration interpretations and practices prevailing in the countries in which the Group operates.

Deferred tax is provided, using the liability method, on all temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised, except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and associates and joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Dividends

Final and special dividends proposed by the directors are classified as a separate allocation of retained earnings within the equity section of the statement of financial position, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

### Foreign currencies

These financial statements are presented in RMB. The Company and its subsidiaries have determined their functional currencies to be their respective local currencies of Hong Kong Dollars ("HK\$"), Japanese Yen ("JPY"), Malaysia Ringgit ("MYR") and RMB. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies recorded by the entities in the Group are initially recorded using their respective functional currency rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the end of the reporting period. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of the Company and certain overseas subsidiaries are currencies other than the RMB. As at the end of the reporting period, the assets and liabilities of these entities are translated into RMB at the exchange rates ruling at the end of the reporting period and their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting exchange differences are recognised in other comprehensive income and accumulated in the foreign currency translation reserve. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated statement of cash flows, the cash flows of the Company and certain overseas subsidiaries are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of the Company and certain overseas subsidiaries which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 3. ESTIMATION UNCERTAINTY

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

The key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

### (a) Fair value of ordinary shares subscription option for unlisted equity shares

The directors have used the BS Model to determine the total fair value of the option obtained. Significant judgement, such as risk-free rate, dividend yield, expected volatility and expected life of option, is required to be made by the directors as the parameters for applying the BS Model. The Company engaged an independent appraiser to perform an appraisal of the fair value of the option. The fair value of the option was RMB13,785,000 as at December 31, 2010. Further details are included in note 20 to the financial statements.

### (b) Recognition of share-based compensation costs

The Company grants Awarded Shares to its employees. The fair value of the Awarded Shares was based on the market value of the Company's shares at grant date. The fair value of the Awarded Shares awarded during the year ended December 31, 2010 was approximately RMB43,245,000 (2009: RMB54,558,000).

The grant of equity instruments is conditional upon satisfying specified vesting conditions, including service period, performance condition linked to financial performance measure. Judgement is required to take into account the vesting conditions and adjust the number of equity instruments included in the measurement of share-based compensation costs.

### (c) Software development costs

Software development costs are capitalised in accordance with the accounting policy for research and development costs. Determining the amounts to be capitalised requires assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits. At December 31, 2010, the best estimate of the carrying amount of capitalised development costs was RMB25,468,000 (2009: RMB23,362,000).

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 3. ESTIMATION UNCERTAINTY (continued)

### (d) Television program production costs

The Group has entered into a contractual arrangement with other parties to jointly produce a television program. Television program production costs are capitalised in accordance with the accounting policy for television program production costs. Determining the amounts to be capitalised requires assumptions regarding the expected future cash generation of the television program, discount rates to be applied and the expected period of benefits. At December 31, 2010, the best estimate of the carrying amount of capitalised television program production costs was RMB19,865,000 (2009: Nil).

### (e) Revenue recognition

- *Application software*

Judgement is required to determine the portion of the deferral of software revenue, which represents the expected cost for PCS, together with a reasonable profit on those services. Determining the amount of PCS requires estimates of the product life cycle for the information security software which is subject to changes to the product's functionality and termination of the provision of virus definition updates.

As the Group offers contractual cash rebates and rights of returns of its products under various policies and programs with its distributors and resellers, judgement is required to estimate the amount of future rebates and returns.

- *Entertainment software — Online games services*

Revenue is recognised upon activation of the prepaid game cards or online points based on the actual usage of the game playing time by end customers. As the prepaid game cards are sold through distributors or the Group's websites, the discount rate offered varies among different distribution channels. The amount of revenue is calculated from actual usage and unit price per point per day, which is determined on a weighted average basis.

### (f) Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies. The carrying value of deferred tax assets relating to recognised tax losses was nil as at December 31, 2010 (2009: RMB4,833,000). The amount of unrecognised tax losses as at December 31, 2010 was RMB82,961,000 (2009: RMB24,257,000). Further details are disclosed in note 9.

In addition, deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Certain entities of the Group were recognised as "High New Technology Enterprise" in Mainland China and entitled to a preferential corporate income tax rate of 15% during the three years from January 1, 2008 to December 31, 2010. The tax regulations call for a renewal process after the expiry period of three years. For the measurement of deferred tax assets and liabilities, judgement is required to determine whether these entities will continue to meet the criteria of "High New Technology Enterprise" and estimate the tax rates expected to apply to 2011 and thereafter.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 3. ESTIMATION UNCERTAINTY (continued)

### (g) Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires management to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at December 31, 2010 was RMB11,710,000 (2009: RMB2,377,000).

### (h) Impairment of trade receivables

The Group's policy for impairment of trade receivables is based on an assessment of the recoverability of trade receivables. The identification of doubtful debts requires management judgement and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will have impact on the carrying amounts of trade receivables and impairment loss in the period in which such estimate has been changed.

### (i) Impairment of non-financial assets (other than goodwill)

The Group assesses whether there are any indicators of impairment for all non-financial assets at the end of each reporting period. Indefinite life intangible assets are tested for impairment annually and at other times when such an indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. An impairment exists when the carrying value of an asset or a cash-generating unit exceeds its recoverable amounts, which is the higher of its fair value less costs to sell and its value in use. The calculation of the fair value less costs to sell is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 4. OPERATING SEGMENT INFORMATION

For management purposes, the Group is organised into business units based on their products and services, and has two reportable operating segments as follows:

- (a) The entertainment software segment engages in research and development of online games, and provision of online games, mobile games and casual game services.
- (b) The application software segment engages in the research, development and distribution of internet security software, dictionary software and office application software products.

Management monitors the operating results of its operating segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on segment profit, which is a measure of adjusted profit before tax. The adjusted profit before tax is measured consistently with the Group's profit before tax except that finance income and finance costs from the Group's financial instruments as well as administrative expenses, employee share-based payments, fair value gain on a financial asset at fair value through profit or loss, share of profits and losses of associates and jointly-controlled entities, other expenses and other income and gains are excluded from such measurement.

| YEAR ENDED DECEMBER 31, 2010  | ENTERTAINMENT<br>SOFTWARE<br>RMB'000 | APPLICATION<br>SOFTWARE<br>RMB'000 | TOTAL<br>RMB'000 |
|---|--------------------------------------|------------------------------------|------------------|
| <b>SEGMENT REVENUE:</b>   |                                      |                                    |                  |
| Sales to external customers   | 640,917                              | 330,480                            | 971,397          |
| <b>SEGMENT RESULTS</b>  | <b>327,300</b>                       | <b>112,837</b>                     | <b>440,137</b>   |
| <i>Reconciliation:</i>  |                                      |                                    |                  |
| Administrative expenses   |                                      |                                    | (111,143)        |
| Share-based compensation costs  |                                      |                                    | (42,119)         |
| Other income and gains  |                                      |                                    | 31,528           |
| Other expenses  |                                      |                                    | (38,203)         |
| Fair value gain on a financial asset at fair value through profit or loss |                                      |                                    | 13,785           |
| Gain on disposal of an associate  |                                      |                                    | 105,189          |
| Finance income  |                                      |                                    | 33,162           |
| Finance costs   |                                      |                                    | (721)            |
| Share of profits and losses of:   |                                      |                                    |                  |
| Associates  |                                      |                                    | 14,433           |
| Jointly-controlled entities   |                                      |                                    | (6,360)          |
| <b>PROFIT BEFORE TAX</b>  |                                      |                                    | <b>439,688</b>   |
| <b>OTHER SEGMENT INFORMATION:</b>   |                                      |                                    |                  |
| Depreciation and amortisation   | 30,625                               | 39,709                             | 70,334           |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 4. OPERATING SEGMENT INFORMATION (continued)

| YEAR ENDED DECEMBER 31, 2009      | ENTERTAINMENT<br>SOFTWARE<br>RMB'000 | APPLICATION<br>SOFTWARE<br>RMB'000 | TOTAL<br>RMB'000 |
|-----------------------------------|--------------------------------------|------------------------------------|------------------|
| <b>SEGMENT REVENUE:</b>           |                                      |                                    |                  |
| Sales to external customers       | 684,431                              | 337,981                            | 1,022,412        |
| <b>SEGMENT RESULTS</b>            |                                      |                                    |                  |
|                                   | 378,600                              | 144,100                            | 522,700          |
| <i>Reconciliation:</i>            |                                      |                                    |                  |
| Administrative expenses           |                                      |                                    | (101,630)        |
| Share-based compensation costs    |                                      |                                    | (41,312)         |
| Other income and gains            |                                      |                                    | 26,867           |
| Other expenses                    |                                      |                                    | (2,598)          |
| Finance income                    |                                      |                                    | 25,523           |
| Share of profits and losses of:   |                                      |                                    |                  |
| Associate                         |                                      |                                    | 25,715           |
| Jointly-controlled entity         |                                      |                                    | (6,952)          |
| <b>PROFIT BEFORE TAX</b>          |                                      |                                    | <b>448,313</b>   |
| <b>OTHER SEGMENT INFORMATION:</b> |                                      |                                    |                  |
| Depreciation and amortisation     | 16,585                               | 31,799                             | 48,384           |

### Geographical information

(a) Revenue from external customers:

|                 | 2010<br>RMB'000 | 2009<br>RMB'000 |
|-----------------|-----------------|-----------------|
| Mainland China  | 852,482         | 957,422         |
| Hong Kong       | 20,572          | —               |
| Japan           | 72,646          | 53,974          |
| Other countries | 25,697          | 11,016          |
| <b>Total</b>    | <b>971,397</b>  | 1,022,412       |

The revenue information is based on the location of the Group's operations.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 4. OPERATING SEGMENT INFORMATION (continued)

### Geographical information (continued)

(b) Non-current assets:

|                 | 2010<br>RMB'000 | 2009<br>RMB'000 |
|-----------------|-----------------|-----------------|
| Mainland China  | 516,138         | 518,399         |
| Japan           | 2,030           | 697             |
| Other countries | 19,691          | 33,151          |
| <b>Total</b>    | <b>537,859</b>  | <b>552,247</b>  |

The non-current assets information above is based on the location of assets and excludes financial instruments and deferred tax assets.

### Information about a major customer

Revenue from continuing operations of approximately RMB106,575,000 (2009: RMB90,416,000) was derived from a single customer under entertainment software overseas licensing arrangements.

## 5. REVENUE, OTHER INCOME AND GAINS

Revenue represents the net invoiced value of goods sold, after allowances for returns and trade discounts; the value of services rendered; and the royalties derived from licensing agreements.

An analysis of the Group's revenue, other income and gains is as follows:

|                               | 2010<br>RMB'000 | 2009<br>RMB'000  |
|-------------------------------|-----------------|------------------|
| <i>Revenue</i>                |                 |                  |
| Sales of packaged software    | 90,967          | 109,319          |
| Rendering of services         | 738,632         | 807,958          |
| Royalties                     | 141,798         | 105,135          |
|                               | <b>971,397</b>  | <b>1,022,412</b> |
|                               |                 |                  |
|                               | 2010<br>RMB'000 | 2009<br>RMB'000  |
| <i>Other income and gains</i> |                 |                  |
| Government grants             | 30,048          | 24,524           |
| Others                        | 1,480           | 2,343            |
|                               | <b>31,528</b>   | <b>26,867</b>    |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 6. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

|  | NOTES | 2010<br>RMB'000 | 2009<br>RMB'000 |
|--|-------|-----------------|-----------------|
| Employee benefit expense (including directors' remuneration (note 8)): |       |                 |                 |
| Wages and salaries   |       | 253,964         | 209,595         |
| Social insurance costs and staff welfare                               |       | 54,442          | 44,853          |
| Share-based compensation costs   |       | 42,119          | 41,312          |
| Pension plan contributions   |       | 21,610          | 19,217          |
|  |       | <b>372,135</b>  | 314,977         |
| Minimum lease payments under operating leases:                         |       |                 |                 |
| Servers  |       | 29,487          | 33,546          |
| Buildings  |       | 13,616          | 14,468          |
|  |       | <b>43,103</b>   | 48,014          |
| Depreciation   | (a)   | 57,652          | 41,220          |
| Amortisation of lease prepayments                                      | (a)   | 627             | 166             |
| Amortisation of other intangible assets:                               |       |                 |                 |
| Amortisation of capitalised software costs*                            | (a)   | 17,158          | 5,481           |
| Amortisation of purchased software                                     | (a)   | 6,393           | 9,591           |
| Amortisation of others   | (a)   | 1,373           | 1,065           |
| Write-down of inventories***   |       | 3,223           | —               |
| Loss on disposal of items of property, plant and equipment***          |       | 299             | 216             |
| Foreign exchange differences, net***                                   |       | 1,006           | 984             |
| Impairment of goodwill**   | 14    | 2,377           | —               |
| Impairment of other intangible assets***                               |       | 5,160           | —               |
| Impairment of investment in an associate***                            | 17    | —               | 400             |
| Impairment of investments in jointly-controlled entities***            | 18    | 13,974          | —               |
| Impairment of loans to shareholders of jointly-controlled entities***  |       | 10,250          | —               |
| Donation***  |       | 1,000           | —               |
| Auditors' remuneration   |       | 9,450           | 5,880           |
| Finance costs  |       | 721             | —               |
| Government grants:   |       |                 |                 |
| — recorded as a reduction to research and development cost**           |       | (17,075)        | (14,779)        |
| — recorded in other income and gains                                   | 5     | (30,048)        | (24,524)        |
|  |       | <b>(47,123)</b> | (39,303)        |
| Gain on disposal of an associate                                       | 17    | (105,189)       | —               |
| Fair value gain on other financial asset                               | 20    | (13,785)        | —               |
| Bank interest income   |       | (33,162)        | (25,523)        |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 6. PROFIT BEFORE TAX (continued)

- \* The amortisation of capitalised software costs is included in "research and development costs" on the face of the consolidated income statement.
- \*\* Government grants which were granted to support the development of software and online game technology are recorded as a reduction to "research and development cost" on the face of the consolidated income statement during the year. Government grants received/receivable for which the related expenditures have not yet been incurred are included in "deferred revenue" in the consolidated statement of financial position. There are no unfulfilled conditions or contingencies relating to these grants.
- \*\*\* They are included in "other expenses" on the face of the consolidated income statement.

Note:

- (a) Depreciation of property, plant and equipment and amortisation of lease prepayments, purchased software, capitalised software costs and other intangible assets

|                                | 2010<br>RMB'000 | 2009<br>RMB'000 |
|--------------------------------|-----------------|-----------------|
| Included in:                   |                 |                 |
| Cost of revenue                | 20,636          | 17,804          |
| Research and development costs | 46,151          | 28,585          |
| Selling and distribution costs | 3,547           | 2,952           |
| Administrative expenses        | 12,869          | 8,182           |
|                                | <b>83,203</b>   | 57,523          |

## 7. SHARE-BASED COMPENSATION COSTS

### (a) Share options

#### **2004 and 2007 Pre-IPO Share Option Schemes**

In June 2004, the Company adopted the 2004 Pre-IPO Share Option Scheme (the "2004 Scheme"). The 2004 Scheme provides for the grant of share options to employees, chief executives or directors (including executives or non-executives or independent non-executives) of the Group.

Options granted under the 2004 Scheme generally vest over a period of four years, with one fourth of the options to vest on the first anniversary of the grant date, and an additional one eighth to vest at the end of each of the third to eighth six-month periods after the grant date as stipulated in the share option agreement.

Options under the 2004 Scheme were granted for periods of up to ten years. The exercise price of share options was determined by the directors.

Pursuant to a directors' resolution dated January 22, 2007, the Company adopted the 2007 Pre-IPO Share Option Scheme (the "2007 Scheme"), for the purpose of providing incentives and awards to employees, senior management and directors of the Group. The vesting terms of the 2007 Scheme are the same as those of the 2004, except for 1,333,554 share options granted to directors of the Group in February 2007 which are subject to certain performance conditions and have been fully achieved.

The total expense recognised for employee services received in respect of the 2004 Scheme and the 2007 Scheme for the year ended December 31, 2010 was RMB4,623,000 (2009: RMB20,395,000).

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### 2004 and 2007 Pre-IPO Share Option Schemes (continued)

The 2004 Scheme and the 2007 Scheme were terminated on September 3, 2007. No share options have been granted since then. The following table illustrates the numbers and weighted average exercise prices ("WAEP") of, and movements in, the Company's share options for the years ended December 31, 2010 and 2009.

|                                  | GROUP AND COMPANY                     |                                   |                                       |                                   |
|----------------------------------|---------------------------------------|-----------------------------------|---------------------------------------|-----------------------------------|
|                                  | 2010<br>NUMBER<br>OF SHARE<br>OPTIONS | 2010<br>WAEP<br>US\$ PER<br>SHARE | 2009<br>NUMBER<br>OF SHARE<br>OPTIONS | 2009<br>WAEP<br>US\$ PER<br>SHARE |
| 2004 Scheme                      |                                       |                                   |                                       |                                   |
| Outstanding at January 1         | 17,525,500                            | 0.1078                            | 23,882,125                            | 0.1083                            |
| Forfeited during the year        | (54,000)                              | 0.2379                            | (110,000)                             | 0.2374                            |
| Exercised during the year        | (4,991,000)                           | 0.1788                            | (6,246,625)                           | 0.1074                            |
| Outstanding at December 31       | 12,480,500                            | 0.0789                            | 17,525,500                            | 0.1078                            |
| Exercisable at December 31       | 12,480,500                            | 0.0789                            | 16,325,500                            | 0.0982                            |
| 2007 Scheme                      |                                       |                                   |                                       |                                   |
| Outstanding at January 1         | 80,619,600                            | 0.2410                            | 99,897,400                            | 0.2410                            |
| Forfeited during the year        | (1,551,000)                           | 0.2432                            | (4,526,000)                           | 0.2400                            |
| Exercised during the year        | (22,051,500)                          | 0.2407                            | (14,751,800)                          | 0.2408                            |
| Outstanding at December 31       | 57,017,100                            | 0.2411                            | 80,619,600                            | 0.2410                            |
| Exercisable at December 31       | 46,882,720                            | 0.2409                            | 47,597,460                            | 0.2407                            |
| Total outstanding at December 31 | 69,497,600                            | 0.2120                            | 98,145,100                            | 0.2172                            |
| Total exercisable at December 31 | 59,363,220                            | 0.2069                            | 63,922,960                            | 0.2043                            |

The weighted average share price at the date of exercise for the options exercised in 2010 was US\$0.7213 (2009: US\$0.6996).

The weighted average remaining contractual life for the Company's share options outstanding under the 2004 Scheme as at December 31, 2010 was 4.05 years (2009: 5.27 years), and the range of exercise prices for these outstanding options was US\$0.0005 to US\$0.2400 (2009: US\$0.0005 to US\$0.2400).

The weighted average remaining contractual life for the Company's share options outstanding under the 2007 Scheme as at December 31, 2010 was 6.09 years (2009: 7.09 years), and the range of exercise prices for these outstanding options was US\$0.2400 to US\$0.4616 (2009: US\$0.2400 to US\$0.4616).

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### 2004 and 2007 Pre-IPO Share Option Schemes (continued)

The following share options were outstanding under the 2004 Scheme and the 2007 Scheme during the years ended December 31, 2010 and 2009.

| NAME OR CATEGORY OF PARTICIPANT | NUMBER OF SHARE OPTIONS |                           |                           |                      | DATE OF GRANT OF SHARE OPTIONS | EXERCISE PRICE OF SHARE OPTIONS US\$ PER SHARE |
|---------------------------------|-------------------------|---------------------------|---------------------------|----------------------|--------------------------------|--|
|                                 | AT JANUARY 1, 2010      | EXERCISED DURING THE YEAR | FORFEITED DURING THE YEAR | AT DECEMBER 31, 2010 |                                |  |
| <b>EXECUTIVE DIRECTORS</b>      |                         |                           |                           |                      |                                |  |
| Donghui Wang                    | 800,000                 | (800,000)                 | —                         | —                    | March 1, 2005                  | 0.2118   |
|                                 | 600,000                 | (600,000)                 | —                         | —                    | August 1, 2005                 | 0.2118   |
|                                 | 800,000                 | (700,000)                 | —                         | 100,000              | December 1, 2006               | 0.2400   |
|                                 | 5,000,000               | (3,258,000)               | —                         | 1,742,000            | February 1, 2007**             | 0.2400   |
|                                 | <b>7,200,000</b>        | <b>(5,358,000)</b>        | <b>—</b>                  | <b>1,842,000</b>     |                                |  |
| Tao Zou                         | 1,450,000               | (1,050,000)               | —                         | 400,000              | December 1, 2006               | 0.2400   |
|                                 | 5,400,000               | (3,841,000)               | —                         | 1,559,000            | February 1, 2007**             | 0.2400   |
|                                 | <b>6,850,000</b>        | <b>(4,891,000)</b>        | <b>—</b>                  | <b>1,959,000</b>     |                                |  |
| <b>NON-EXECUTIVE DIRECTORS</b>  |                         |                           |                           |                      |                                |  |
| Jun Lei                         | 5,311,500               | —                         | —                         | 5,311,500            | August 1, 2004                 | 0.0353   |
|                                 | 22,451,800              | —                         | —                         | 22,451,800           | February 1, 2007**             | 0.2400   |
|                                 | <b>27,763,300</b>       | <b>—</b>                  | <b>—</b>                  | <b>27,763,300</b>    |                                |  |
| Shuen Lung Cheung*              | 1,000,000               | —                         | —                         | 1,000,000            | August 1, 2004                 | 0.0353   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### 2004 and 2007 Pre-IPO Share Option Schemes (continued)

| NAME OR CATEGORY<br>OF PARTICIPANT | NUMBER OF SHARE OPTIONS  |                                 |                                 |                            | DATE OF<br>GRANT<br>OF SHARE<br>OPTIONS | EXERCISE<br>PRICE OF<br>SHARE<br>OPTIONS<br>US\$<br>PER SHARE |
|------------------------------------|--------------------------|---------------------------------|---------------------------------|----------------------------|---|---|
|                                    | AT<br>JANUARY 1,<br>2010 | EXERCISED<br>DURING<br>THE YEAR | FORFEITED<br>DURING<br>THE YEAR | AT<br>DECEMBER 31,<br>2010 |   |   |
| <b>OTHER EMPLOYEES</b>             |                          |                                 |                                 |                            |   |   |
| In aggregate                       |                          |                                 |                                 |                            |   |   |
|                                    | 1,700,500                | —                               | —                               | 1,700,500                  | January 1, 2000 <sup>***</sup>          | 0.0005  |
|                                    | 2,535,000                | (1,253,500)                     | —                               | 1,281,500                  | August 1, 2004                          | 0.0353  |
|                                    | 80,000                   | (80,000)                        | —                               | —                          | April 1, 2005                           | 0.2118  |
|                                    | 1,155,500                | (176,500)                       | (4,000)                         | 975,000                    | August 1, 2005                          | 0.2118  |
|                                    | 41,000                   | (41,000)                        | —                               | —                          | January 1, 2006                         | 0.2118  |
|                                    | 800,000                  | (40,000)                        | —                               | 760,000                    | August 1, 2006                          | 0.2118  |
|                                    | 1,252,000                | (250,000)                       | (50,000)                        | 952,000                    | December 1, 2006                        | 0.2400  |
|                                    | 46,208,800               | (14,660,000)                    | (1,343,500)                     | 30,205,300                 | February 1, 2007 <sup>**</sup>          | 0.2400  |
|                                    | 619,000                  | (10,000)                        | —                               | 609,000                    | April 1, 2007 <sup>**</sup>             | 0.2400  |
|                                    | 565,000                  | (215,000)                       | (185,000)                       | 165,000                    | May 8, 2007 <sup>**</sup>               | 0.2400  |
|                                    | 375,000                  | (67,500)                        | (22,500)                        | 285,000                    | August 1, 2007 <sup>**</sup>            | 0.4616  |
|                                    | <b>55,331,800</b>        | <b>(16,793,500)</b>             | <b>(1,605,000)</b>              | <b>36,933,300</b>          |   |   |
|                                    | <b>98,145,100</b>        | <b>(27,042,500)</b>             | <b>(1,605,000)</b>              | <b>69,497,600</b>          |   |   |

\* Mr. Shuen Lung Cheung has been appointed as a non-executive director of the Company with effect from March 25, 2010.

\*\* These options were granted under the 2007 Scheme, while others were granted under the 2004 Scheme.

\*\*\* The option agreement was restated on August 1, 2004, and has an expiry period of ten years starting from the restatement date.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### 2004 and 2007 Pre-IPO Share Option Schemes (continued)

| NAME OR CATEGORY<br>OF PARTICIPANT | NUMBER OF SHARE OPTIONS  |                                 |                                 |                            | DATE OF<br>GRANT<br>OF SHARE<br>OPTIONS | EXERCISE<br>PRICE OF<br>SHARE<br>OPTIONS<br>US\$<br>PER SHARE |
|------------------------------------|--------------------------|---------------------------------|---------------------------------|----------------------------|---|---|
|                                    | AT<br>JANUARY 1,<br>2009 | EXERCISED<br>DURING<br>THE YEAR | FORFEITED<br>DURING<br>THE YEAR | AT<br>DECEMBER 31,<br>2009 |   |   |
| <b>EXECUTIVE DIRECTORS</b>         |                          |                                 |                                 |                            |   |   |
| Donghui Wang                       | 800,000                  | —                               | —                               | 800,000                    | March 1, 2005                           | 0.2118  |
|                                    | 600,000                  | —                               | —                               | 600,000                    | August 1, 2005                          | 0.2118  |
|                                    | 800,000                  | —                               | —                               | 800,000                    | December 1, 2006                        | 0.2400  |
|                                    | 5,000,000                | —                               | —                               | 5,000,000                  | February 1, 2007**                      | 0.2400  |
|                                    | 7,200,000                | —                               | —                               | 7,200,000                  |   |   |
| Tao Zou                            | 200,000                  | (200,000)                       | —                               | —                          | August 1, 2004                          | 0.0353  |
|                                    | 1,600,000                | (150,000)                       | —                               | 1,450,000                  | December 1, 2006                        | 0.2400  |
|                                    | 5,400,000                | —                               | —                               | 5,400,000                  | February 1, 2007**                      | 0.2400  |
|                                    | 7,200,000                | (350,000)                       | —                               | 6,850,000                  |   |   |
| <b>NON-EXECUTIVE DIRECTORS</b>     |                          |                                 |                                 |                            |   |   |
| Jun Lei                            | 5,311,500                | —                               | —                               | 5,311,500                  | August 1, 2004                          | 0.0353  |
|                                    | 22,451,800               | —                               | —                               | 22,451,800                 | February 1, 2007**                      | 0.2400  |
|                                    | 27,763,300               | —                               | —                               | 27,763,300                 |   |   |
| Wing Chung Anders Cheung†          | 500,000                  | —                               | —                               | 500,000                    | August 1, 2004                          | 0.0353  |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### 2004 and 2007 Pre-IPO Share Option Schemes (continued)

| NAME OR CATEGORY<br>OF PARTICIPANT | NUMBER OF SHARE OPTIONS  |                                 |                                 |                            | DATE OF<br>GRANT<br>OF SHARE<br>OPTIONS | EXERCISE<br>PRICE OF<br>SHARE<br>OPTIONS<br>US\$<br>PER SHARE |
|------------------------------------|--------------------------|---------------------------------|---------------------------------|----------------------------|---|---|
|                                    | AT<br>JANUARY 1,<br>2009 | EXERCISED<br>DURING<br>THE YEAR | FORFEITED<br>DURING<br>THE YEAR | AT<br>DECEMBER 31,<br>2009 |   |   |
| <b>OTHER EMPLOYEES</b>             |                          |                                 |                                 |                            |   |   |
| In aggregate                       |                          |                                 |                                 |                            |   |   |
|                                    | 1,770,500                | (70,000)                        | —                               | 1,700,500                  | January 1, 2000                         | 0.0005  |
|                                    | 6,532,000                | (3,497,000)                     | —                               | 3,035,000                  | August 1, 2004                          | 0.0353  |
|                                    | 442,625                  | (442,625)                       | —                               | —                          | January 1, 2005                         | 0.2118  |
|                                    | 250,000                  | (160,000)                       | (10,000)                        | 80,000                     | April 1, 2005                           | 0.2118  |
|                                    | 2,309,500                | (1,154,000)                     | —                               | 1,155,500                  | August 1, 2005                          | 0.2118  |
|                                    | 216,000                  | (175,000)                       | —                               | 41,000                     | January 1, 2006                         | 0.2118  |
|                                    | 800,000                  | —                               | —                               | 800,000                    | August 1, 2006                          | 0.2118  |
|                                    | 1,750,000                | (398,000)                       | (100,000)                       | 1,252,000                  | December 1, 2006                        | 0.2400  |
|                                    | 65,147,600               | (14,412,800)                    | (4,526,000)                     | 46,208,800                 | February 1, 2007**                      | 0.2400  |
|                                    | 788,000                  | (169,000)                       | —                               | 619,000                    | April 1, 2007**                         | 0.2400  |
|                                    | 680,000                  | (115,000)                       | —                               | 565,000                    | May 8, 2007**                           | 0.2400  |
|                                    | 430,000                  | (55,000)                        | —                               | 375,000                    | August 1, 2007**                        | 0.4616  |
|                                    | 81,116,225               | (20,648,425)                    | (4,636,000)                     | 55,831,800                 |   |   |
|                                    | 123,779,525              | (20,998,425)                    | (4,636,000)                     | 98,145,100                 |   |   |

\* Mr. Wing Chung Anders Cheung retired as a non-executive director of the Company on March 25, 2010.

\*\* These options were granted under the 2007 Scheme, while others were granted under the 2004 Scheme.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (a) Share options (continued)

#### **2004 and 2007 Pre-IPO Share Option Schemes** (continued)

As of December 31, 2010, the Company had 69,497,600 share options outstanding under the 2004 Scheme and 2007 Scheme. The exercise in full of the outstanding share options would, under present capital structure of the Company, result in the issue of 69,497,600 additional ordinary shares of the Company and additional share capital of RMB230,000 and share premium account of RMB97,336,000.

At the date of approval of these financial statements, the Company had 63,712,900 share options outstanding under the 2004 Scheme and 2007 Scheme, which represented approximately 5.7% of the Company's shares in issue as at that date.

#### **Kingsoft Japan Inc. ("Kingsoft Japan") Share Options**

Pursuant to Kingsoft Japan's shareholder resolution dated November 2, 2006 (the "November Resolution"), Kingsoft Japan is authorised to grant share options to employees in exchange for Kingsoft Japan's ordinary shares. The maximum number of Kingsoft Japan's ordinary shares in respect of which options may be granted is 1,000 in aggregate. Options are conditional upon a successful initial public offering of Kingsoft Japan (the "Condition"). Options granted expire in ten years. The exercise price is JPY10,000 per share.

- (a) Pursuant to a directors' resolution on January 4, 2007, 410 options were granted to certain employees which vest over a period of three years, with one third of options to vest on the first anniversary of the grant date, and an additional one twelfth to vest after each three months and exercisable upon the Condition. 210 options out of such 410 options have already been forfeited.
- (b) Pursuant to a directors' resolution on March 30, 2007, 90 options were granted to employees and a consultant, which are exercisable upon the Condition above.
- (c) Pursuant to a directors' resolution on July 31, 2007, the authorisation to issue the remaining 500 options under the November Resolution was revoked, and another 710 options were granted to the employees. Among which, 520 options vest over a period of two years, with half of the options to vest on the first anniversary of the grant date or the date when the employee joined the company, which is earlier, and an additional one eighth to vest each three months thereafter; and the remaining 190 options vest over a period of three years, with one third of the options to vest on the first anniversary of the grant date or the date when the employee joined the company, which is earlier, and an additional one twelfth to vest after each three months. The exercise of the above options is conditional upon a successful initial public offering of Kingsoft Japan.

The expense recognised in respect of Kingsoft Japan share options during the year ended December 31, 2010 was nil (2009: RMB73,000).

No share options were granted or exercised in 2010 and 2009, and no share options were forfeited in 2010 and 2009.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (b) Share Award Scheme

On the Adoption Date, the board of directors of the Company approved and adopted the Share Award Scheme in which selected employees of the Group are entitled to participate. Unless early terminated by the board of directors, the Share Award Scheme is valid and effective for a term of five years commencing on the Adoption Date. On November 25, 2010, the board of directors of the Company resolved to extend the termination date of the Share Awarded Scheme from March 30, 2013 to March 30, 2017. The board of directors will not grant any award of shares which would result in the total number of shares, which are the subject of awards granted by the board of directors under the Share Award Scheme (but not counting any which have lapsed or have been forfeited), representing in aggregate over 10% of the issued capital of the Company as at the date of such grant.

For the Awarded Shares granted under the Share Award Scheme, the fair value of the Awarded Shares is recognised as an expense and credited to equity over the period in which the vesting conditions (i.e., service conditions and/or performance conditions) are fulfilled. The total amount expensed over the vesting period is determined by reference to the fair value of the Awarded Shares granted.

During the year ended December 31, 2010, 8,764,600 shares (2009: 12,042,000 shares) were awarded to a number of employees with vesting period of three years, out of which, 45,000 (2009: 8,382,000 shares) awarded shares were also subject to certain performance conditions. No shares of the Company were acquired by the Share Award Scheme Trust during the year ended December 31, 2010. During the year ended December 31, 2009, the Share Award Scheme Trust acquired 8,501,000 shares of the Company through purchases on the open market at a total cost (including related transaction costs) of approximately RMB43,050,000.

The expense recognised for employee services received in respect of the Share Award Scheme for the year ended December 31, 2010 was RMB37,496,000 (2009: RMB20,844,000).

The following table illustrates the numbers of and movements in the Company's Awarded Shares for the years ended December 31, 2010 and 2009.

|   | <b>2010<br/>NUMBER OF<br/>AWARDED<br/>SHARES</b> | <b>2009<br/>NUMBER OF<br/>AWARDED<br/>SHARES</b> |
|---|--|--|
| Outstanding as at January 1               | <b>21,350,000</b>                                | 15,558,000                                       |
| Granted during the year                   | <b>8,764,600</b>                                 | 12,042,000                                       |
| Forfeited during the year                 | <b>(6,988,000)</b>                               | (3,047,000)                                      |
| Exercised and transferred during the year | <b>(6,529,799)</b>                               | (3,203,000)                                      |
| Outstanding as at December 31             | <b>16,596,801</b>                                | 21,350,000                                       |
| Exercisable as at December 31             | <b>864,000</b>                                   | 692,000  |

The fair value of the Awarded Shares was based on the market value of the Company's shares at the grant date. The weighted average fair value of the shares awarded during 2010 was RMB4.93 each (2009: RMB3.26 each).

As at December 31, 2010, 97,200 forfeited or unawarded shares were held by the Share Award Scheme Trust and would be awarded in future (2009: 1,086,000).

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (b) Share Award Scheme (continued)

Subsequent to the end of the reporting period, on January 12, 2011, 250,000 shares were granted to certain employees in respect of their services to the Group in the forthcoming years. These Awarded Shares vest between January 12, 2012 and January 12, 2014. The price of the Company's shares at the date of grant was RMB3.43 per share.

At the date of approval of these financial statements, the Company had 13,188,668 Awarded Shares outstanding under the Share Award Scheme, which represented approximately 1.2% of the Company's shares in issue as at that date.

The following Awarded Shares were outstanding under the Share Award Scheme during the years ended December 31, 2010 and 2009.

| NAME OR CATEGORY OF PARTICIPANT | NUMBER OF AWARDED SHARES |                         |                           |   |                      | GRANT DATE        |
|---------------------------------|--------------------------|-------------------------|---------------------------|---|----------------------|-------------------|
|                                 | AT JANUARY 1, 2010       | GRANTED DURING THE YEAR | FORFEITED DURING THE YEAR | EXERCISED AND TRANSFERRED DURING THE YEAR | AT DECEMBER 31, 2010 |                   |
| <b>EXECUTIVE DIRECTORS</b>      |                          |                         |                           |   |                      |                   |
| Pak Kwan Kau                    | 1,500,000                | —                       | —                         | (500,000)                                 | 1,000,000            | July 13, 2009     |
|                                 | 1,500,000                | —                       | —                         | (500,000)                                 | 1,000,000            |                   |
| Donghui Wang                    | 254,000                  | —                       | —                         | (127,000)                                 | 127,000              | October 13, 2008  |
|                                 | 1,500,000                | —                       | —                         | (500,000)                                 | 1,000,000            | July 13, 2009     |
|                                 | —                        | 57,000                  | —                         | —   | 57,000               | March 26, 2010    |
|                                 | 1,754,000                | 57,000                  | —                         | (627,000)                                 | 1,184,000            |                   |
| Tao Zou                         | 324,000                  | —                       | —                         | —   | 324,000              | October 13, 2008  |
|                                 | 2,691,000                | —                       | (2,691,000)               | —   | —                    | June 8, 2009      |
|                                 | —                        | 78,000                  | —                         | —   | 78,000               | March 26, 2010    |
|                                 | 3,015,000                | 78,000                  | (2,691,000)               | —   | 402,000              |                   |
| <b>OTHER EMPLOYEES</b>          |                          |                         |                           |   |                      |                   |
| In aggregate                    | 3,519,000                | —                       | (592,000)                 | (1,545,000)                               | 1,382,000            | June 26, 2008     |
|                                 | 4,511,000                | —                       | (513,000)                 | (1,759,000)                               | 2,239,000            | October 13, 2008  |
|                                 | 400,000                  | —                       | —                         | (200,000)                                 | 200,000              | November 27, 2008 |
|                                 | 100,000                  | —                       | —                         | (50,000)                                  | 50,000               | December 1, 2008  |
|                                 | 200,000                  | —                       | (200,000)                 | —   | —                    | December 25, 2008 |
|                                 | 1,600,000                | —                       | —                         | (533,333)                                 | 1,066,667            | January 1, 2009   |
|                                 | 3,321,000                | —                       | (2,841,000)               | (160,000)                                 | 320,000              | June 8, 2009      |
|                                 | 80,000                   | —                       | —                         | (26,666)                                  | 53,334               | November 27, 2009 |
|                                 | 1,350,000                | —                       | (58,000)                  | (341,000)                                 | 951,000              | December 1, 2009  |
|                                 | —                        | 350,000                 | —                         | —   | 350,000              | January 12, 2010  |
|                                 | —                        | 5,492,600               | (78,000)                  | (787,800) <sup>*</sup>                    | 4,626,800            | March 26, 2010    |
|                                 | —                        | 2,460,000               | —                         | —   | 2,460,000            | May 26, 2010      |
|                                 | —                        | 88,000                  | (15,000)                  | —   | 73,000               | June 23, 2010     |
|                                 | —                        | 209,000                 | —                         | —   | 209,000              | July 12, 2010     |
|                                 | —                        | 30,000                  | —                         | —   | 30,000               | November 26, 2010 |
|                                 | 15,081,000               | 8,629,600               | (4,297,000)               | (5,402,799)                               | 14,010,801           |                   |
|                                 | 21,350,000               | 8,764,600               | (6,988,000)               | (6,529,799)                               | 16,596,801           |                   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 7. SHARE-BASED COMPENSATION COSTS (continued)

### (b) Share Award Scheme (continued)

\* During the year ended December 31, 2010, the Company provided a one-time election to certain employees for them to elect immediate cash settlement for the Awarded Shares granted to them. All the concerned employees had made their elections in May 2010. Consequently, 787,800 Awarded Shares were cash-settled and vested immediately.

| NAME OR CATEGORY<br>OF PARTICIPANT | NUMBER OF AWARDED SHARES |                               |                                 |   |            | AT<br>DECEMBER 31,<br>2009 | GRANT DATE |
|------------------------------------|--------------------------|-------------------------------|---------------------------------|---|------------|----------------------------|------------|
|                                    | AT<br>JANUARY 1,<br>2009 | GRANTED<br>DURING<br>THE YEAR | FORFEITED<br>DURING<br>THE YEAR | EXERCISED<br>AND<br>TRANSFERRED<br>DURING<br>THE YEAR |            |                            |            |
| <b>EXECUTIVE DIRECTORS</b>         |                          |                               |                                 |   |            |                            |            |
| Pak Kwan Kau                       | —                        | 1,500,000                     | —                               | —   | 1,500,000  | July 13, 2009              |            |
|                                    | —                        | 1,500,000                     | —                               | —   | 1,500,000  |                            |            |
| Donghui Wang                       | 381,000                  | —                             | —                               | (127,000)   | 254,000    | October 13, 2008           |            |
|                                    | —                        | 1,500,000                     | —                               | —   | 1,500,000  | July 13, 2009              |            |
|                                    | 381,000                  | 1,500,000                     | —                               | (127,000)   | 1,754,000  |                            |            |
| Tao Zou                            | 324,000                  | —                             | —                               | —   | 324,000    | October 13, 2008           |            |
|                                    | —                        | 2,691,000                     | —                               | —   | 2,691,000  | June 8, 2009               |            |
|                                    | 324,000                  | 2,691,000                     | —                               | —   | 3,015,000  |                            |            |
| <b>OTHER EMPLOYEES</b>             |                          |                               |                                 |   |            |                            |            |
| In aggregate                       | 5,058,000                | —                             | (379,000)                       | (1,160,000)   | 3,519,000  | June 26, 2008              |            |
|                                    | 6,744,000                | —                             | (667,000)                       | (1,566,000)   | 4,511,000  | October 13, 2008           |            |
|                                    | 2,001,000                | —                             | (2,001,000)                     | —   | —          | October 24, 2008           |            |
|                                    | 600,000                  | —                             | —                               | (200,000)   | 400,000    | November 27, 2008          |            |
|                                    | 150,000                  | —                             | —                               | (50,000)  | 100,000    | December 1, 2008           |            |
|                                    | 300,000                  | —                             | —                               | (100,000)   | 200,000    | December 25, 2008          |            |
|                                    | —                        | 1,600,000                     | —                               | —   | 1,600,000  | January 1, 2009            |            |
|                                    | —                        | 3,321,000                     | —                               | —   | 3,321,000  | June 8, 2009               |            |
|                                    | —                        | 80,000                        | —                               | —   | 80,000     | November 27, 2009          |            |
|                                    | —                        | 1,350,000                     | —                               | —   | 1,350,000  | December 1, 2009           |            |
|                                    | 14,853,000               | 6,351,000                     | (3,047,000)                     | (3,076,000)   | 15,081,000 |                            |            |
|                                    | 15,558,000               | 12,042,000                    | (3,047,000)                     | (3,203,000)   | 21,350,000 |                            |            |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 8. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS

### (a) Directors' remuneration

Details of directors' remuneration are as follows:

|   | GROUP           |                 |
|---|-----------------|-----------------|
|   | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Fees                                      | 663             | 683             |
| Other emoluments:                         |                 |                 |
| Salaries, allowances and benefits in kind | 2,959           | 4,187           |
| Discretionary bonuses                     | 1,500           | 2,901           |
| Pension plan contributions                | 20              | 18              |
| Share-based compensation                  | 9,466           | 12,199          |
|   | <b>14,608</b>   | <b>19,988</b>   |

Year ended December 31, 2010

|                                      | SALARIES,<br>ALLOWANCES<br>AND BENEFITS |                    |              |           |              | DISCRETIONARY<br>BONUSES | PENSION PLAN<br>CONTRIBUTIONS | SHARE-BASED<br>COMPENSATION | TOTAL |
|--------------------------------------|---|--------------------|--------------|-----------|--------------|--------------------------|-------------------------------|-----------------------------|-------|
|                                      | FEES<br>RMB'000                         | IN KIND<br>RMB'000 | RMB'000      | RMB'000   | RMB'000      |                          |                               |                             |       |
| Executive directors:                 |   |                    |              |           |              |                          |                               |                             |       |
| Pak Kwan Kau*                        | —                                       | 700                | 1,500        | —         | 3,253        | 5,453                    |                               |                             |       |
| Donghui Wang                         | —                                       | 857                | —            | —         | 3,984        | 4,841                    |                               |                             |       |
| Tao Zou                              | —                                       | 957                | —            | 10        | 853          | 1,820                    |                               |                             |       |
| Non-executive directors:             |   |                    |              |           |              |                          |                               |                             |       |
| Wing Chung Anders Cheung**           | —                                       | 46                 | —            | —         | —            | 46                       |                               |                             |       |
| Wai Ming Wong**                      | —                                       | 46                 | —            | —         | —            | 46                       |                               |                             |       |
| Shuen Lung Cheung                    | —                                       | 153                | —            | —         | —            | 153                      |                               |                             |       |
| Jun Lei                              | —                                       | 200                | —            | 10        | 1,376        | 1,586                    |                               |                             |       |
| Independent non-executive directors: |   |                    |              |           |              |                          |                               |                             |       |
| Guangming George Lu                  | 199                                     | —                  | —            | —         | —            | 199                      |                               |                             |       |
| Shun Tak Wong                        | 265                                     | —                  | —            | —         | —            | 265                      |                               |                             |       |
| Mingming Huang                       | 199                                     | —                  | —            | —         | —            | 199                      |                               |                             |       |
|                                      | <b>663</b>                              | <b>2,959</b>       | <b>1,500</b> | <b>20</b> | <b>9,466</b> | <b>14,608</b>            |                               |                             |       |

\* Mr. Pak Kwan Kau agreed to waive his allowance from January 2010 and his salary from August 2010.

\*\* Mr. Wing Chung Anders Cheung and Mr. Wai Ming Wong retired as non-executive directors of the Company on March 25, 2010.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 8. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS (continued)

### (a) Directors' remuneration (continued)

Year ended December 31, 2009

|                                      | FEES<br>RMB'000 | SALARIES,<br>ALLOWANCES<br>AND BENEFITS<br>IN KIND<br>RMB'000 | DISCRETIONARY<br>BONUSES<br>RMB'000 | PENSION PLAN<br>CONTRIBUTIONS<br>RMB'000 | SHARE-BASED<br>COMPENSATION<br>RMB'000 | TOTAL<br>RMB'000 |
|--------------------------------------|-----------------|---|-------------------------------------|--|--|------------------|
| Executive directors:                 |                 |   |                                     |  |  |                  |
| Pak Kwan Kau                         | —               | 1,850   | 1,500                               | —  | 2,082                                  | 5,432            |
| Donghui Wang                         | —               | 832   | 1,147                               | —  | 3,634                                  | 5,613            |
| Tao Zou                              | —               | 846   | 254                                 | 9  | 1,754                                  | 2,863            |
| Non-executive directors:             |                 |   |                                     |  |  |                  |
| Wing Chung Anders Cheung             | —               | 205   | —                                   | —  | —                                      | 205              |
| Wai Ming Wong                        | —               | 205   | —                                   | —  | —                                      | 205              |
| Choon Chong Tay*                     | —               | 52  | —                                   | —  | —                                      | 52               |
| Jun Lei                              | —               | 197   | —                                   | 9  | 4,729                                  | 4,935            |
| Independent non-executive directors: |                 |   |                                     |  |  |                  |
| Guangming George Lu                  | 205             | —   | —                                   | —  | —                                      | 205              |
| Shun Tak Wong                        | 273             | —   | —                                   | —  | —                                      | 273              |
| Mingming Huang                       | 205             | —   | —                                   | —  | —                                      | 205              |
|                                      | 683             | 4,187   | 2,901                               | 18                                       | 12,199                                 | 19,988           |

\* Mr. Choon Chong Tay retired as a non-executive director of the Company on April 1, 2009.

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

During the year, certain directors were granted Awarded Shares, in respect of their services to the Group, under the Share Award Scheme of the Company, further details of which are set out in note 7 to the financial statements. The fair value of such Awarded Shares, which has been recognised in the income statement over the vesting period, was determined as at the date of the grant and the amount included in the financial statements for the current year is included in the above directors' remuneration disclosures.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 8. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS (continued)

### (b) Five highest paid individuals

The five highest paid individuals included three (2009: four) directors, details of whose remuneration are set out above. Details of the remuneration of the remaining two (2009: one) non-director, highest paid employees for the year as follows:

|   | <b>GROUP</b>   |                |
|---|----------------|----------------|
|   | <b>2010</b>    | <b>2009</b>    |
|   | <b>RMB'000</b> | <b>RMB'000</b> |
| Salaries, allowances and benefits in kind | <b>1,297</b>   | 752            |
| Discretionary bonuses                     | <b>987</b>     | 150            |
| Pension plan contributions                | <b>37</b>      | 26             |
| Share-based compensation                  | <b>3,326</b>   | 2,239          |
|   | <b>5,647</b>   | 3,167          |

The number of non-director, highest paid individuals whose remuneration fell within the following bands is as follows:

|                                | <b>NUMBER OF EMPLOYEES</b> |             |
|--------------------------------|----------------------------|-------------|
|                                | <b>2010</b>                | <b>2009</b> |
| HK\$2,000,001 to HK\$2,500,000 | <b>1</b>                   | —           |
| HK\$3,500,001 to HK\$4,000,000 | <b>1</b>                   | 1           |

During the year, Awarded Shares were granted to two non-directors, highest paid employee in respect of their services to the Group, further details of which are included in the disclosures in note 7 to the financial statements. The fair value of such Awarded Shares, which has been recognised in the income statement over the vesting period, was determined as at the date of grant and the amount included in the financial statements for the current year is included in the above non-directors, highest paid employees' remuneration disclosures.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 9. INCOME TAX

PRC corporate income tax represents the tax charged on the estimated assessable profits arising in Mainland China. In general, the PRC subsidiaries of the Group are subject to the PRC corporate income tax rate of 25% except for certain PRC subsidiaries which are entitled to tax holidays and preferential tax rates.

Hong Kong profits tax has been provided at the rate of 16.5% (2009: 16.5%) on estimated assessable profits arising in Hong Kong during the year ended December 31, 2010.

In accordance with Japanese tax laws, the income tax rate applicable to the Group's subsidiary in Japan was 41% for the year ended December 31, 2010 (2009: 43.1%).

The Group's subsidiary in Malaysia was granted the Multimedia Corridor Malaysia Status ("MSC Malaysia Status"). Therefore the online games related activities of the subsidiary were exempted from corporate income tax for the periods from December 2009 to December 2014.

The major components of income tax expense for the years ended December 31, 2010 and 2009 are:

|                                      | <b>GROUP</b>   |                |
|--------------------------------------|----------------|----------------|
|                                      | <b>2010</b>    | <b>2009</b>    |
|                                      | <b>RMB'000</b> | <b>RMB'000</b> |
| Current — Mainland China             | <b>34,003</b>  | 46,532         |
| Current — Hong Kong                  | <b>2,460</b>   | —              |
| Current — Elsewhere                  | <b>9,303</b>   | 3,792          |
| Deferred                             | <b>19,389</b>  | 9,135          |
| <b>Total tax charge for the year</b> | <b>65,155</b>  | 59,459         |

A reconciliation of the tax expense applicable to profit before tax at the statutory rates for the jurisdictions in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rates is as follows:

|  | <b>GROUP</b>    |                |
|--|-----------------|----------------|
|  | <b>2010</b>     | <b>2009</b>    |
|  | <b>RMB'000</b>  | <b>RMB'000</b> |
| Profit before tax  | <b>439,688</b>  | 448,313        |
| At the respective statutory income tax rates   | <b>110,230</b>  | 112,078        |
| Lower tax rates for specific provinces or enacted by local authority                   | <b>(63,765)</b> | (63,468)       |
| Expenses not deductible for tax  | <b>14,070</b>   | 14,348         |
| Income not subject to tax  | <b>(10,986)</b> | (10,938)       |
| Profits and losses attributable to associates and jointly-controlled entities          | <b>(2,108)</b>  | (4,691)        |
| Tax losses not recognised  | <b>7,218</b>    | 3,666          |
| Other unrecognised deductible temporary difference                                     | <b>1,980</b>    | 4,601          |
| Tax losses and other deductible temporary difference utilised from previous periods    | <b>(4,388)</b>  | —              |
| Effect of withholding tax on the distributable profits of the Group's PRC subsidiaries | <b>12,904</b>   | 3,863          |
| <b>Income tax expense reported in the consolidated income statement</b>                | <b>65,155</b>   | 59,459         |
| <b>Effective income tax rate</b>   | <b>15%</b>      | 13%            |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 9. INCOME TAX (continued)

Deferred income tax relates to the following:

|   | CONSOLIDATED<br>STATEMENT OF<br>FINANCIAL POSITION |                 | CONSOLIDATED<br>INCOME STATEMENT |                 |
|---|--|-----------------|----------------------------------|-----------------|
|   | 2010<br>RMB'000                                    | 2009<br>RMB'000 | 2010<br>RMB'000                  | 2009<br>RMB'000 |
| <i>Deferred income tax liabilities</i>  |  |                 |                                  |                 |
| Government grants   | —  | (656)           | (656)                            | (869)           |
| Deferred cost   | (1,163)  | (2,364)         | (1,201)                          | (362)           |
| Waiver of reorganisation consideration  | —  | (583)           | (583)                            | —               |
| Fair value adjustment arising from<br>acquisition of a subsidiary             | (2,343)  | (441)           | (441)                            | —               |
| Gain on disposal of an associate  | (5,825)  | —               | 5,825                            | —               |
| Withholding taxes on the distributable<br>profits of Group's PRC subsidiaries | (18,100)   | (5,196)         | 12,904                           | 3,863           |
| Capitalised software costs  | (3,906)  | (3,715)         | 191                              | 4,000           |
| Others  | (3,801)  | (3,698)         | 103                              | 2,443           |
|   | <b>(35,138)</b>                                    | (16,653)        | <b>16,142</b>                    | 9,075           |
| <i>Deferred income tax assets</i>   |  |                 |                                  |                 |
| Property, plant and equipment   | 453  | 261             | (192)                            | 415             |
| Deferred revenue  | 20,068   | 19,741          | (327)                            | 4,332           |
| Accrued expenses  | 4,041  | 4,082           | 41                               | 102             |
| Government grants   | 1,108  | —               | (1,108)                          | —               |
| Tax losses carried forward  | —  | 4,833           | 4,833                            | (4,789)         |
|   | <b>25,670</b>                                      | 28,917          | <b>3,247</b>                     | 60              |
| Deferred income tax expense   |  |                 | <b>19,389</b>                    | 9,135           |

The Group has tax losses arising in the PRC totalling RMB82,961,000 as at December 31, 2010 (2009: RMB48,817,000) that are available for offsetting against future taxable profits of the companies in which the losses arose.

Deferred tax assets have not been recognised in respect of the following items:

|                                  | 2010<br>RMB'000 | 2009<br>RMB'000 |
|----------------------------------|-----------------|-----------------|
| Tax losses                       | 82,961          | 24,257          |
| Deductible temporary differences | 22,357          | 43,061          |
|                                  | <b>105,318</b>  | 67,318          |

Deferred tax assets have not been recognised in respect of the above items as it is not considered probable that taxable profits will be available against which the above items can be utilised.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 9. INCOME TAX (continued)

The amounts and expiration dates of the tax losses carried forward at December 31, 2010 and 2009 are listed below:

| <b>EXPIRATION DATE</b> | <b>2010<br/>RMB'000</b> | <b>2009<br/>RMB'000</b> |
|------------------------|-------------------------|-------------------------|
| December 31, 2010      | —                       | —                       |
| December 31, 2011      | 93                      | 93                      |
| December 31, 2012      | —                       | —                       |
| December 31, 2013      | 20,679                  | 8,202                   |
| December 31, 2014      | 24,795                  | 15,962                  |
| December 31, 2015      | 37,394                  | —                       |

Pursuant to the PRC Corporate Income Tax Law, a 10% withholding tax is levied on dividends declared to foreign investors from the foreign investment enterprises established in Mainland China. The requirement is effective from January 1, 2008 and applies to earnings after December 31, 2007. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign investors. The Group is therefore liable for withholding taxes on dividends distributed by those subsidiaries established in Mainland China in respect of earnings generated from January 1, 2008.

Deferred tax liability is recognised for the estimated withholding taxes to the extent that it is probable that those subsidiaries will distribute earnings in the foreseeable future. This requires an estimation of the likely timing and level of dividends to be distributed, and a judgement as to whether the dividends are associated to earnings generated after December 31, 2007 or not. The aggregate amount of temporary differences associated with investments in subsidiaries, for which deferred tax liabilities have not been recognised for the withholding taxes that would be payable on the unremitted earnings of the Group's subsidiaries established in Mainland China, totalled approximately RMB730 million at December 31, 2010 (2009: RMB663 million). In the opinion of the directors, it is not probable that these subsidiaries will distribute such earnings in the foreseeable future.

The share of tax attributable to associates and jointly-controlled entities amounting to RMB2,152,000 (2009: RMB2,896,000) and RMB517,000 (tax credit) (2009: tax credit of RMB378,000), respectively, is included in "Share of profits and losses of associates and jointly-controlled entities" in the consolidated income statement.

## 10. PROFIT ATTRIBUTABLE TO OWNERS OF THE PARENT

The consolidated profit attributable to owners of the parent for the year ended December 31, 2010 includes a gain of RMB428,682,000 (2009: loss RMB9,904,000) which has been dealt with in the financial statements of the Company.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 11. DIVIDENDS

|   | <b>2010</b>    | <b>2009</b>    |
|---|----------------|----------------|
|   | <b>RMB'000</b> | <b>RMB'000</b> |
| Final dividend proposed (notes (a) and (b)):<br>HK\$0.15 (2009: HK\$0.15) per share based on issued share capital<br>as at year end | <b>143,131</b> | 144,538        |
| Special dividend proposed (notes (a) and (b)):<br>HK\$0.25 (2009: Nil) per share based on issued share capital<br>as at year end    | <b>238,551</b> | —              |
| Less: Dividend for shares held for share award scheme as at year end  | <b>(5,682)</b> | (2,963)        |
|   | <b>376,000</b> | 141,575        |

Notes:

- (a) The actual 2009 final dividend paid was RMB143,153,000, after eliminating RMB2,833,000 paid for shares held by the Share Award Scheme Trust.
- (b) The proposed final and special dividends for the year are subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 12. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share amount is based on the profit for the year attributable to ordinary equity holders of the parent, and the weighted average number of ordinary shares of 1,090,540,697 (2009: 1,064,275,119) in issue during the year.

The calculation of diluted earnings per share amount is based on the profit for the year attributable to ordinary equity holders of the parent. The weighted average number of ordinary shares used in the calculation is the number of ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise of all dilutive potential ordinary shares relating to the Group's share option schemes and the Share Award Scheme into ordinary shares.

The calculations of basic and diluted earnings per share are based on:

|  | <b>2010</b>          | <b>2009</b>    |
|--|----------------------|----------------|
|  | <b>RMB'000</b>       | <b>RMB'000</b> |
| <b>EARNINGS</b>  |                      |                |
| Profit attributable to ordinary equity holders of the parent   | <b>372,480</b>       | 387,224        |
| <b>NUMBER OF SHARES</b>  |                      |                |
|  | <b>2010</b>          | <b>2009</b>    |
| <b>SHARES</b>  |                      |                |
| Weighted average number of ordinary shares in issue less shares held for the Share Award Scheme      | <b>1,090,540,697</b> | 1,064,275,119  |
| Effect of dilution:  |                      |                |
| Share options  | <b>53,925,574</b>    | 70,366,460     |
| Awarded Shares   | <b>14,759,825</b>    | 15,088,872     |
| Weighted average number of ordinary shares for the purpose of calculating diluted earnings per share | <b>1,159,226,096</b> | 1,149,730,451  |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 13. PROPERTY, PLANT AND EQUIPMENT

| Group   | LEASEHOLD<br>LAND AND<br>BUILDINGS | ELECTRONIC<br>EQUIPMENT | OFFICE<br>EQUIPMENT<br>AND FIXTURES | MOTOR<br>VEHICLES | LEASEHOLD<br>IMPROVEMENTS | CONSTRUCTION<br>IN PROGRESS | TOTAL     |
|---|------------------------------------|-------------------------|-------------------------------------|-------------------|---------------------------|-----------------------------|-----------|
|   | RMB'000                            | RMB'000                 | RMB'000                             | RMB'000           | RMB'000                   | RMB'000                     | RMB'000   |
| <b>December 31, 2010</b>                                    |                                    |                         |                                     |                   |                           |                             |           |
| At December 31, 2009, and<br>January 1, 2010:               |                                    |                         |                                     |                   |                           |                             |           |
| Cost  | 247,823                            | 137,781                 | 114,696                             | 2,412             | 7,446                     | 303                         | 510,461   |
| Accumulated<br>depreciation                                 | (2,869)                            | (73,564)                | (17,665)                            | (1,341)           | (7,042)                   | —                           | (102,481) |
| Net carrying amount   | 244,954                            | 64,217                  | 97,031                              | 1,071             | 404                       | 303                         | 407,980   |
| At January 1, 2010, net of<br>accumulated<br>depreciation   | 244,954                            | 64,217                  | 97,031                              | 1,071             | 404                       | 303                         | 407,980   |
| Additions   | 4,328                              | 21,830                  | 2,184                               | 1,326             | 850                       | 11,120                      | 41,638    |
| Acquisition from a business<br>combination (note 34)        | —                                  | 655                     | 294                                 | —                 | 618                       | —                           | 1,567     |
| Disposals   | —                                  | (363)                   | (157)                               | (246)             | —                         | —                           | (766)     |
| Depreciation charge for the<br>year                         | (4,007)                            | (29,423)                | (23,228)                            | (438)             | (556)                     | —                           | (57,652)  |
| At December 31, 2010,<br>net of accumulated<br>depreciation | 245,275                            | 56,916                  | 76,124                              | 1,713             | 1,316                     | 11,423                      | 392,767   |
| At December 31, 2010:                                       |                                    |                         |                                     |                   |                           |                             |           |
| Cost  | 252,151                            | 157,373                 | 116,068                             | 3,072             | 5,061                     | 11,423                      | 545,148   |
| Accumulated depreciation                                    | (6,876)                            | (100,457)               | (39,944)                            | (1,359)           | (3,745)                   | —                           | (152,381) |
| Net carrying amount   | 245,275                            | 56,916                  | 76,124                              | 1,713             | 1,316                     | 11,423                      | 392,767   |
| <b>December 31, 2009</b>                                    |                                    |                         |                                     |                   |                           |                             |           |
| At December 31, 2008, and<br>January 1, 2009:               |                                    |                         |                                     |                   |                           |                             |           |
| Cost  | —                                  | 100,858                 | 4,343                               | 2,094             | 13,938                    | 293,880                     | 415,113   |
| Accumulated depreciation                                    | —                                  | (51,944)                | (3,325)                             | (966)             | (13,252)                  | —                           | (69,487)  |
| Net carrying amount   | —                                  | 48,914                  | 1,018                               | 1,128             | 686                       | 293,880                     | 345,626   |
| At January 1, 2009, net of<br>accumulated<br>depreciation   | —                                  | 48,914                  | 1,018                               | 1,128             | 686                       | 293,880                     | 345,626   |
| Additions   | 1,095                              | 33,188                  | 15,964                              | 318               | 417                       | 52,909                      | 103,891   |
| Transfer from/(to)  | 246,728                            | 4,925                   | 94,833                              | —                 | —                         | (346,486)                   | —         |
| Disposals   | —                                  | (176)                   | (8)                                 | —                 | (133)                     | —                           | (317)     |
| Depreciation charge for the<br>year                         | (2,869)                            | (22,634)                | (14,776)                            | (375)             | (566)                     | —                           | (41,220)  |
| At December 31, 2009,<br>net of accumulated<br>depreciation | 244,954                            | 64,217                  | 97,031                              | 1,071             | 404                       | 303                         | 407,980   |
| At December 31, 2009:                                       |                                    |                         |                                     |                   |                           |                             |           |
| Cost  | 247,823                            | 137,781                 | 114,696                             | 2,412             | 7,446                     | 303                         | 510,461   |
| Accumulated depreciation                                    | (2,869)                            | (73,564)                | (17,665)                            | (1,341)           | (7,042)                   | —                           | (102,481) |
| Net carrying amount   | 244,954                            | 64,217                  | 97,031                              | 1,071             | 404                       | 303                         | 407,980   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 13. PROPERTY, PLANT AND EQUIPMENT (continued)

The Group's leasehold land included in property, plant and equipment is situated in Mainland China and is held under a medium term lease of 50 years.

During the year ended December 31, 2010, the Company did not acquire property, plant and equipment, and depreciation charge of RMB1,200 was provided during the year. As at December 31, 2010, the cost, accumulated depreciation and net carrying amount of the electronic equipment of the Company amounted to RMB3,400, RMB1,200 and RMB2,200, respectively.

## 14. GOODWILL

| GROUP  | RMB'000        |
|--|----------------|
| At January 1, 2009:                                    |                |
| Cost   | 2,377          |
| Accumulated impairment                                 | —              |
| Net carrying amount                                    | 2,377          |
| Cost at January 1, 2009, net of accumulated impairment | 2,377          |
| At December 31, 2009                                   | 2,377          |
| At December 31, 2009:                                  |                |
| Cost   | 2,377          |
| Accumulated impairment                                 | —              |
| Net carrying amount                                    | 2,377          |
| Cost at January 1, 2010, net of accumulated impairment | <b>2,377</b>   |
| Acquisition of a subsidiary (note 34)                  | <b>11,710</b>  |
| Impairment during the year                             | <b>(2,377)</b> |
| Cost and net carrying amount at December 31, 2010      | <b>11,710</b>  |
| At December 31, 2010:                                  |                |
| Cost   | <b>14,087</b>  |
| Accumulated impairment                                 | <b>(2,377)</b> |
| Net carrying amount                                    | <b>11,710</b>  |

Goodwill acquired through the business combination in 2008 has been allocated to the INFOGATE cash-generating unit, which is included in the reportable segment of application software. The recoverable amount of the INFOGATE cash-generating unit has been determined based on a value in use calculation using cash flow projections from financial budgets approved by management covering a five year period. The projected cash flows have been updated to reflect the decreased demand for products and services. As a result of this analysis, management has recognised an impairment charge of RMB2,377,000, which is recorded in other expenses in the consolidated income statement during the year ended December 31, 2010.

Goodwill of RMB11,710,000 acquired through the business combination of Conew.com Corporation ("Conew") during the year ended December 31, 2010 has been allocated to the internet security software cash-generating unit, which is included in the reportable segment of application software. Further details are included in note 34 to the financial statements. The Group performed the annual impairment assessment as at December 31, 2010. The recoverable amount of the internet security software cash-generating unit has been determined based on a value in use calculation using cash flow projections from financial budgets approved by management covering a five-year period.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 15. OTHER INTANGIBLE ASSETS

| GROUP   | PURCHASED<br>SOFTWARE<br>RMB'000 | CAPITALISED<br>SOFTWARE<br>COSTS<br>RMB'000 | CAPITALISED<br>TELEVISION<br>PROGRAM<br>PRODUCTION<br>COST<br>RMB'000 | OTHERS<br>RMB'000 | TOTAL<br>RMB'000 |
|---|----------------------------------|---|---|-------------------|------------------|
| <b>DECEMBER 31, 2010</b>                                    |                                  |   |   |                   |                  |
| Cost at January 1, 2010, net of<br>accumulated amortisation | 21,556                           | 23,362                                      | —   | 3,571             | 48,489           |
| Addition  | 2,139                            | 20,177                                      | 19,865  | —                 | 42,181           |
| Acquisition from a business combination<br>(note 34)        | —                                | —   | —   | 9,372             | 9,372            |
| Amortisation provided during the year                       | (6,393)                          | (18,071)                                    | —   | (1,373)           | (25,837)         |
| Impairment during the year                                  | (2,612)                          | —   | —   | (2,548)           | (5,160)          |
| At December 31, 2010  | 14,690                           | 25,468                                      | 19,865  | 9,022             | 69,045           |
| At December 31, 2010:                                       |                                  |   |   |                   |                  |
| Cost  | 40,986                           | 70,174                                      | 19,865  | 9,372             | 140,397          |
| Accumulated amortisation                                    | (26,296)                         | (44,706)                                    | —   | (350)             | (71,352)         |
| Net carrying amount   | 14,690                           | 25,468                                      | 19,865  | 9,022             | 69,045           |
| <b>DECEMBER 31, 2009</b>                                    |                                  |   |   |                   |                  |
| At January 1, 2009:   |                                  |   |   |                   |                  |
| Cost  | 40,010                           | 18,270                                      | —   | 5,080             | 63,360           |
| Accumulated amortisation                                    | (14,578)                         | (9,267)                                     | —   | (444)             | (24,289)         |
| Net carrying amount   | 25,432                           | 9,003                                       | —   | 4,636             | 39,071           |
| Cost at January 1, 2009, net of<br>accumulated amortisation | 25,432                           | 9,003                                       | —   | 4,636             | 39,071           |
| Addition  | 5,715                            | 18,883                                      | —   | —                 | 24,598           |
| Amortisation provided during the year                       | (9,591)                          | (4,524)                                     | —   | (1,065)           | (15,180)         |
| At December 31, 2009  | 21,556                           | 23,362                                      | —   | 3,571             | 48,489           |
| At December 31, 2009:                                       |                                  |   |   |                   |                  |
| Cost  | 45,287                           | 37,153                                      | —   | 5,080             | 87,520           |
| Accumulated amortisation                                    | (23,731)                         | (13,791)                                    | —   | (1,509)           | (39,031)         |
| Net carrying amount   | 21,556                           | 23,362                                      | —   | 3,571             | 48,489           |

During the years ended December 31, 2010 and 2009, capitalised software costs were related to development expenditure on application software products.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 15. OTHER INTANGIBLE ASSETS (continued)

During the year ended December 31, 2010, the Group recorded an impairment charge of RMB300,000 for the remaining value of the trade name of INFOGATE and an impairment charge of RMB4,860,000 in relation to the software, customer list, contract backlog, and other intangible assets of INFOGATE. The impairments were mainly resulted from a significant decline in forecasted sales and cash flows from INFOGATE.

|                                | <b>COMPANY</b> |                |
|--------------------------------|----------------|----------------|
|                                | <b>2010</b>    | <b>2009</b>    |
|                                | <b>RMB'000</b> | <b>RMB'000</b> |
| Carrying amount at January 1   | 763            | 3,058          |
| Amortisation                   | (763)          | (2,295)        |
| Carrying amount at December 31 | —              | 763            |
| At December 31:                |                |                |
| Cost                           | 7,304          | 7,304          |
| Accumulated amortisation       | (7,304)        | (6,541)        |
| Net carrying amount            | —              | 763            |

The Company's intangible assets represent the purchased software.

## 16. LEASE PREPAYMENTS

|                                | <b>GROUP</b>   |                |
|--------------------------------|----------------|----------------|
|                                | <b>2010</b>    | <b>2009</b>    |
|                                | <b>RMB'000</b> | <b>RMB'000</b> |
| Carrying amount at January 1   | 6,972          | 7,138          |
| Addition                       | 38,738         | —              |
| Amortisation                   | (627)          | (166)          |
| Carrying amount at December 31 | 45,083         | 6,972          |
| <b>AT DECEMBER 31:</b>         |                |                |
| Cost                           | 46,206         | 7,468          |
| Accumulated amortisation       | (1,123)        | (496)          |
| Net carrying amount            | 45,083         | 6,972          |

The Group's lease prepayments represent prepaid land lease payments. The leasehold land is situated in Zhuhai, the PRC, and is held under a medium term lease.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 17. INVESTMENTS IN ASSOCIATES

|  | GROUP           |                 |
|--|-----------------|-----------------|
|  | 2010<br>RMB'000 | 2009<br>RMB'000 |
| At January 1                                     | 6,378           | 27,077          |
| Newly acquired associate                         | —               | 400             |
| Share of profits of associates                   | 14,433          | 25,715          |
| Dividends received from an associate             | (13,950)        | (46,414)        |
| Disposal of an associate                         | (5,717)         | —               |
| Reclassified as an available-for-sale investment | (1,144)         | —               |
| Provision for impairment                         | —               | (400)           |
| At December 31                                   | —               | 6,378           |

Particulars of the associates are as follows:

| NAME   | PLACE OF<br>REGISTRATION | NOMINAL<br>VALUE OF<br>REGISTERED<br>CAPITAL | PERCENTAGE OF<br>EQUITY INTEREST<br>ATTRIBUTABLE TO<br>THE GROUP | PRINCIPAL ACTIVITIES   |
|--|--------------------------|--|--|--|
| Guangzhou Kingsoft<br>Duoyi Internet<br>Technology Co. Ltd.<br>("Kingsoft<br>Guangzhou") | PRC                      | RMB13,330,000                                | 30   | Research, development of<br>online games and provision of<br>online game services  |
| Guangzhou Tuotu Computer<br>Technology Co., Ltd.   | PRC                      | RMB100,000                                   | 19.9   | Research and development<br>of computer and network<br>related technology; provision<br>of network service; design and<br>publishing of advertisements |

Both of the above interests in associates are indirectly held by the Company.

On December 27, 2010, the Group, through its wholly owned subsidiary, Beijing Kingsoft Digital Entertainment Technology co., Ltd. ("Beijing Digital Entertainment"), entered into an agreement with the other shareholder (the "Buyer") who held 70% equity interest of Kingsoft Guangzhou, pursuant to which Beijing Digital Entertainment will sell its 30% equity interest to the Buyer in two steps for a total cash consideration of RMB126 million. The first disposal of 25% equity interest in Kingsoft Guangzhou was completed during the year ended December 31, 2010 and the second disposal of the remaining 5% equity interest will be completed within nine months after the completion of the first disposal or a later time agreed by both parties. After the completion of the first disposal, the Group ceased to have significant influence over Kingsoft Guangzhou and accounted for its remaining 5% equity interest in Kingsoft Guangzhou as available-for-sale investment and measured it at fair value of RMB18,675,000 (note 19). As a result, a gain of RMB105,189,000 was recognised in the consolidated income statement for the year ended December 31, 2010.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 17. INVESTMENTS IN ASSOCIATES (continued)

In addition, the Group is granted an option to repurchase 15% equity interest in Kingsoft Guangzhou at a consideration of RMB63 million plus 6% interest, which is excisable in the event that Kingsoft Guangzhou succeeds an IPO or the equity interest is sold by the Buyer to a venture capital company before December 31, 2013, or any online game entity, of which the Buyer holds over 30% equity interest, launches its IPO before December 31, 2015. The option is not recognised in the consolidated financial position as of December 31, 2010, as the management considers that the likelihood to exercise the option is low.

## 18. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

|                              | GROUP           |                 | COMPANY         |                 |
|------------------------------|-----------------|-----------------|-----------------|-----------------|
|                              | 2010<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Unlisted investment, at cost | —               | —               | 34,181          | 35,370          |
| Share of net assets          | 8,846           | 15,533          | —               | —               |
| Goodwill on acquisition      | 23,921          | 24,579          | —               | —               |
| Impairment                   | (13,974)        | —               | (15,388)        | —               |
|                              | <b>18,793</b>   | 40,112          | <b>18,793</b>   | 35,370          |

Particulars of the jointly-controlled entities are as follows:

| Name  | Place of registration/incorporation | Nominal value of registered capital/issued ordinary share capital | Percentage of equity interest attributable to the Group | Principal activities              |
|---|-------------------------------------|---|---|-----------------------------------|
| Beijing Kingsoft Lianking Technology Corporation Limited ("Kingsoft Lianking") (note) | PRC                                 | RMB8,000,600  | 40  | Research and development of games |
| Shanghai Zhixiong Network Technology Co., Ltd. ("Shanghai Zhixiong")                  | PRC                                 | RMB24,970,000   | 19.9  | Research and development of games |
| Sky Profit Limited ("Sky Profit")   | Cayman Islands                      | US\$50,000  | 26.42*  | Investment holding                |

\* The Company held 3,410,594 preferred shares and 796,026 ordinary shares of US\$0.001 each of Sky Profit.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 18. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES (continued)

The following table illustrates the summarised financial information of the Group's jointly-controlled entities:

|  | <b>2010</b>     | <b>2009</b>    |
|--|-----------------|----------------|
|  | <b>RMB'000</b>  | <b>RMB'000</b> |
| <b>Share of the jointly-controlled entities' assets and liabilities:</b> |                 |                |
| Current assets   | <b>4,388</b>    | 5,996          |
| Non-current assets   | <b>10,147</b>   | 11,648         |
| Current liabilities  | <b>(2,489)</b>  | (511)          |
| Non-current liabilities  | <b>(3,200)</b>  | (1,600)        |
| Net assets   | <b>8,846</b>    | 15,533         |
| <b>Share of the jointly-controlled entities' results:</b>                |                 |                |
| Revenue  | <b>3,991</b>    | 1,282          |
| Other income   | <b>27</b>       | 4              |
|  | <b>4,018</b>    | 1,286          |
| Total expenses   | <b>(10,895)</b> | (8,616)        |
| Tax  | <b>517</b>      | 378            |
| Loss after tax   | <b>(6,360)</b>  | (6,952)        |

Note:

Pursuant to the cooperative agreement dated May 23, 2009, the Group is required to transfer up to 15% of its equity interest in Kingsoft Lianking at no consideration to the other shareholders of Kingsoft Lianking should the revenue of the first online game developed by Kingsoft Lianking achieve certain predetermined revenue targets in the coming years, or upon the happening of specified events. Another 10% of the Group's equity interest in Kingsoft Lianking will be required to transfer to the other shareholders should the revenue of online games developed by Kingsoft Lianking achieve certain predetermined revenue targets during the first five years. On the contrary, if the revenue of the first online game developed by Kingsoft Lianking is below certain predetermined revenue targets and the first online game of Kingsoft Lianking is not ready for commercialisation during the first 24 months of its operation, the Group is entitled to acquire up to 19% of equity interest in Kingsoft Lianking from the other shareholders at no consideration.

For investments in jointly-controlled entities, the Group assesses at end of each reporting period whether there is objective evidence that an investment is impaired. Each of the above investments is deemed as a separate cash-generating unit as the Group considers not to integrate them with the rest of the Group's other entertainment software or application software business.

- (a) Investment in Kingsoft Lianking: The Group performed the impairment assessment as at December 31, 2010. The recoverable amount of the investment has been determined based on a value in use calculation using cash flow projections from financial budgets approved by management covering a five-year period. The projected cash flows have been updated to reflect the performance of the first self-developed online game of Kingsoft Lianking. Based on this analysis, management has recognised an impairment charge of RMB1,936,000 against the investment in Kingsoft Lianking, which is recorded in other expenses in the consolidated income statement during the year ended December 31, 2010.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 18. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES (continued)

- (b) Investment in Shanghai Zhixiong: The Group considers that the investment in Shanghai Zhixiong is not recoverable because Shanghai Zhixiong has terminated its operation and does not have sufficient cash flow. Management has recognised an impairment charge of RMB3,638,000 against investment in Shanghai Zhixiong, which is recorded in other expenses in the consolidated income statement during the year ended December 31, 2010.
- (c) Investment in Sky Profit: The Group performed the impairment assessment as at December 31, 2010. The recoverable amount of the investment has been determined based on a value in use calculation using cash flow projections from financial budgets approved by management covering a five-year period. The projected cash flows have been updated to reflect a significant decline in forecasted sales. As a result of this analysis, management has recognised an impairment charge of RMB8,400,000 against the investment in Sky Profit, which is recorded in other expenses in the consolidated income statement during the year ended December 31, 2010.

## 19. AVAILABLE-FOR-SALE INVESTMENT

|   | GROUP   |         |
|---|---------|---------|
|   | 2010    | 2009    |
|   | RMB'000 | RMB'000 |
| Unlisted equity investment, at fair value | 18,675  | —       |

The Group, upon disposal of its 25% interest to the other shareholder of Kingsoft Guangzhou, reclassified its remaining 5% interest in Kingsoft Guangzhou as available-for-sale investment during the year ended December 31, 2010. No gain or loss in respect of the Group's available-for-sale investment was recognised in other comprehensive income during the year ended December 31, 2010.

## 20. OTHER FINANCIAL ASSET

|                                     | 2010    | 2009    |
|-------------------------------------|---------|---------|
|                                     | RMB'000 | RMB'000 |
| Ordinary shares subscription option | 13,785  | —       |

The ordinary shares subscription option (the "Option") was granted by an online game service provider in Vietnam (the "Grantor") to a subsidiary of the Group on August 1, 2010 for the subsidiary or any of its designated subsidiary to subscribe from the Grantor at a predetermined exercise price a maximum of 1,859,251 ordinary shares of the Grantor, issued as fully-paid subject to adjustment. The Option is exercisable in instalments over a six-year period with certain accelerating vesting conditions. The Option was, upon initial recognition, designated as a financial asset at fair value through profit or loss.

## 21. LOAN RECEIVABLES

The loan receivables are interest-free housing loans granted to employees, which were carried at amortised cost with effective interest rates of 5.96% and 5.76% per annum during the years ended December 31, 2010 and 2009, respectively. The general terms of the loan receivables are three to five years and they are repaid monthly by employees.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 22. LONG-TERM PREPAYMENTS

|                            | <b>GROUP</b>   |                |
|----------------------------|----------------|----------------|
|                            | <b>2010</b>    | <b>2009</b>    |
|                            | <b>RMB'000</b> | <b>RMB'000</b> |
| Deposit for land use right | —              | 38,738         |
|                            | —              | 38,738         |

## 23. INVENTORIES

|                     | <b>GROUP</b>   |                |
|---------------------|----------------|----------------|
|                     | <b>2010</b>    | <b>2009</b>    |
|                     | <b>RMB'000</b> | <b>RMB'000</b> |
| Packaging materials | <b>340</b>     | 1,977          |
| Packaged goods      | <b>2,516</b>   | 3,407          |
|                     | <b>2,856</b>   | 5,384          |

## 24. TRADE RECEIVABLES

|                   | <b>GROUP</b>   |                |
|-------------------|----------------|----------------|
|                   | <b>2010</b>    | <b>2009</b>    |
|                   | <b>RMB'000</b> | <b>RMB'000</b> |
| Trade receivables | <b>100,506</b> | 121,780        |
| Impairment        | <b>(1,567)</b> | (1,402)        |
|                   | <b>98,939</b>  | 120,378        |

Trade receivables, which are non-interest-bearing and generally on credit terms of 30 to 90 days, are recognised and carried at original invoiced amounts less any impairment loss. An estimate for doubtful debts is made when there is objective evidence that an impairment loss on receivables has been incurred. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the trade receivable is impaired. Bad debts are written off as incurred. The Group generally does not require collateral from its customers.

An aged analysis of the Group's trade receivables as at the end of the reporting period, based on the invoice date and net of provisions, is as follows:

|                | <b>GROUP</b>   |                |
|----------------|----------------|----------------|
|                | <b>2010</b>    | <b>2009</b>    |
|                | <b>RMB'000</b> | <b>RMB'000</b> |
| 0 to 30 days   | <b>37,948</b>  | 43,029         |
| 31 to 60 days  | <b>24,233</b>  | 38,002         |
| 61 to 90 days  | <b>14,966</b>  | 26,393         |
| 91 to 365 days | <b>15,749</b>  | 11,180         |
| Over one year  | <b>6,043</b>   | 1,774          |
|                | <b>98,939</b>  | 120,378        |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 24. TRADE RECEIVABLES (continued)

The movements in provision for impairment of trade receivables are as follows:

|                                     | <b>2010</b><br><b>RMB'000</b> | <b>2009</b><br><b>RMB'000</b> |
|-------------------------------------|-------------------------------|-------------------------------|
| At January 1                        | 1,402                         | 1,205                         |
| Impairment losses recognised        | 640                           | 197                           |
| Amount written off as uncollectible | (475)                         | —                             |
|                                     | <b>1,567</b>                  | 1,402                         |

Included in the above provision for impairment of trade receivables is a provision for individual impaired trade receivables of RMB1,567,000 (2009: RMB1,402,000) with a carrying amount before provision of RMB1,567,000 (2009: RMB1,402,000).

The individually impaired trade receivables relate to customers that were in financial difficulties or were in default in both interest and/or principal payments. The Group does not hold any collateral or other credit enhancements over these balances.

## 25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

|  | <b>GROUP</b>                  |                               |
|--|-------------------------------|-------------------------------|
|  | <b>2010</b><br><b>RMB'000</b> | <b>2009</b><br><b>RMB'000</b> |
| Prepayments  | 30,218                        | 18,228                        |
| Value-added tax receivable                         | 6,641                         | 5,339                         |
| Deposits   | 4,839                         | 6,714                         |
| Loans to shareholders of a subsidiary (note 37(b)) | 13,607                        | 13,912                        |
| Loan to shareholder of a jointly-controlled entity | —                             | 4,000                         |
| Proceeds receivable from disposal of an associate  | 20,825                        | —                             |
| Other receivables                                  | 8,995                         | 11,882                        |
|  | <b>85,125</b>                 | 60,075                        |

|  | <b>COMPANY</b>                |                               |
|--|-------------------------------|-------------------------------|
|  | <b>2010</b><br><b>RMB'000</b> | <b>2009</b><br><b>RMB'000</b> |
| Prepayments  | 260                           | 373                           |
| Loans to shareholders of a subsidiary (note 37(b)) | 13,607                        | 13,912                        |
| Other receivables                                  | —                             | 20                            |
|  | <b>13,867</b>                 | 14,305                        |

None of the above assets is either past due or impaired. The financial assets included in above balances relate to receivables for which there was no recent history of default.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 26. CASH AND CASH EQUIVALENTS

|   | NOTES | GROUP            |                 |
|---|-------|------------------|-----------------|
|   |       | 2010<br>RMB'000  | 2009<br>RMB'000 |
| Cash and bank balances  | (a)   | 259,995          | 258,975         |
| Time deposits with original maturity of<br>three months or less when acquired | (a)   | 926,716          | 146,620         |
|   |       | <b>1,186,711</b> | 405,595         |
| Time deposits with original maturity of<br>over three months when acquired    | (a)   | 469,446          | 862,503         |
|   |       | <b>1,656,157</b> | 1,268,098       |
| Denominated in RMB  | (b)   | 1,459,968        | 1,126,688       |
| Denominated in US\$   |       | 52,670           | 49,330          |
| Denominated in HK\$   |       | 76,567           | 45,659          |
| Denominated in JPY  |       | 50,354           | 38,895          |
| Denominated in MYR  |       | 16,598           | 7,526           |
|   |       | <b>1,656,157</b> | 1,268,098       |
|   |       | COMPANY          |                 |
|   |       | 2010<br>RMB'000  | 2009<br>RMB'000 |
| Cash and bank balances  |       | 51,442           | 47,498          |
| Time deposits with original maturity of three months or less when acquired    |       | 45,573           | 38,056          |
|   |       | <b>97,015</b>    | 85,554          |

- (a) Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and a year depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. The carrying amounts of the cash and cash equivalents as at December 31, 2010 and 2009 approximate to their fair values.
- (b) The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 27. TRADE PAYABLES

An aged analysis of the Group's trade payables as at the end of the reporting period, based on the invoice date, is as follows:

|                | GROUP           |                 |
|----------------|-----------------|-----------------|
|                | 2010<br>RMB'000 | 2009<br>RMB'000 |
| 0 to 30 days   | 6,357           | 8,746           |
| 31 to 60 days  | 1,834           | 422             |
| 61 to 90 days  | 2,118           | 726             |
| 91 to 365 days | 2,631           | 1,270           |
| Over one year  | 2,631           | 1,433           |
|                | <b>15,571</b>   | 12,597          |

Trade payables are non-interest-bearing and are normally settled on terms of two to three months.

## 28. INTEREST-BEARING BANK LOAN

|                      | GROUP AND COMPANY         |          | 2010<br>RMB'000 | 2009<br>RMB'000 |
|----------------------|---------------------------|----------|-----------------|-----------------|
|                      | EFFECTIVE INTEREST RATE   | MATURITY |                 |                 |
| Current<br>Bank loan | HIBOR plus 1.1% per annum | 2011     | <b>102,108</b>  | —               |

The interest-bearing bank loan represented a drawdown of HK\$120,000,000 (RMB102,108,000) from the Group's banking facility of HK\$200,000,000 in June 2010. As undertaking of such banking facility, the Group provided an RMB deposit of not less than the amount of this bank loan from time to time outstanding with a maximum of HK\$200,000,000.

## 29. ACCRUED EXPENSES AND OTHER PAYABLES

|                                  | GROUP           |                 |
|----------------------------------|-----------------|-----------------|
|                                  | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Deposits received from customers | 6,034           | 12,504          |
| Other payables                   | 109,448         | 136,204         |
| Other taxes payable              | 13,641          | 15,550          |
| Accruals                         | 34,080          | 22,638          |
|                                  | <b>163,203</b>  | 186,896         |

Other payables are non-interest-bearing.

The Company's other payables are related to accruals of expenses.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 30. DEFERRED REVENUE

|                        | <b>GROUP</b>     |                |
|------------------------|------------------|----------------|
|                        | <b>2010</b>      | <b>2009</b>    |
|                        | <b>RMB'000</b>   | <b>RMB'000</b> |
| Entertainment software | <b>114,745</b>   | 105,784        |
| Application software   | <b>60,174</b>    | 82,667         |
| Government grants      | <b>15,790</b>    | 12,336         |
|                        | <b>190,709</b>   | 200,787        |
| Less: Current portion  | <b>(161,570)</b> | (158,643)      |
| Non-current portion    | <b>29,139</b>    | 42,144         |

## 31. SHARE CAPITAL

### Shares

|  | <b>2010</b>    | <b>2009</b>    |
|--|----------------|----------------|
|  | <b>RMB'000</b> | <b>RMB'000</b> |
| Authorised:  |                |                |
| 2,400,000,000 (2009: 2,400,000,000) ordinary shares of US\$0.0005 each | <b>9,260</b>   | 9,260          |
| Issued and fully paid:   |                |                |
| 1,121,407,633 (2009: 1,094,365,133) ordinary shares of US\$0.0005 each | <b>4,527</b>   | 4,434          |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 31. SHARE CAPITAL (continued)

During the years ended December 31, 2009 and 2010, the movements in the Company's issued share capital were as follows:

| COMPANY  | NOTE | NUMBER OF<br>SHARES IN<br>ISSUE | ISSUED<br>SHARE<br>CAPITAL<br>RMB'000 | SHARE<br>PREMIUM<br>ACCOUNT<br>RMB'000 | SHARES HELD<br>FOR SHARE<br>AWARD<br>SCHEME<br>RMB'000 | TOTAL<br>RMB'000 |
|--|------|---------------------------------|---------------------------------------|--|--|------------------|
| At January 1, 2009   |      | 1,056,228,708                   | 4,362                                 | 639,034                                | (40,050)   | 603,346          |
| Approved and paid final dividend in respect of the previous year |      | —                               | —                                     | (1,068)                                | —  | (1,068)          |
| Shares purchased for a share award scheme                        | (a)  | (8,501,000)                     | —                                     | —                                      | (43,050)   | (43,050)         |
| Exercise of share options  |      | 20,998,425                      | 72                                    | 28,958                                 | —  | 29,030           |
| Vested awarded shares transferred to employees                   |      | 3,203,000                       | —                                     | —                                      | 10,735   | 10,735           |
| Proposed final 2009 dividend                                     |      | —                               | —                                     | (141,575)                              | —  | (141,575)        |
| At December 31, 2009 and January 1, 2010                         |      | <b>1,071,929,133</b>            | <b>4,434</b>                          | <b>525,349</b>                         | <b>(72,365)</b>  | <b>457,418</b>   |
| Approved and paid final dividend in respect of the previous year |      | —                               | —                                     | (1,578)                                | —  | (1,578)          |
| Exercise of share options  |      | <b>27,042,500</b>               | <b>93</b>                             | <b>80,470</b>                          | —  | <b>80,563</b>    |
| Vested awarded shares transferred to employees                   |      | <b>5,741,999</b>                | —                                     | —                                      | <b>14,592</b>  | <b>14,592</b>    |
| Proposed final 2010 and special dividends                        |      | —                               | —                                     | (196,000)                              | —  | (196,000)        |
| At December 31, 2010   |      | <b>1,104,713,632*</b>           | <b>4,527</b>                          | <b>408,241</b>                         | <b>(57,773)</b>  | <b>354,995</b>   |

\* Excluded 16,694,001 (2009: 22,436,000) shares held by the Share Award Scheme Trust as at December 31, 2010.

Note:

- (a) The Company adopted the Share Award Scheme in 2008 as set out in note 7(b). No shares of the Company were acquired by the Share Award Scheme Trust during the year ended December 31, 2010. During the year ended December 31, 2009, the Share Award Scheme Trust acquired 8,501,000 shares of the Company through purchases on the open market at a total cost (including related transaction costs) of approximately RMB43,050,000.

### Share options

Details of the Company's share option schemes and the share options issued under the schemes are included in note 7 to the financial statements.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 32. INVESTMENTS IN SUBSIDIARIES AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES

|  | COMPANY         |                 |
|--|-----------------|-----------------|
|  | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Unlisted shares, at cost   | 18,393          | 18,921          |
| Capital contribution in respect of employee share-based compensation | 198,332         | 176,139         |
|  | <b>216,725</b>  | 195,060         |

The amounts due from and to subsidiaries included in the Company's current assets and current liabilities of RMB791,402,000 (2009: RMB327,470,000) and RMB84,309,000 (2009: RMB52,738,000), respectively, are unsecured, interest-free and are repayable on demand.

Particulars of the subsidiaries are as follows:

| Name   | NOTES | PLACE OF INCORPORATION/REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2010 | PRINCIPAL ACTIVITIES |
|--|-------|--|---|---|----------------------|
| Kingsoft Entertainment Software Holdings Limited ("Kingsoft Entertainment Holdings")         |       | Cayman Islands                                     | US\$1   | 100   | Investment holding   |
| Kingsoft Application Software Holdings Limited ("Kingsoft Application Holdings")             |       | Cayman Islands                                     | HK\$1   | 100   | Investment holding   |
| Kingsoft Internet Security Software Holdings Limited ("Kingsoft Internet Security Holdings") |       | Cayman Islands                                     | US\$20,000  | 81.25   | Investment holding   |
| Westhouse Holdings Limited ("Westhouse Holdings")*   |       | Cayman Islands                                     | US\$2,560,000   | 100   | Investment holding   |
| Conew**  |       | British Virgin Islands                             | US\$8,250   | 81.25   | Investment holding   |
| Kingsoft Entertainment Software Corporation Limited  |       | Hong Kong  | HK\$1   | 100   | Investment holding   |
| Kingsoft Application Software Corporation Limited  |       | Hong Kong  | HK\$1   | 100   | Investment holding   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 32. INVESTMENTS IN SUBSIDIARIES AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

| Name   | NOTES | PLACE OF INCORPORATION/REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2010 | PRINCIPAL ACTIVITIES   |
|--|-------|--|---|---|--|
| Kingsoft Internet Security Software Corporation Limited                    |       | Hong Kong  | HK\$1   | 81.25   | Investment holding   |
| Westhouse Corporation Limited*   |       | Hong Kong  | HK\$18,600,000  | 100   | Investment holding   |
| Kingsoft (M) SDN.BHD ("Kingsoft Malaysia")                                 |       | Malaysia   | MYR1,000,000  | 100   | Import and export of software and hardware and related business  |
| Kingsoft Japan   |       | Japan  | JPY447,875,000  | 51  | Development and sale of the security software and office application software                                    |
| Beijing Kingsoft Software Co., Ltd.#                                       |       | PRC/Mainland China                                 | RMB10,000,000   | 100   | Marketing and distribution of application software   |
| Beijing Digital Entertainment#   | (a)   | PRC/Mainland China                                 | RMB10,000,000   | 100   | Marketing and operation of SMS and wireless service of online games and application software, ICP license holder |
| Beijing Kingsoft Internet Security Software Co., Ltd.#                     |       | PRC/Mainland China                                 | RMB8,000,000  | 81.25   | Sale and operation of internet security software   |
| Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian")#  | (a)   | PRC/Mainland China                                 | RMB1,500,000  | 100   | Investment holding   |
| Shell Internet (Beijing) Security Technology Co., Ltd. ("Shell Internet")# |       | PRC/Mainland China                                 | RMB3,500,000  | 100   | Provision of internet security service for individuals and enterprises   |
| Conew Network Technology (Beijing) Co., Ltd. ("Conew Network")**#          |       | PRC/Mainland China                                 | US\$1,243,813   | 81.25   | Research and development for, and sales of application software business   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 32. INVESTMENTS IN SUBSIDIARIES AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

| Name  | NOTES | PLACE OF INCORPORATION/REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2010 | PRINCIPAL ACTIVITIES  |
|---|-------|--|---|---|---|
| Beijing Conew Technology Development Co., Ltd. ("Conew Technology")**#                      |       | PRC/Mainland China                                 | RMB300,000  | 81.25   | ICP license holder  |
| Dalian Kingsoft Interactive Entertainment Co., Ltd. ("Kingsoft Dalian")#                    |       | PRC/Mainland China                                 | RMB30,000,000   | 80  | Research, development and distribution of games                                 |
| Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment")# |       | PRC/Mainland China                                 | RMB100,000,000  | 100   | Research and development of games   |
| Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment")#         | (b)   | PRC/Mainland China                                 | RMB10,000,000   | 100   | Marketing and operation of entertainment software products, ICP license holder  |
| Chengdu Westhouse Interactive Entertainment Co., Ltd.*#                                     |       | PRC/Mainland China                                 | —   | 100   | Research and development of games   |
| Zhuhai Kingsoft Digital Technology Co., Ltd.#   |       | PRC/Mainland China                                 | RMB198,048,000  | 100   | Investment holding  |
| Zhuhai Juntian Electronic Technology Co., Ltd.#   |       | PRC/Mainland China                                 | RMB18,952,000   | 81.25   | Investment holding, research, development and distribution of security software |
| Zhuhai Kingsoft Software Co., Ltd. ("Zhuhai Software")#                                     |       | PRC/Mainland China                                 | RMB215,500,000  | 100   | Research, development and distribution of consumer application software         |
| Zhuhai Xishanju Software Co., Ltd.#   |       | PRC/Mainland China                                 | RMB2,200,000  | 100   | Investment holding  |
| Zhuhai Kingsoft Online Game Technology Co., Ltd.#   |       | PRC/Mainland China                                 | RMB10,000,000   | 100   | Research and development for online games                                       |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 32. INVESTMENTS IN SUBSIDIARIES AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

| Name  | NOTES | PLACE OF INCORPORATION/REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2010 | PRINCIPAL ACTIVITIES   |
|---|-------|--|---|---|--|
| Zhuhai Qiwen Application Software Co., Ltd. ("Zhuhai Qiwen") <sup>#</sup>                   | (c)   | PRC/Mainland China                                 | RMB68,000,000   | 100   | Investment holding   |
| Zhuhai Kingsoft Application Software Co., Ltd. ("Zhuhai Kingsoft Application") <sup>#</sup> | (c)   | PRC/Mainland China                                 | RMB68,000,000   | 100   | Sale of office application software                                      |
| Shenzhen Kingsoft Information Security Technology Co., Ltd. <sup>#</sup>                    |       | PRC/Mainland China                                 | RMB20,000,000   | 100   | Research and development for, and sales of application software business |

\* Companies established during the year ended December 31, 2010

\*\* Companies acquired during the year ended December 31, 2010 (note 34).

# The English names of these companies represent the best efforts by management of the Company in directly translating the Chinese names of these companies as no English names have been registered.

All the above companies are with limited liability. They are indirectly held by the Company, except for Kingsoft Application Holdings, Kingsoft Entertainment Holdings, Kingsoft Internet Security Holdings, Kingsoft Malaysia and Kingsoft Japan, which are directly held by the Company.

Notes:

- (a) In March 2007, the two individual equity holders of Kingsoft Qijian ("Kingsoft Qijian's equity holders") entered into a loan agreement with Chengdu Interactive Entertainment, pursuant to which Chengdu Interactive Entertainment provided an interest-free loan of RMB1,200,000 and RMB300,000 respectively to Kingsoft Qijian's equity holders. The loans are secured by the respective equity interests in Kingsoft Qijian held by Kingsoft Qijian's equity holders. Chengdu Interactive Entertainment has been granted an exclusive irrevocable option to purchase part or all of the equity interests in Kingsoft Qijian held by Kingsoft Qijian's equity holders. Kingsoft Qijian's equity holders entrusts all of their respective shareholder rights in Kingsoft Qijian to Chengdu Interactive Entertainment. Kingsoft Qijian's equity holders give up the dividends in Kingsoft Qijian and Chengdu Interactive Entertainment is entitled to dividends if Kingsoft Qijian declares dividend. The Company has rights to obtain the majority of the benefits from Kingsoft Qijian's operations, and also exposes to risks incidental to the activities of Kingsoft Qijian. Accordingly, Kingsoft Qijian is accounted for as a subsidiary by virtue of the Company's control over it.

Kingsoft Qijian wholly owns Beijing Digital Entertainment. Accordingly, Beijing Digital Entertainment is accounted for as a subsidiary by virtue of the Company's control, through Kingsoft Qijian, over it.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 32. INVESTMENTS IN SUBSIDIARIES AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

- (b) As at December 31, 2010, Chengdu Digital Entertainment is 99% owned by Beijing Digital Entertainment. The non-controlling equity holder of Chengdu Digital Entertainment borrowed a loan from Chengdu Interactive Entertainment for its investment in Chengdu Digital Entertainment and the loan is secured by its equity interest in Chengdu Digital Entertainment. Chengdu Interactive Entertainment is granted an exclusive call option to buy at its sole discretion at any time part or all of the equity interest held by the non-controlling equity holder in Chengdu Digital Entertainment. During the pledge period, the non-controlling equity holder forfeits the right to dividends from Chengdu Digital Entertainment and Chengdu Interactive Entertainment is entitled to this portion of dividend from Chengdu Digital Entertainment. Chengdu Digital Entertainment (as the licensee) entered into a license agreement with Chengdu Interactive Entertainment (as the licensor) and the Company, via Chengdu Interactive Entertainment, has rights to obtain the majority of the benefits from Chengdu Digital Entertainment's operations, and also exposes to risks incidental to the activities of Chengdu Digital Entertainment. Accordingly, Chengdu Digital Entertainment is accounted for as a wholly-owned subsidiary by virtue of the Company's control over it.
- (c) In February and August 2010, the two individual equity holders of Zhuhai Qiwen ("Zhuhai Qiwen's equity holders") entered into loan agreements with Zhuhai Software, pursuant to which Zhuhai Software provided an interest-free loan of total RMB8,000,000 and RMB60,000,000 respectively to Zhuhai Qiwen's equity holders. The loans are secured by the respective equity interests held by Zhuhai Qiwen's equity holders. Zhuhai Software has been granted an exclusive irrevocable option to purchase part or all of the equity interests in Zhuhai Qiwen held by Zhuhai Qiwen's equity holders. Zhuhai Qiwen's equity holders entrusts all of their respective shareholder rights in Zhuhai Qiwen to Zhuhai Software. Zhuhai Qiwen's equity holders give up the dividends in Zhuhai Qiwen and Zhuhai Software is entitled to dividends if Zhuhai Qiwen declares dividend. The Company, via Zhuhai Software, has rights to obtain the majority of the benefits from Zhuhai Qiwen's operations, and also exposes to risks incidental to the activities of Zhuhai Qiwen. Accordingly, Zhuhai Qiwen and its wholly-owned subsidiary, Zhuhai Kingsoft Application, are accounted for as subsidiaries by virtue of the Company's control over it.
- (d) In August, 2010, the two individual equity holders of Conew Technology ("Conew Technology's equity holders") entrusted all of their respective shareholder rights in Conew Technology to Conew Network. Conew Network was granted an exclusive irrevocable option to purchase part or all of the equity interests in Conew Technology held by Conew Technology's equity holders. Conew Technology's equity holders give up the dividends in Conew Technology to Conew Network and Conew Network is entitled to dividends if Conew Technology declares dividend. The Company, via Conew Network, has rights to obtain the majority of the benefits from Conew Technology's operations, and also exposes to risks incidental to the activities of Conew Technology. Accordingly, Conew Technology is accounted for as a subsidiary by virtue of the Company's control over it.

## 33. RESERVES

### (a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity.

In accordance with the regulations in the PRC and the respective articles of association, the PRC subsidiaries of the Group are required to make an appropriation of retained earnings equal to at least 10% of their respective after-tax profits, calculated in accordance with the PRC accounting standards and regulations. Such appropriations are classified in the consolidated financial position as statutory reserves and start from the first period in which after-tax profits exceed all prior year accumulated losses. Appropriations to these reserves are not required after these reserves have reached 50% of the registered capital of the respective companies.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 33. RESERVES (continued)

### (a) Group (continued)

The statutory reserves can be utilised, upon approval of the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such reserve balance is maintained at minimum of 25% of the registered capital before its increase.

In addition, as determined by respective boards of directors, the PRC subsidiaries may allocate a portion of their after-tax profits to the discretionary reserves.

These statutory reserves are not transferable to the Company in the form of dividends, advances or loans. There are no legal requirements in the PRC to fund these reserves by transfer of cash to any restricted accounts, and the Group does not do so.

Changes in the Company's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances, the carrying amount of the controlling and non-controlling interests are adjusted to reflect changes in their relative interest in the subsidiary, the difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognised directly in equity and attributed to the owners of the parent, which is recorded in the "capital reserve" in the consolidated statement of financial position.

### (b) Company

|  | NOTE | SHARE<br>PREMIUM<br>ACCOUNT<br>RMB'000 | EMPLOYEE<br>SHARE-BASED<br>RESERVE<br>RMB'000 | FOREIGN<br>CURRENCY<br>TRANSLATION<br>RESERVE<br>RMB'000 | RETAINED<br>EARNINGS/<br>(ACCUMULATED<br>LOSSES)<br>RMB'000 | TOTAL<br>RMB'000 |
|--|------|--|---|--|---|------------------|
| <b>At January 1, 2009</b>  |      | 639,034                                | 194,023                                       | (70,705)   | (139,353)   | 622,999          |
| Total comprehensive income for the year                          |      | —                                      | —   | (663)  | (9,904)   | (10,567)         |
| Approved and paid final dividend in respect of the previous year |      | (1,068)                                | —   | —  | —   | (1,068)          |
| Exercise of share options  |      | 28,958                                 | —   | —  | —   | 28,958           |
| Share-based compensation costs                                   |      | —                                      | 41,060  | —  | —   | 41,060           |
| Vested awarded shares transferred to employees                   |      | —                                      | (10,735)                                      | —  | —   | (10,735)         |
| Proposed final 2009 dividend                                     | 11   | (141,575)                              | —   | —  | —   | (141,575)        |
| <b>At December 31, 2009 and January 1, 2010</b>                  |      | <b>525,349</b>                         | <b>224,348</b>                                | <b>(71,368)</b>  | <b>(149,257)</b>  | <b>529,072</b>   |
| Total comprehensive income for the year                          |      | —                                      | —   | (17,060)   | 428,682   | 411,622          |
| Approved and paid final dividend in respect of the previous year |      | (1,578)                                | —   | —  | —   | (1,578)          |
| Exercise of share options  |      | 80,470                                 | (38,333)                                      | —  | —   | 42,137           |
| Share-based compensation costs                                   |      | —                                      | 36,639  | —  | —   | 36,639           |
| Vested awarded shares transferred to employees                   |      | —                                      | (14,592)                                      | —  | —   | (14,592)         |
| Proposed final 2010 and special dividends                        | 11   | (196,000)                              | —   | —  | (180,000)   | (376,000)        |
| <b>At December 31, 2010</b>                                      |      | <b>408,241</b>                         | <b>208,062</b>                                | <b>(88,428)</b>  | <b>99,425</b>   | <b>627,300</b>   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 33. RESERVES (continued)

### (b) Company (continued)

The share option reserve comprises the fair value of share options granted which are yet to be exercised, as further explained in the accounting policy for share-based payment transactions in note 2.4 to the financial statements. The amount will be either transferred to the share premium account when the related options are exercised, or be transferred to retained profits should the related options expire or be forfeited.

## 34. BUSINESS COMBINATION

On October 1, 2010, the Group, through its wholly-owned subsidiary Kingsoft Internet Security Holdings, acquired a 100% equity interest of Conew, an unlisted company incorporated in the British Virgin Islands specialising in research and development of anti-virus and photo processing software. The acquisition of Conew can significantly enlarge the range of products in the application software segment and enhances the management team. The purchase consideration for the acquisition was 150,000,000 newly issued ordinary shares of Kingsoft Internet Security Holdings representing 18.75% of its enlarged capital.

The fair values of the identifiable assets and liabilities of Conew as at the date of acquisition were as follows:

|  | <b>FAIR VALUE<br/>RECOGNISED<br/>ON<br/>ACQUISITION<br/>RMB'000</b> |
|--|---|
| Property, plant and equipment  | 1,567   |
| Cash and cash equivalents  | 1,026   |
| Other receivables  | 1,781   |
| Software   | 6,812   |
| Other intangible assets  | 2,560   |
| Accrued expenses and other payables  | (113)   |
| Other current liabilities  | (3,000)   |
| Deferred tax liabilities   | (2,343)   |
| <b>Total identifiable net assets at fair value</b>   | <b>8,290</b>  |
| Goodwill on acquisition  | 11,710  |
| <b>Purchase consideration satisfied by 18.75% of the enlarged capital<br/>of Kingsoft Internet Security Holdings</b> | <b>20,000</b>   |

The fair values of the other receivables as at the date of acquisition amounted to RMB1,781,000. The gross contractual amounts of other receivables were RMB1,781,000.

The Group incurred transaction costs of RMB408,000 for this acquisition. These transaction costs have been expensed and are included in administrative expenses in the consolidated income statement.

The goodwill of RMB11,710,000 comprises the value of expected synergies and other benefits from combining the assets and activities of Conew with those of the Group, which is not separately recognised. Goodwill is allocated entirely to the application software segment. None of the recognised goodwill is expected to be deductible for income tax purposes.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 34. BUSINESS COMBINATION (continued)

An analysis of the cash flows in respect of the acquisition of a subsidiary is as follows:

|  | <b>RMB'000</b> |
|--|----------------|
| Cash consideration   | —              |
| Cash and bank balances acquired  | 1,026          |
| Net inflow of cash and cash equivalents included in cash flows from investing activities | 1,026          |
| Transaction costs of the acquisition included in cash flows from operating activities    | (408)          |
|  | <b>618</b>     |

Since the acquisition, Conew has not contributed any turnover to the Group but incurred a loss of RMB4,797,000 to the consolidated profit for the year ended December 31, 2010.

Had the combination taken place at the beginning of the year, the revenue of the Group and the profit of the Group for the year would have been RMB972,078,000 and RMB368,421,000, respectively.

## 35. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

### Supplemental cash flow information

|   | <b>2010<br/>RMB'000</b> | <b>2009<br/>RMB'000</b> |
|---|-------------------------|-------------------------|
| Cash received from interest                       | <b>35,549</b>           | 17,044                  |
| Cash paid for income tax for operating activities | <b>(47,294)</b>         | (41,146)                |

## 36. COMMITMENTS

### Operating lease commitments — Group as lessee

The Group has entered into commercial leases for office premises and electronic equipment. These non-cancellable leases have remaining terms of between one and five years. There are no restrictions placed upon the lessees by entering into these leases. Future minimum lease payments under these leases as at the end of the reporting period are as follows:

|   | <b>GROUP</b>            |                         | <b>COMPANY</b>          |                         |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>2010<br/>RMB'000</b> | <b>2009<br/>RMB'000</b> | <b>2010<br/>RMB'000</b> | <b>2009<br/>RMB'000</b> |
| Within one year                             | <b>27,693</b>           | 25,508                  | <b>82</b>               | 75                      |
| After one year but not more than five years | <b>1,552</b>            | 785                     | <b>88</b>               | 170                     |
|   | <b>29,245</b>           | 26,293                  | <b>170</b>              | 245                     |

As at December 31, 2010, the calculation of lease payment of some electronic equipment was based on the actual number of users of the relevant servers. The rental expense under these operating leases was RMB12,685,000 for the year ended December 31, 2010 (2009: RMB11,103,000). As future lease payments for these arrangements are based on the actual number of users and thus cannot be reasonably estimated, they are not included in the minimum lease payments shown above.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 36. COMMITMENTS (continued)

### Capital commitments

|                                   | NOTES | GROUP            |                 |
|-----------------------------------|-------|------------------|-----------------|
|                                   |       | 2010<br>RMB'000  | 2009<br>RMB'000 |
| Contracted, but not provided for: |       |                  |                 |
| Purchase of electronic equipment  |       | 214              | 3,168           |
| Acquisition of land and buildings | (a)   | 990,644          | 1,000,000       |
| Investment in Vietnam             | (b)   | 1,318            | 5,360           |
| Acquisition of intangible assets  |       | 11,394           | 4,317           |
|                                   |       | <b>1,003,570</b> | 1,012,845       |

|                                   | NOTE | COMPANY         |                 |
|-----------------------------------|------|-----------------|-----------------|
|                                   |      | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Contracted, but not provided for: |      |                 |                 |
| Investment in Vietnam             | (b)  | 1,318           | 1,360           |

(a) The capital commitment represented the commitment to purchase a land use right for a piece of land in Zhuhai, the PRC, and invest for the land development and constructions in the future. The Group will invest an aggregate of RMB1,000,000,000 in five years since 2009 in the land development and constructions in accordance with the relevant land acquisition agreement.

(b) The Company has entered into an agreement to contribute US\$199,000 (equivalent to RMB1,318,000) for a 19.9% equity interest in Kim Quang Software and Technology Joint Stock Company, a company engaged in software business in Vietnam. The transaction has not been completed as of December 31, 2010.

## 37. RELATED PARTY TRANSACTIONS

(a) In addition to the transactions detailed elsewhere in these financial statements, the Group had the following transactions with related parties during the year:

|  | NOTES | GROUP           |                 |
|--|-------|-----------------|-----------------|
|  |       | 2010<br>RMB'000 | 2009<br>RMB'000 |
| Loan to shareholders of a subsidiary                                     | (i)   | —               | 13,912          |
| Advertising fees paid to a company with a common director of the Company | (ii)  | 1,298           | 1,389           |

(i) The loan was subject to an interest rate of HIBOR + 1.5% per annum and was repaid in four years after the payment of the loan in June 2009. The loan was secured by certain equity interest of the subsidiary held by the aforementioned shareholders.

(ii) The directors of the Company consider that the advertising fees were paid according to the rates similar to those offered to the major customers of the supplier.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 37. RELATED PARTY TRANSACTIONS (continued)

- (b) Outstanding balance with related parties:

The Group had the following outstanding balance with related parties as at the end of the reporting period:

|  | <b>GROUP</b>   |                |
|--|----------------|----------------|
|  | <b>2010</b>    | <b>2009</b>    |
|  | <b>RMB'000</b> | <b>RMB'000</b> |
| Due from related parties:  |                |                |
| Loan to shareholders of a subsidiary included in prepayments, deposits and other receivables | <b>13,607</b>  | 13,912         |

- (c) Other transactions with related parties:

On December 18, 2008, the Company entered into an agreement with Sky Profit and its subsidiaries (collectively, the "Sky Profit Group"), its shareholders, and Shanghai Qinhe Internet Technology Software Development Co., Ltd. and Shanghai Qiao Heng Internet Technology Co., Ltd., the latter two are effectively controlled by the Sky Profit Group (collectively, the "Sky Profit Companies") through control contract arrangements. Pursuant to the aforesaid agreement, (1) the Company shall acquire, in two tranches of subscription, preferred shares of Sky Profit (representing in aggregate approximately 30.03% of the entire enlarged issued share capital of Sky Profit) at a total consideration of US\$8,000,000; and (2) the Company shall enter into a strategic business partnership arrangement with the Sky Profit Companies, for the purposes of mutual promotion and expansion. A substantial shareholder of Sky Profit is Jun Lei, a substantial shareholder and non-executive director of the Company. During the year ended December 31, 2009, the first tranche of above transaction was completed and the second tranche was cancelled due to non-fulfilment of the conditions.

- (d) Compensation of key management personnel of the Group

Other than the directors' remuneration disclosed in note 8, the compensation of other key management personnel of the Group are as follows:

|  | <b>GROUP</b>   |                |
|--|----------------|----------------|
|  | <b>2010</b>    | <b>2009</b>    |
|  | <b>RMB'000</b> | <b>RMB'000</b> |
| Salaries, allowances and benefits in kind                  | <b>9,248</b>   | 9,043          |
| Pension plan contributions                                 | <b>177</b>     | 156            |
| Share-based compensation costs                             | <b>5,797</b>   | 6,514          |
| <b>Total compensation paid to key management personnel</b> | <b>15,222</b>  | 15,713         |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 38. FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of each of the categories of financial instruments as at the end of the reporting period are as follows:

| FINANCIAL ASSETS  | GROUP                                       |   |   | 2009             |  |                  |
|---|---|---|---|------------------|--|------------------|
|   | 2010<br>LOANS AND<br>RECEIVABLES<br>RMB'000 | 2010<br>AVAILABLE-<br>FOR-SALE<br>INVESTMENT<br>RMB'000 | DESIGNATED<br>AS FINANCIAL<br>ASSETS AT<br>FAIR VALUE<br>THROUGH<br>PROFIT<br>OR LOSS<br>UPON INITIAL<br>RECOGNITION<br>RMB'000 | TOTAL<br>RMB'000 | LOANS<br>AND<br>RECEIVABLES<br>RMB'000 | TOTAL<br>RMB'000 |
| Other financial asset   | —   | —   | 13,785  | 13,785           | —                                      | —                |
| Available-for-sale investment   | —   | 18,675  | —   | 18,675           | —                                      | —                |
| Loan receivables  | 3,542                                       | —   | —   | 3,542            | 2,649                                  | 2,649            |
| Trade receivables   | 98,939                                      | —   | —   | 98,939           | 120,378                                | 120,378          |
| Financial assets included in prepayments,<br>deposits and other receivables | 48,266                                      | —   | —   | 48,266           | 36,508                                 | 36,508           |
| Cash and cash equivalents   | 1,656,157                                   | —   | —   | 1,656,157        | 1,268,098                              | 1,268,098        |
| <b>Total</b>  | <b>1,806,904</b>                            | <b>18,675</b>   | <b>13,785</b>   | <b>1,839,364</b> | <b>1,427,633</b>                       | <b>1,427,633</b> |

| FINANCIAL LIABILITIES   | GROUP  |  |
|---|--|--|
|   | 2010<br>FINANCIAL<br>LIABILITIES<br>AT<br>AMORTISED<br>COST<br>RMB'000 | 2009<br>FINANCIAL<br>LIABILITIES<br>AT<br>AMORTISED<br>COST<br>RMB'000 |
| Trade payables  | 15,571   | 12,597   |
| Financial liabilities included in accrued expenses and other payables | 109,448  | 136,204  |
| Interest-bearing bank loan  | 102,108  | —  |
| <b>Total</b>  | <b>227,127</b>   | <b>148,801</b>   |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 38. FINANCIAL INSTRUMENTS BY CATEGORY (continued)

The carrying amounts of each of the categories of financial instruments as at the end of the reporting period are as follows: (continued)

| <b>FINANCIAL ASSETS</b>   | <b>COMPANY</b>  |   |
|---|---|---|
|   | <b>2010<br/>LOANS<br/>AND<br/>RECEIVABLES<br/>RMB'000</b> | <b>2009<br/>LOANS<br/>AND<br/>RECEIVABLES<br/>RMB'000</b> |
| Financial assets included in prepayments,<br>deposits and other receivables | <b>13,607</b>   | 13,932  |
| Due from subsidiaries   | <b>791,402</b>  | 327,470   |
| Cash and cash equivalents   | <b>97,015</b>   | 85,554  |
| <b>Total</b>  | <b>902,024</b>  | 426,956   |

| <b>FINANCIAL LIABILITIES</b>  | <b>COMPANY</b>  |   |
|---|---|---|
|   | <b>2010<br/>FINANCIAL<br/>LIABILITIES<br/>AT<br/>AMORTISED<br/>COST<br/>RMB'000</b> | <b>2009<br/>FINANCIAL<br/>LIABILITIES<br/>AT<br/>AMORTISED<br/>COST<br/>RMB'000</b> |
| Financial liabilities included in accrued expenses and other payables | <b>1,075</b>  | 2,897   |
| Due to subsidiaries   | <b>84,309</b>   | 52,738  |
| Interest-bearing bank loan  | <b>102,108</b>  | —   |
| <b>Total</b>  | <b>187,492</b>  | 55,635  |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 39. FAIR VALUE AND FAIR VALUE HIERARCHY

The carrying amounts and fair values of the Group's and the Company's financial instruments are as follows:

### Group

|   | CARRYING AMOUNTS |                 | FAIR VALUES      |                 |
|---|------------------|-----------------|------------------|-----------------|
|   | 2010<br>RMB'000  | 2009<br>RMB'000 | 2010<br>RMB'000  | 2009<br>RMB'000 |
| <b>Financial assets</b>   |                  |                 |                  |                 |
| Cash and cash equivalents   | <b>1,656,157</b> | 1,268,098       | <b>1,656,157</b> | 1,268,098       |
| Loan receivables  | <b>3,542</b>     | 2,649           | <b>3,542</b>     | 2,649           |
| Trade receivables   | <b>98,939</b>    | 120,378         | <b>98,939</b>    | 120,378         |
| Financial assets included in prepayments,<br>deposits and other receivables | <b>48,266</b>    | 36,508          | <b>48,266</b>    | 36,508          |
| Available-for-sale investment   | <b>18,675</b>    | —               | <b>18,675</b>    | —               |
| Other financial asset   | <b>13,785</b>    | —               | <b>13,785</b>    | —               |
|   | <b>1,839,364</b> | 1,427,633       | <b>1,839,364</b> | 1,427,633       |
| <b>Financial liabilities</b>  |                  |                 |                  |                 |
| Trade payables  | <b>15,571</b>    | 12,597          | <b>15,571</b>    | 12,597          |
| Financial liabilities included in<br>other payables and accruals            | <b>109,448</b>   | 136,204         | <b>109,448</b>   | 136,204         |
| Interest-bearing bank loan  | <b>102,108</b>   | —               | <b>102,108</b>   | —               |
|   | <b>227,127</b>   | 148,801         | <b>227,127</b>   | 148,801         |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 39. FAIR VALUE AND FAIR VALUE HIERARCHY (continued)

### Company

|  | CARRYING AMOUNTS |                 | FAIR VALUES     |                 |
|--|------------------|-----------------|-----------------|-----------------|
|  | 2010<br>RMB'000  | 2009<br>RMB'000 | 2010<br>RMB'000 | 2009<br>RMB'000 |
| <b>Financial assets</b>  |                  |                 |                 |                 |
| Cash and cash equivalents  | 97,015           | 85,554          | 97,015          | 85,554          |
| Financial assets included in prepayments, deposits and other receivables | 13,607           | 13,932          | 13,607          | 13,932          |
| Due from subsidiaries  | 791,402          | 327,470         | 791,402         | 327,470         |
|  | <b>902,024</b>   | 426,956         | <b>902,024</b>  | 426,956         |
| <b>Financial liabilities</b>   |                  |                 |                 |                 |
| Due to subsidiaries  | 84,309           | 52,738          | 84,309          | 52,738          |
| Financial liabilities included in accrued expenses and other payables    | 1,075            | 2,897           | 1,075           | 2,897           |
| Interest-bearing bank loan   | 102,108          | —               | 102,108         | —               |
|  | <b>187,492</b>   | 55,635          | <b>187,492</b>  | 55,635          |

The fair values of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

The fair values of cash and cash equivalents, trade receivables, trade payables, financial assets included in prepayments, deposits and other receivables, financial liabilities included in accrued expenses and other payables and amounts due from/to subsidiaries, approximate to their carrying amounts largely due to the short-term maturities of these instruments.

The fair value of loan receivables, interest-bearing bank loan have been calculated by discounting the expected future cash flows using rates currently available for instruments on similar terms, credit risk and remaining maturities.

The fair value of unlisted available-for-sale investment has been estimated by reference to the proceeds to be received from the second transfer pursuant to the agreement with details included in note 17.

The fair value of other financial asset has been estimated using the BS Model. The valuation technique is based on assumptions that are not supported by observable market prices or rates. The valuation requires the directors to make estimates about life of option, expected volatility, underlying equity value and discount rates. The directors believe that the estimated fair values resulting from the valuation technique, which are recorded in the consolidated statement of financial position, and the related changes in fair values, which are recorded in consolidated income statement, are reasonable, and that they were the most appropriate values at the end of the reporting period.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 39. FAIR VALUE AND FAIR VALUE HIERARCHY (continued)

### Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair values of financial instruments:

Level 1: fair values measured based on quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: fair values measured based on valuation techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: fair values measured based on valuation techniques for which any inputs which have a significant effect on the recorded fair value are not based on observable market data (unobservable inputs)

### Assets measured at fair value:

Group

As at December 31, 2010

|   | <b>LEVEL 1</b> | <b>LEVEL 2</b> | <b>LEVEL 3</b> | <b>TOTAL</b>   |
|---|----------------|----------------|----------------|----------------|
|   | <b>RMB'000</b> | <b>RMB'000</b> | <b>RMB'000</b> | <b>RMB'000</b> |
| Available-for-sale investment                                 | —              | 18,675         | —              | 18,675         |
| Other financial asset at fair value through<br>profit or loss | —              | —              | 13,785         | 13,785         |
|   | —              | 18,675         | 13,785         | 32,460         |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 40. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

### (a) Financial risk management objectives and policies

The Group operates in the PRC and other Asian countries, which generates revenue and incurs expenses in US\$, JPY, HK\$, MYR and RMB. The Group's operations are exposed to liquidity risk, foreign currency risk, interest rate risk and credit risk. The Group's overall risk management approach is to moderate the effects of such volatility on its financial performance. Financial risk management policies are periodically reviewed and approved by the board of directors.

As part of overall corporate governance, the Group has set up an internal control department to oversee the management of financial risks exposure of all group entities. The internal control department establishes internal policies to define authority levels, oversight responsibilities, risk identification and measurement protocols and policy structures to manage risks that arise from the use of financial instruments. On a day-to-day basis, the chief executive officer and chief financial officer have the primary responsibility for measuring and managing specific risk exposures while the board of directors exercises independent risk oversight on the group as a whole. The chief executive officer and chief financial officer report to the board of directors directly.

Management reviews and agrees policies for managing each of these risks and they are summarised below.

### (b) Liquidity risk

The principal approach the Group uses to manage liquidity risk arising from financial liabilities is to maintain an adequate level of cash and cash equivalents with different banks.

The Group recorded net cash flows from operating activities of approximately RMB407,416,000 and RMB446,874,000 for the years ended December 31, 2010 and 2009, respectively. For the same period, the Group had net cash flows generated from investing activities of approximately RMB374,225,000 and used in investing activities of approximately RMB503,721,000, respectively. The Group also recorded net cash flows generated from financing activities of approximately RMB464,000 and used in financing activities of approximately RMB153,411,000 for the years ended December 31, 2010 and 2009, respectively.

The Group recorded increases in cash and cash equivalents of approximately RMB782,105,000 and decrease of approximately RMB210,258,000 for the years ended December 31, 2010 and 2009, respectively.

The contractual maturity of financial liabilities including trade payables has been disclosed in note 27. For trade payables, they are generally on credit terms of two to three months after the invoice date. For accrued expenses and other payables, there are generally no specified contractual maturity for these liabilities, and they are paid on a regular basis or upon counterparty's formal notification.

With regard to 2010 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain a balance between a continuity of funding and flexibility through the settlements from clients and the subsequent payments to vendors.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 40. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (c) Foreign currency risk

Certain expenses of the Group are denominated in currencies other than the RMB. The Group generates foreign currency revenue from license sales made in other Asian countries. The exchange rates of RMB against US\$, HK\$, JPY and MYR have been comparatively stable in the past.

A majority of the Group's businesses are transacted in RMB, which is not freely convertible into foreign currencies. On January 1, 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted daily by the People's Bank of China. However, the unification of the exchange rates does not imply the free convertibility of RMB into US\$ or other foreign currencies. All foreign exchange transactions continue to take place either through the People's Bank of China or other banks authorised to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

Commencing on July 21, 2005, PRC reformed its exchange rate regime by changing to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Under the managed floating exchange rate regime, the RMB is no longer pegged to the US\$.

The following table demonstrates the sensitivity at the end of the reporting period to a reasonably possible change in the RMB exchange rate, with all other variables held constant.

|                                    | <b>INCREASE/<br/>(DECREASE)<br/>IN PROFIT<br/>BEFORE TAX<br/>RMB'000</b> |
|------------------------------------|--|
| <b>2010</b>                        |  |
| If RMB strengthens 5% against HK\$ | <b>(35)</b>  |
| If RMB weakens 5% against HK\$     | <b>35</b>  |
| If RMB strengthens 5% against US\$ | <b>(326)</b>   |
| If RMB weakens 5% against US\$     | <b>326</b>   |
| <b>2009</b>                        |  |
| If RMB strengthens 5% against HK\$ | (77)   |
| If RMB weakens 5% against HK\$     | 77   |
| If RMB strengthens 5% against US\$ | (269)  |
| If RMB weakens 5% against US\$     | 269  |

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 40. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (d) Interest rate risk

The Group has interest-bearing assets including loan to shareholders of a subsidiary, loan receivables, term deposits with initial terms of over three months and cash and cash equivalents, details of which have been disclosed in note 37, 21 and 26.

The Group has a bank loan denominated in HK\$ having a floating interest rate of HIBOR plus 1.1% per annum (note 28). Simultaneously with the loan, the Group has an equivalent RMB deposit, the interest rate of which is higher than the interest rate of the bank loan. Therefore, despite of the finance costs incurred, it would benefit from the related interest income from the RMB deposit.

### (e) Credit risk

The Group places its cash deposits with banks in the PRC. This investment policy limits the Group's exposure to concentration of credit risk. The Group performs ongoing credit evaluations of its customers' financial conditions. With respect to credit risk arising from other financial assets of the Group, comprising loan receivables, trade receivables, and other receivables, the Group's exposure to credit risk arises from default of the counterparties, with a maximum exposure equal to the carrying amounts of these instruments. Concentration of credit risk with respect to trade receivables is limited due to the large number of entities comprising the Group's customer base. The Group generally does not require collateral for trade receivables.

The Group determines concentration of credit risk by monitoring the business and location of its counterparties. At the end of the reporting period, the Group had certain concentrations of credit risk as 36% (2009: 24%) of the Group's trade receivables were due from the Group's largest distributor.

For trade receivables that were past due but not impaired, 92% and 84% of them were aged within one year as at December 31, 2010 and 2009, respectively. The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

### (f) Fair values

Financial assets of the Group mainly include cash and cash equivalents, trade receivables, other receivables and loan receivables. Financial liabilities of the Group mainly include trade payables, accrued expenses and other payables.

The carrying amounts of the Group's financial instruments approximate to their fair values as at the end of the reporting period. Fair value estimates are made at a specific point in time and are based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## 40. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (g) Capital management

The primary objective of the Group's capital management is to ensure that it maintains a healthy capital ratio in order to support its business. The Group monitors capital using the net cash over debt position, which is cash and cash equivalents less trade payables, accrued expenses, other payables and interest-bearing bank loan.

|                                     | <b>GROUP</b>     |                |
|-------------------------------------|------------------|----------------|
|                                     | <b>2010</b>      | <b>2009</b>    |
|                                     | <b>RMB'000</b>   | <b>RMB'000</b> |
| Cash and cash equivalents           | <b>1,656,157</b> | 1,268,098      |
| Trade payables                      | <b>(15,571)</b>  | (12,597)       |
| Accrued expenses and other payables | <b>(163,203)</b> | (186,896)      |
| Interest-bearing bank loan          | <b>(102,108)</b> | —              |
| Net cash over debt position         | <b>1,375,275</b> | 1,068,605      |

## 41. CONTINGENT LIABILITIES

At the end of the reporting period, neither the Group nor the Company had any significant contingent liabilities.

## 42. EVENTS AFTER THE REPORTING PERIOD

- (a) On January 4, 2011, the Group's wholly owned subsidiary, Shell Internet, entered into an agreement (the "Acquisition Agreement") with 7 parties ("Selling Parties") who owned the DriverGenius software which can be downloaded from its official website drivergenius.com and also owned a few websites including mydrivers.com, drivers.com.cn, myfiles.com.cn and 9724.com ("Target Business"), pursuant to which the Group will pay the Selling Parties a maximum total cash consideration of RMB18 million, of which RMB6 million will be conditional upon the achievements by the Target Business of certain operation results within the first 12 months and the second 12 months after the closing of the Acquisition. In return, the Selling Parties will transfer all of the fixed assets, intellectual properties, material contracts and key employees engaged in the Target Business to the Group.

As the valuation of the fair values of the identifiable assets and liabilities of the Target Business is still in process, no purchase price allocation is made and initial accounting for the acquisition is not completed.

- (b) On January 24, 2011, Westhouse Holdings, a wholly-owned subsidiary of Kingsoft Entertainment Holdings, entered into a share purchase agreement with some founding employees and a company owned by the founding employees (the "Founder Co."), whereby the Founder Co. will subscribe for 160 million shares of Westhouse Holdings at a subscription price of HK\$1.1834 per share for an aggregate consideration of approximately HK\$189 million. Concurrently, Kingsoft Entertainment Holdings entered into a loan agreement with the Founder Co., pursuant to which Kingsoft Entertainment Holdings will provide a loan amounting to HK\$151 million to the Founder Co. for the purpose of the share subscription, which bears interest of HIBOR plus 1.3% for the first year and at Hong Kong bank offered loan rate subsequently, and secured by 128 million shares of Westhouse Holdings.
- (c) On March 8, 2011, Kingsoft Internet Security Holdings entered into a share sales agreement with a non-controlling shareholder of Kingsoft Internet Security Holdings, pursuant to which, Kingsoft Internet Security Holdings will issue 100,000,000 new shares for an aggregate consideration of US\$2,499,000, and Kingsoft Internet Security Holdings has also been granted an option to repurchase these shares from the non-controlling shareholder if certain conditions have been fulfilled.
- (d) On February 21, 2011, the Group entered into a land acquisition agreement, pursuant to which the Group will purchase a land use right for a piece of land in Chengdu, the PRC, for a consideration of RMB75,004,000, and also will invest an aggregate of RMB800,000,000 for the land development and related constructions.

# NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2010

## **43. COMPARATIVE AMOUNTS**

As further explained in note 2.2 to the financial statements, due to the adoption of new and revised IFRSs during the current year, the accounting treatment and presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified and restated to conform with the current year's presentation and accounting treatment.

## **44. APPROVAL OF THE FINANCIAL STATEMENTS**

The financial statements were approved and authorised for issue by the board of directors on March 23, 2011.