Kingsoft Corporation Limited
2007 Annual Report

KINGSOFT®

(Continued into the Cayman Islands with limited liability)
Stock Code: 03888

Beijing Zhuhai Chengdu Dalian Japan

Kingsoft Corporation Limited

Annual Report 2007 | KINGSOFT CORPORATION LIMITED

Contents

MISSION

Leveraging the internet and our comprehensive software development platform, Kingsoft is committed to offering top quality and innovative entertainment and applications software to internet users in China.

Building on our experience and success, Kingsoft aims to expanding into overseas markets and becoming a world-class software developer, operator and distributor.

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

21st Floor, Baiyan Building
238 Beisihuan Zhong Road
Haidian District
Beijing
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
Cayman Islands

Executive Directors

Mr. Pak Kwan Kau
Mr. Jun Lei

Non-executive Directors

Mr. Choon Choong Tay
Mr. Wing Chung Anders Cheung
Mr. Wai Ming Wong
Mr. Tuck Lye Koh

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. Wai Ming Wong

Remuneration Committee

Mr. Tuck Lye Koh (Chairman)
Mr. Shun Tak Wong
Mr. Mingming Huang

Nomination Committee

Mr. Guangming George Lu (Chairman)
Mr. Wing Chung Anders Cheung
Mr. Mingming Huang

Strategy Committee

Mr. Jun Lei (Chairman)
Mr. Pak Kwan Kau
Mr. Guangming George Lu

Company Secretary and Qualified Accountant

Ms. Michelle Feng Harnett (ACCA)

CORPORATE INFORMATION (continued)

Compliance Adviser

Evolution Watterson Securities Limited

5th Floor, 8 Queen's Road, Central

Hong Kong

Authorised Representatives

Pak Kwan Kau

Michelle Feng Harnett

Principal Share Registrar and Transfer Office

Appleby Trust (Cayman) Ltd.

Clifton House

75 Fort Street

P.O. Box 1350 GT

George Town

Grand Cayman

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

Standard Chartered Bank (Hong Kong) Limited

Bank of Beijing

China Merchants Bank Beijing

Bank of Communications

Investor and Media Relations

Tel: (86) 10 82325515

Fax: (86) 10 82335757

Email: ir@kingsoft.com

Website: www.kingsoft.com

FINANCIAL HIGHLIGHTS

Consolidated Income Statement

	YEAR ENDED DECEMBER 31,			
	2004 **RMB'000**	**2005** **RMB'000**	**2006** **RMB'000**	**2007** **RMB'000**
Revenue:				
Entertainment software	58,298	133,903	215,356	**396,440**
Application software	52,974	80,322	98,432	**156,521**
Others	735	976	2,643	**3,653**
	112,007	215,201	316,431	**556,614**
Cost of revenue	(15,394)	(33,271)	(44,671)	**(95,484)**
Gross profit	96,613	181,930	271,760	**461,130**
Research and development costs, net of government grants	(19,772)	(42,367)	(58,914)	**(68,450)**
Selling and distribution costs	(40,892)	(67,017)	(59,504)	**(108,723)**
Administrative expenses	(21,998)	(28,879)	(43,766)	**(65,785)**
Share-based compensation costs	(7,216)	(15,576)	(6,852)	**(103,764)**
Other operating costs	(1,826)	(2,115)	(13,296)	**(2,249)**
Impairment of an available-for-sale investment/ an associate	—	(1,000)	(6,000)	**—**
Other income and gains	17	3,715	28,316	**11,531**
Financial income	698	1,312	3,753	**22,775**
Financial costs	(264)	(494)	(6,271)	**(1,211)**
Share of loss of an associate	—	—	(527)	**(2,460)**
Profit before tax	5,360	29,509	108,699	**142,794**
Income tax benefit/(expenses)	(1,578)	4,923	(9,589)	**12,658**
Profit for the year	3,782	34,432	99,110	**155,452**
Attributable to:				
Equity holders of the Company	3,782	35,667	99,525	**164,678**
Minority interests	—	(1,235)	(415)	**(9,226)**
	3,782	34,432	99,110	**155,452**
Proposed final dividend	—	—	—	**95,710**
	RMB	**RMB**	**RMB**	**RMB**
Earnings per share attributable to ordinary equity holders of the Company				
Basic	0.0053	0.0486	0.1245	**0.1815**
Diluted	0.0049	0.0446	0.1185	**0.1725**

FINANCIAL HIGHLIGHTS (continued)

Consolidated Balance Sheets (Selected Items)

	AS AT DECEMBER 31,			
	2004	**2005**	**2006**	**2007**
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**
Cash and cash equivalents	102,414	137,568	333,508	**1,246,077**
Total Assets	172,672	270,933	520,709	**1,499,921**
Total Equity	(16,853)	41,753	267,827	**1,133,657**

Consolidated Cash Flow Statements (Selected Items)

	YEAR ENDED DECEMBER 31,			
	2004	**2005**	**2006**	**2007**
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**
Net cash generated from operating activities	46,606	58,362	139,701	**345,474**
Net cash used in investing activities	(17,550)	(29,561)	(49,265)	**(395,659)**
Net cash generated from financing activities	2,467	6,353	91,464	**647,412**
Net increase in cash and cash equivalents	31,523	35,154	181,900	**597,227**

MILESTONES OF THE GROUP IN 2007

January:

— Commercially launched WPS Office (Word Processing System), in Japan

— Introduced item-billing revenue model to The First Myth

February:

— Introduced item-billing revenue model to JX Online II

March:

— Completed private placement of shares in Kingsoft Japan (Kingsoft Japan Inc., a company incorporated in Japan on March 9, 2005 which is owned as to 51% by the Company, as to 16.6% by EP Dream Technology Limited, as to 16.6% by Siger Network Co., Limited, as to 11.1% by Ichiro Hirosawa and as to 4.7% by JAFCO (held by its three nominee companies)) to JAFCO Co. Ltd., a Japanese private equity company, for a consideration of JPY119.0 million (approximately RMB7.1 million)

— Commercially launched The First Myth in Vietnam

April:

— Kingsoft launched the "Copyright in China" marketing campaign to promote Kingsoft WPS Office software. Ten thousands of customers signed up and committed to using copyrighted software

— Restructured Kingsoft's operations into two divisions: entertainment software and applications software

May:

— Kingsoft teamed up with Quang Minh Dec Communication and Technology Joint Stock Company to distribute and market Kingsoft WPS Office (English and Vietnamese versions) and Kingsoft Internet Security (English version) in Vietnam. This is the first English-language software launched by Kingsoft

June:

— Changed company name to "Kingsoft Corporation Limited"

July:

— Kingsoft established its own laboratory. The cutting-edge technology from the laboratory will provide strong technical support for the R&D teams

August:

— Kingsoft Internet Security obtained the "VB100 (Virus Bulletin) Certification"

— Kingsoft commercially launched its first multi-language WPS Office 2007, which supports Chinese, Japanese and English. WPS concurrent individual online users exceeded one million

September:

— CQ, the self-developed light-hearted MMORPG (Massive Multiplayer Online Role Playing Game) started open beta testing

October:

— Kingsoft was successfully listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), raising net proceeds of approximately HK$649.1 million

Awards:

— Kingsoft Chairman Pak Kwan Kau and vice Chairman. Jun Lei were named The Most Influential Person in the Chinese Game Industry in the Fourth (Year 2007) China Game Industry Annual Conference

— Kingsoft was named one of the Top Ten Game Developers and one of the Top Ten Game Operators in China, and the Best Chinese Games Producers in Overseas Marketing Development in the Fourth (Year 2007) China Game Industry Annual Conference

CHAIRMAN'S STATEMENT

In the year of 2007, Kingsoft Corporation Limited (the "Company", or "Kingsoft") and its subsidiaries (hereinafter collectively referred to as the "Group") have made significant progress in strengthening Kingsoft's position as a leading developer, distributor and service provider of online games and applications software in China, based on market share. We have also demonstrated that we are a leader in creativity, sustainability and investment value. During this year, the management of the Company has demonstrated their dedication and expertise in each of their respective positions. The Board of Directors have also been fully involved in the business by formulating strategies, setting up goals, implementing incentive stock option plans to attract talents, and restructuring the business.

Total revenue for the year ended December 31, 2007 increased by 76% to RMB556.6 million, compared with last year. The Group's total audited profit attributable to equity holders for the year ended December 31, 2007 was RMB164.7 million, an increase of 65% compared with last year. Basic and diluted earnings per share for the year ended December 31, 2007 were RMB0.1815 and RMB0.1725 respectively.

We started Kingsoft by developing and selling applications software, and since 1989 when we commercially launched our first office application software WPS 1.0, the Company had overcome various market challenges in the past 18 years. Today applications software still generates a significant part of our revenue. Revenues from our applications software, with a focus on internet security products, increased by 59% to RMB156.5 million, for the year ended December 31, 2007 compared with last year. In 2006, Kingsoft Internet Security received the "China Famous Brand" award from the Bureau of General Administration of Quality Supervision, Inspection and Quarantine and the "Best Product of the Year in China" award by PC Magazine.

In response to changes in the market and customers' demand, we have leveraged our strong expertise in applications software to transform ourselves into a successful online game developer in recent years. We used to sell applications software to our customers at retail outlets but now, a larger amount of our revenue is generated from renewable subscriptions and recurring online purchases, which is a new form of service less vulnerable to privacy. For online games, we are moving from two dimensional ("2D") and two point 5 dimensional ("2.5D") to three dimensional ("3D") while the revenue model shifts from pay-to-play to free-to-play and item-billing. Today, Kingsoft is pioneering what we believe to be the future business platform on the Internet, from product to service and from retail to online subscription. According to China Internet Network Information Center ("CNNIC"), China's Internet population grew by 53.3% or 73 million in 2007 to reach 210 million in December 2007. The number of broadband Internet users increased at a higher rate of 57.1% to reach 163 million. Internet penetration rate in China was only 16%, which is much lower than many other countries, and 3.1 percentage point lower than the global average standard of 19.1%, indicating strong potential for future growth *(Source: CNNIC, 2008)*. Industry data shows that our online subscribers are increasing at an impressive rate and that we have a higher percentage of revenue generated by online subscribers than many of our competitors.

Development, operation and distribution of online games is our core business, which contributed over two-thirds of our revenue in 2007. Revenues from our entertainment software increased by 84% to RMB396.4 million, for the year ended December 31, 2007 compared with last year. For the three months ended December 31, 2007, our MMORPGs had an aggregate of 0.6 million daily average peak concurrent users, and approximately 1.0 million monthly average paid users with a monthly average revenue per paid user of RMB37. Our first online game JX Online was launched in 2003 and currently we have in our portfolio four very successful self-developed games and two licensed games. Meanwhile, domestically-developed games are becoming more appealing to local users due to cultural stickiness. The market share of domestic games has surpassed imported games. With gaming developing technique maturing, we believe home-developed games will dominate the China market. Thanks to our strong research and development team built over the past years, we have established ourselves as a significant player in the gaming industry and are poised to capture more growth opportunities. We received the "Top Ten Game Developers", "Top Ten Game Operators", and many other awards at the Fourth (Year 2007) China Game Industry Annual Conference held in January 2008.

We realized the importance of a strong research and development team who knows the market and knows how to make use of the market knowledge in game planning, development, operation and promotion. We are an early investor and believer in online game talents and technology. Today, we have one of the largest and strongest R&D teams in China's software industry. As at December 31, 2007, we have approximately 953 research and development staffs. We have restructured the R&D resources for entertainment software and applications software in 2007 to optimize our R&D capability. There are four major research and development centers including various game and software research studios located in Zhuhai, Chengdu, Beijing and Dalian with their individually focused specialty. The strategic investments enable shorter game development cycle and faster response to market trends and we are set to launch as many as three major online games in 2008.

Amongst Kingsoft's applications software, during the reporting period, Kingsoft Internet Security software increased the number of users greatly at a rate of over one million each quarter. Its total number of online daily average paying users increased to 7.6 million for the three month period ended December 31, 2007. In August 2007, Kingsoft Internet Security obtained the "VB100 Certification". With a relatively low penetration and less intense competition than other segments, we see great potential in the Internet security market. We will continue to enhance our service to capture the exponential growth in online subscribers and extend the subscription period of existing users. We will continue to leverage the Internet to market, sell and distribute our Internet security products. We will continue to introduce and improve our comprehensive customer-care programs and keep a focus on delivery of best-in-class online software service experience. We will increase our investment in the market of Internet security services to small and medium enterprises in 2008.

Within the applications software business segment, we will allocate more resources in developing and operating our Internet security software. On March 27, 2008, we announced our strategic partnership with Baidu, the largest Chinese language Internet search provider, to launch a free Internet security service that will benefit as many as 200 million users in China. This strategic partnership highlights our commitment to creating a more secure web surfing experience for Chinese users.

In 2007, the population of China online gamers reached 120 million with a weekly playing time of 7.3 hours per head *(Source: CNNIC, 2008)*. In China, online gaming subscription revenue grew 67% over 2006 and the market size of online game subscription reached RMB12.8 billion in 2007 *(Source: iResearch, 2007–2008)*. The online gaming market size in China is expected to grow at over 20% annually to RMB40.0 billion in 2011 *(Source: iResearch, 2007–2008)*. With continuously strengthened R&D capability, we will be able to shorten our game development cycle and improve our game quality to better meet players' demand. In 2008, we will have three major online games in the pipeline. JX Online World, which is a special installment of the original JX Online series, and The First Myth II, which is the second installment of the original First Myth series, are expected to be launched in the first half of 2008. MAT — our first 3D FPS game will be launched in the second half of 2008.

The development of JX Online III, the third installment of the original JX Online series featuring full 3D graphics and powered by our proprietary JX3 engine, has been a focus of Kingsoft and expected to be in open beta in the second half of 2008. Building on the success of JX Online I and II series, JX Online III has been constantly ranked one of the most-anticipated online games by a number of online communities in recent years.

We will continue to leverage our successes in overseas markets and expand our businesses in other selected markets in Asia where our products and services are competitive and appealing to users in those markets, and where we can identify and work with suitable local partners who can facilitate our entry into these markets. We have also established a division specializing in overseas market development. We will continue to strengthen our R&D capabilities and product value to stay ahead of the competition. We are in the process of studying a number of projects for possible acquisition and joint venture with local enterprises which would create synergy with our existing businesses.

In 2007, Kingsoft completed its initial public offering ("IPO") and became a listed company in the Hong Kong Stock Exchange. This listing is a major milestone for the Company. By tapping the international capital market, we are looking to increase operational efficiency and investment returns for our shareholders. Creativity and sustainability will continue to be the hallmarks of Kingsoft and our corporate strategies will remain consistent. To highlight all these achievements, I'm very pleased to present the first annual report of Kingsoft. 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 our Group.

Pak Kwan Kau

Chairman

PRC, March 31, 2008

MANAGEMENT DISCUSSION AND ANALYSIS

Operational Highlights

	FOR THE THREE MONTHS ENDED							
	MARCH 31, 2006	JUNE 30, 2006	SEPTEMBER 30, 2006	DECEMBER 31, 2006	MARCH 31, 2007	JUNE 30, 2007	SEPTEMBER 30, 2007	DECEMBER 31, 2007
ONLINE GAMES								
Daily Average Peak Concurrent Users	324,529	397,547	458,398	553,897	**508,188**	**491,757**	**529,794**	**605,569**
Monthly Average Paid users	1,056,028	1,114,497	1,086,633	1,172,219	**1,196,656**	**1,136,197**	**1,035,371**	**1,001,381**
Monthly Average Revenue per Paid Users (RMB)	19	14	13	18	**22**	**28**	**31**	**37**
ONLINE SERVICES OF INTERNET SECURITIES								
Average Paid Users Daily	628,761	1,141,613	1,914,048	2,922,546	**3,965,540**	**5,324,747**	**6,505,150**	**7,555,280**
Monthly Average Revenue per Paid Users (RMB)	2.7	2.1	1.9	1.8	**1.5**	**1.5**	**1.4**	**1.5**

Kingsoft is pleased to present the first set of annual results following its listing on the Hong Kong Stock Exchange on October 9, 2007. Rapid growth in the Company's entertainment and applications software businesses continued amid China's booming internet traffic and the people's increasing needs for online entertainment and online application software services. The Company continues to expand its research and development infrastructure and franchises of Kingsoft brand names, further strengthening its position as a leading software developer, distributor and service provider in China.

2007 was a very successful year for Kingsoft. Our revenue increased by 76% year-over-year to RMB556.6 million. Approximately 71% was generated from the entertainment software business segment and 28% was generated from the applications software business segment. The Company's net profit attributable to common shareholders increased by 65% year-over-year to RMB164.7 million for the year ended December 31, 2007, which outperformed the 2007 profit forecast in the Prospectus by 61%. In addition, profit attributable to equity holders of the Company excluding the effect of share-based compensation cost increased by 152% to RMB268.0 million for the year ended December 31, 2007, which outperformed the 2007 profit forecast in the Prospectus by 27%. The outperformance primarily resulted from that our total revenue was 8% greater than the forecast and an unexpected rise in income tax credit of RMB15.1 million as illustrated in the section "Income Tax Credit/Expense".

In October 2007, Kingsoft completed its IPO and raised aggregate net proceeds of HK$649.1 million, which greatly enhanced the Company's financial position.

Industry Review

— **Online Game**

Asia is the largest online game market in the world. The China online game market, in particular, has significant potential for growth due to its large, relatively young and increasingly affluent population and the lack of other competing forms of entertainment in China. In 2007, the population of China internet users increased 53% year over year to 210 million and that of the China online gamers reached 120 million with a weekly playing time of 7.3 hours per head *(Source: CNNIC, 2008)*. Online gaming subscription revenue grew 67% over 2006 and the market size of online game subscription reached RMB12.8 billion in 2007 *(Source: iResearch, 2007–2008)*. The market size is expected to grow at over 20% annually to RMB40.0 billion in 2011 *(Source: iResearch, 2007–2008)*.

Online game is a very engaging form of entertainment and enjoys high user loyalty. With increasing Internet, broadband and personal computer penetration and the growing prominence of the Internet as an entertainment source, the market potential for online game is enormous.

Another notable trend in the online game industry is the growing influence of domestic game developers. The early development of the online games industry in China was accomplished through the introduction of existing massively multi-player online role-playing games (MMORPGs) licensed from overseas game developers. In recent years, the number of domestically developed online games has increased rapidly and these games currently constitute a significant portion of the online game market in China. As domestic online game developers enhance their skills, the number and popularity of domestically developed online games are expected to continue to increase.

With technology and customer taste evolving, the online game industry has developed in complexity of revenue models, storylines, enhanced graphics and virtual community building.

— **Applications Software**

There are numerous growth drivers for China's security software market. The number of Internet users in China is increasing and the proliferation of viruses, particularly Trojan software, spyware and hacking had made Internet users more aware of the importance of network security. Online game players, users of e-mail or online messaging services, internet users downloading music and movie files are increasingly demanding for better accounts security services than ever before in China. Internet security services tailored to local internet users is the key success factor in this business. Internet security software is among the mostly downloaded contents by the internet users in China after music, movies, research materials and games; over 77% of the internet users are habitual to updating virus files on a regular basis *(Source: CNNIC, 2008)*.

Business Review

Entertainment Software

Kingsoft develops, operates and distributes entertainment software including MMORPGs and casual games. MMORPGs are a genre of online computer games in which large numbers of users assume the roles of characters and interact simultaneously in a virtual game community which continuously evolves while casual online games are typically session-based and can be played to a conclusion within a short period of time.

— **MMORPGs**

From the launch of our first game in December 2003 to the end of 2007, Kingsoft has six self-developed and licensed games in its portfolio, namely JX Online, The First Myth, JX Online II, Xian Lu Qi Yuan II, Shui Hu Q Zhuan and CQ. JX Online is our first self-developed MMORPG. Launched in 2003, the game is the original installment of the JX Online series, which helped Kingsoft make its mark in the online game industry in China. Kingsoft developed JX Online II and launched it in 2005, which fast became popular among the game players. The First Myth is the original installment of The First Myth series. It was developed in-house and launched in 2005. CQ, a cartoon-style in-house developed game based on war stories of the ancient Chun Qiu era, was commercialised in October 2007. The two licensed games, Xian Lu Qi Yuan II and Shui Hu Q Zhuan were launched in 2006.

Our research and development team focuses on developing online games featuring cultural themes which appeal to the PRC market. For the three months ended December 31, 2007, our MMORPGs had an aggregate of 0.6 million daily average peak concurrent users, and approximately 1.0 million monthly average paid users with a monthly average revenue per paid user of RMB37.

During the reporting period, we adopted a two-pronged revenue model, i.e. pay-to-play and item based, to allow players more options and flexibility. As MMORPGs are a highly engaging and individualised form of entertainment, more and more users are choosing to play item-billing revenue model games. On the other hand, the item-billing revenue model is able to increase core user retention and extend product life cycle, and it helps fuel our strong revenue growth.

Furthermore, we have expanded our markets by introducing our games overseas. In addition to JX Online, we have launched The First Myth and JX Online II in Vietnam in March 2007 and March 2008 respectively. Games licensing revenue outside of China represented 17% of our total entertainment software revenue for 2007.

— **Casual Games**

Kingsoft Dalian Studio is currently developing a 3D graphics first-person shooter game MAT. It was launched in Thailand through our operator in January 2008, and is scheduled to be launched in the second half of 2008 in China. We believe casual games will complement our current product portfolio and may provide us with certain benefits and opportunities not typically available through MMORPGs.

Applications Software

Our applications software portfolio includes Kingsoft Internet Security, Kingsoft PowerWord and WPS Office, which are well recognised by the market.

— **Internet Security Software**

Our principal Internet security software product is Kingsoft Internet Security, which is one of the leading domestically produced Internet security software products in China. Kingsoft Internet Security offers secure content management functions, such as anti-virus, anti-Trojan, anti-spy and anti-spam, incorporated into a single and easy-to-use platform. It is used to defend against, scan and remove over 530,000 security threats such as viruses; remove spyware and Trojans from computer memory to secure user systems and block phishing websites and emails to prevent identity thefts.

During the year, Kingsoft Internet Security software increased the number of users greatly at a rate of over one million each quarter. Its total number of online daily average paying users increased to 7.6 million for the three month period ended December 31, 2007.

In August 2007, Kingsoft Internet Security obtained the "VB100 Certification".

We have increasingly leveraged the Internet to market, sell and distribute our products by entering into advertising and distributing arrangement with Internet content providers and website operators in order to increase user awareness of Kingsoft operated websites as to enhance the capacity in direct sales via the Internet. By making the Internet a more popular service platform for us, we will be at more advantageous position to capture future growth opportunities.

For the Year Ended December 31, 2007

The following table sets forth the comparative numbers for the years ended December 31, 2007 and December 31, 2006, respectively.

	2007 RMB'000	2006 RMB'000
Revenue:		
Entertainment software	**396,440**	215,356
Applications software	**156,521**	98,432
Others	**3,653**	2,643
	556,614	316,431
Cost of revenue	**(95,484)**	(44,671)
Gross profit	**461,130**	271,760
Research and development costs, net of government grants	**(68,450)**	(58,914)
Selling and distribution costs	**(108,723)**	(59,504)
Administrative expenses	**(65,785)**	(43,766)
Share-based compensation costs	**(103,764)**	(6,852)
Other operating costs	**(2,249)**	(13,296)
Impairment of an associate	**—**	(6,000)
Other income and gains	**11,531**	28,316
Finance income	**22,775**	3,753
Finance costs	**(1,211)**	(6,271)
Share of loss of an associate	**(2,460)**	(527)
Profit before tax	**142,794**	108,699
Income tax credit/(expense)	**12,658**	(9,589)
Profit for the year	**155,452**	99,110
Attributable to:		
Equity holders of the Company	**164,678**	99,525
Minority interests	**(9,226)**	(415)
	155,452	99,110
Proposed final dividend	**95,170**	—
	RMB	**RMB**
Earnings per share attributable to ordinary equity holders of the Company		
Basic	**0.1815**	0.1245
Diluted	**0.1725**	0.1185

Revenue

Our revenue increased by 76% year-over-year to RMB556.6 million. Approximately 71% was generated from the entertainment software business segment and 28% was generated from the applications software business segment.

— *Entertainment Software*

Revenue from our entertainment software increased by 84% to RMB396.4 million. The strong revenue growth was mainly attributable to the increased popularity of our MMOPRGs. Our daily average peak concurrent users increased by 9% to 0.6 million year-over-year for the three months ended December 31, 2007. The monthly average revenue per paid user ("Monthly ARPU") for our MMOPRGs increased by 106% year-over-year to RMB37 for the three months ended December 31, 2007. We expect an upward trend in the monthly ARPU to continue as more and more of our paying users are shifting to the item-billing revenue model while we launch more new item-billing revenue model games.

— *Applications Software*

Revenue from our applications software business increased by 59% year-over-year to RMB156.5 million primarily due to a significant increase in the number of subscribers for online services of Kingsoft Internet Security software.

During the year, the revenue contributed from Kingsoft Internet Security including individual subscriptions and enterprise products and services was RMB111.4 million, represented 71% of the total revenue of our applications software and an 132% increase from last year.

Gross Profit and Cost of Revenue

Our gross profit increased by 70% year-over-year to RMB461.1 million. Our gross profit margin decreased by 3% year-over-year to 83%. The decrease was resulted mainly from that our overseas revenue from entertainment made up a decreased proportion of the total revenue. The cost of revenue related to support such revenue is minimum.

Our cost of revenue increased by 114% year-over-year to RMB95.5 million primarily due to increased revenue from MMORPGs and online services of Kingsoft Internet Security compared to the previous year. Our server hosting related expenses increased year-over-year as a result of increased server rental costs, depreciation, custody fees and bandwidth rental fees as we increased the number of our servers for MMORPGs and online services of Kingsoft Internet Security.

Research and Development Costs

Our R&D expenses, before government grants increased by 36% year-over-year to RMB87.2 million primarily due to the increase in salaries and benefits paying to our R&D personnel and an overall increase in R&D headcount.

Government grants for 2007 and 2006 were research project based for our development of software and online game technologies and amounted to RMB18.8 million and RMB5.1 million, respectively. Government grants we received to some extent offset the increase in research and development expenses during the period.

The following table sets forth a breakdown of our research and development costs for the year ended December 31, 2007 and 2006:

	FOR THE YEAR ENDED DECEMBER 31,	
	2007	**2006**
	RMB'000	**RMB'000**
Staff cost	**75,795**	57,188
Depreciation & Amortization	**4,468**	2,973
Others	**7,910**	6,095
	88,173	66,256
Less: Capitalised software costs (except share-based compensation costs)	**(1,817)**	(2,834)
Add: Amortization of capitalised software costs	**882**	602
Less: Government grants for research and development activities	**(18,788)**	(5,110)
Total	**68,450**	58,914

Selling and Distribution Costs

Our selling and distribution expenses increased 83% year-over-year to RMB108.7 million primarily due to an increase in online advertisement expenses related to promoting our MMORPGs and online services of Kingsoft Internet Security.

Administrative Expenses

Our administrative expenses increased by 50% year-over-year to RMB65.8 million primarily due to an increase in professional fees, employee salary costs and benefits, increased depreciation and amortization charges and increased administrative office expenses, which were mainly rental costs and utilities expenses.

Share-based Compensation Costs

Our share-based compensation costs increased significantly by 1,414% year-over-year to RMB103.8 million primarily due to the issue and grant of approximately 112.6 million share options to our employees under the 2007 Pre-IPO Share Option Scheme in 2007.

Other Operating Costs

Our other operating costs decreased by 83% year-over-year to RMB2.2 million primarily due to significant decrease in our bad-debt impaired receivables.

Other Income and Gains

Other income and gains decreased by 59% year-over-year to RMB11.5 million primarily due to reduced non-research-project based government grants.

Finance Income

Our finance income increased by 507% year-over-year to RMB22.8 million due to our increased bank deposits.

Finance Costs

Our finance costs decreased by 81% year-over-year to RMB1.2 million primarily due to the transaction costs associated with the issuance of old shares in the IPO were repaid or repayable by the selling shareholders on a pro-rata basis and those costs related to the issuance of new shares were mostly charged to share premium, a balance sheet item.

Share of Loss of an Associate

Our share of loss of an associate increased by 367% year-over-year to RMB2.5 million, which is our share, as the 40% equity holder, of the losses by our associate, Kingsoft Guangzhou. Kingsoft Guangzhou launched its first game, Meng Xiang Shi Jie in November 2007 with daily average peak concurrent users of 41 thousands in December 2007. We expect to record a recurring investment income from Kingsoft Guangzhou in 2008.

Income Tax Credit/Expenses

Our income tax credit was RMB12.7 million in 2007 versus income tax expense of RMB9.6 million in 2006.

The income tax credit of RMB12.7 million resulted from a combination of the current income tax expense of RMB15.4 million and deferred tax credit of RMB28.0 million.

Pursuant to the new corporate income tax laws concluded and approved in the 5th session of the 10th National Congress March 16, 2007 and under applicable accounting standards, the Company reports deferred tax assets as of December 31, 2007 at the new unified statutory income tax rate of 25% for its subsidiaries in China. This changed estimate for the applicable income taxes of the Company resulted an extra tax credit of RMB15.1 million for 2007. However, if the Company's high and new technology enterprise status is granted by the Chinese tax authorities, we will continue enjoy preferential tax treatments and accordingly reduce the deferred tax assets to reflect the lower preferred income tax rates.

Profit Attributable to Equity Holders of the Company

Our profit attributable to equity holders of the Company increased by 65% year-over-year to RMB164.7 million.

Profit Attributable to Equity Holders of the Company before Stock Compensation Costs

Profit attributable to equity holders of the Company before stock compensation costs, which is defined as profit attributable to equity holders excluding the effect of share-based compensation costs attributable to the equity holders, a measure supplementary to the consolidated financial statements presented in accordance with IFRSs.

We believe the profit attributable to equity holders of the Company before stock compensation costs will enhance investors' overall understanding of the Company's operating performance.

When assessing our operating performance, you should not consider this data in isolation or as a substitute for our profit or any other operating performance measure that is calculated in accordance with IFRSs. In addition, our profit attributable to equity holders of the Company before stock compensation costs may not be comparable to similarly titled measures utilized by other companies.

Our profit attributable to equity holders of the Company before stock compensation costs increased by 152% year-over-year to RMB268.0 million.

The profit margin excluding the effect of stock compensation costs was improved to 48% for the year ended December 31, 2007 versus 34% for the year ended December 31, 2006.

Certain Balance Sheet and Cash Flow Items

— *Deferred Revenue*

Deferred revenue (including current and non-current portion) increased by 38% year-over-year to RMB191.7 million as at December 31, 2007. The increases in deferred revenue were consistent with our increased sales of prepaid games cards and online points for our online games and prepayments for online subscription for our application software products.

— *Cash and Net Cash Generated from Operating Activities*

Cash and Cash equivalent increased by 274% year-over-year to RMB1.2 billion mostly resulted from the net IPO proceeds and the increase in net cash generated by our operating activities.

Cash generated by our operating activities reflects our profit for the year, as the case may be, as adjusted for non-cash items, such as depreciation, amortization of capitalized software costs, and share-based compensation costs, as well as the effect of changes in certain balance sheet items, such as deferred revenue and accrued expenses and other payables. Our net cash generated by operating activities increase by 147% to RMB345.5 million for the year ended December 31, 2007.

— *Capital Expenditures*

Capital expenditures represent cash payments for acquisition of fixed assets and intangible assets such as software. Cash used for capital expenditures increased by 110% year-over-year to RMB51.0 million for year ended December 31, 2007. During the year, we incurred more capital expenditures due to the following factors: as we began the operation of CQ and purchased additional servers; we paid US$1 million for licensing 3D game engine software; we made payments for the construction of our research centre in Zhuhai and expenditures associated with the implementation of SAP and upgrades of our billing systems.

Prospects

Our dual-engine growth strategy has been fueled by China's internet growth. Looking ahead, we believe the strong market demands will further drive our business growth in both the entertainment and applications software segments.

As at December 31, 2007, we have approximately 953 research and development staff. We have restructured the R&D resources for entertainment software and applications software in 2007 to optimize our R&D capability. There are four major research and development centers including multiple game and software research studios located in Zhuhai, Chengdu, Beijing and Dalian with individually focused specialty.

With continuously strengthened R&D capability, we will be able to shorten our game development cycle and improve our game quality to better meet players' demand in 2008. We will have three major online games in the pipeline. JX Online World, which is a special installment of the original JX Online series, and The First Myth II, which is the second installment of the original First Myth series, are expected to be launched in the first half of 2008. MAT — our first 3D FPS game will be launched in the second half of 2008.

The development of JX Online III, the third installment of the original JX Online series featuring full 3D graphics and powered by our proprietary JX Online III engine, has been a focus of Kingsoft and is expected to be in open beta in the second half of 2008. Building on the success of JX Online I and II series, JX Online III has been constantly ranked one of the most-anticipated online games by a number of online communities in recent years.

We will continue to leverage our successes in overseas markets and expand our businesses in other selected markets in Asia where our products and services are competitive and appealing to users in those markets, and where we can identify and work with suitable local partners who can facilitate our entry into these markets. Our strong franchise overseas, is further evidenced by the recent launch of JX Online II, Kingsoft's third MMORPG after JX Online and First Myth operated by Vinagame in Vietnam. It has recorded peak concurrent users of over 110,000 in March, 2008.

Within the applications software business segment, we will allocate more resources in developing and operating our internet security software. On March 27, 2008, we have announced our strategic partnership with Baidu, the largest Chinese language Internet search provider, to launch a free Internet security service that will benefit as many as 200 million users in China. This strategic partnership highlights our commitment to creating a more secure Web surfing experience for Chinese users.

We will continue to leverage the Internet to market, sell and distribute our Internet security products. The number of the online subscribers of our Internet security grew at a rate of over 1 million quarterly. We will continue to introduce and improve our comprehensive customer-care programs and keep a focus on the delivery of the best-in-class online software service experience. We will increase our investment in the market of Internet security services to small and medium enterprises in 2008.

We are in the process of studying a number of projects for possible acquisition and joint venture with local enterprises which would create synergy with our existing businesses.

We are very optimistic about the operating environment in 2008 and believe Kingsoft will continue its robust growth in the coming year.

Other Information

Exposure to Exchange Rate Fluctuations

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. RMB against US$, HK$ and JPY 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$. The exchange rate of the US$ against the RMB was adjusted to RMB8.11 per US$ as at July 21, 2005, representing an appreciation of approximately 2%.

The People's Bank of China announces the closing prices of foreign currencies such as the US$ traded against the RMB in the interbank foreign exchange market after the closing of the market on each business day, and makes these prices the central parity for trading against the RMB on the following business day.

Conversely, if the RMB had strengthened (weakened) 5% against the US$, HK$ and JPY with all other variables held constant, profit would have been RMB955 thousand and RMB869 thousand lower (higher) for years ended December 31, 2007 and 2006, respectively; equity would have been RMB37,736 thousand and RMB4,447 thousand lower (higher) as at December 31, 2007 and 2006, respectively.

Employee and Remuneration Policies

As at December 31, 2007, the Group had approximately 1,660 full-time employees (2006: 1,300). The number of employees of the Group varies from time to time depending on needs and they are remunerated based on industry practice.

The Group determines its staff's remuneration based on factors such as qualifications and years of experience. The staff cost of the Group (including Directors' and senior management's emoluments) in 2005, 2006 and 2007 were approximately RMB88.3 million, RMB109.0 million and RMB244.1 million, respectively.

Purchase, Sale or Redemption of Listed Securities

During the year ended December 31, 2007, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

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 2007 is set out in the table below:

AREA OF USE	PLANNED AMOUNT (HK$' MIL)	AMOUNT REMAINING AS AT DECEMBER 31, 2007 (HK$' MIL)
Expansion of research and development capabilities	170.1	168.8
Expansion in certain overseas market	76.0	75.5
IT infrastructure upgrade	94.1	75.9
Strategic acquisitions and joint ventures	115.8	115.8
Construction of research and development facilities in Zhuhai	72.4	66.8
General corporate purposes	27.9	20.0

DIRECTORS AND SENIOR MANAGEMENT

Executive Directors

Pak Kwan KAU, aged 43, 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, and one of the ten most influential leaders in China's games industry at the inaugural China Game Industry Annual Conference in January 2005. Mr. Kau has never held directorship in any listed public companies. Mr. Kau was appointed as acting Chief Executive Officer of the company in December 2007.

Jun LEI, aged 38, is an executive Director, and vice Chairman of the Board of our company. Mr. Lei has been employed by us since 1992. 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 played a key role in developing the operation of our Group and expanding our business operations. He has been our chief executive officer since 1998, and under his leadership, we further expanded applications 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 utilises the Internet.

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 opening ceremony of the China Game Industry Annual Conference in January 2008. In December 2007, Mr. Lei relinquished his position as Chief Executive Officer, Chief Technology Officer and President of the Company, but remained as an executive Director and vice Chairman of the Board of the Company. Mr. Lei was appointed as chairman of Board Strategy Committee in December 2007. Mr.Lei has held directorship in 2020 CHINACAP ACQUIRCO, INC. — an AMEX listed company since January 2007. 2020 CHINACAP ACQUIRCO, INC. is listed on AMEX since November 8, 2007.

Non-executive Directors

Choon Chong TAY, aged 38, has been a non-executive director of our company since January 2008. He is also the Senior Vice President of GIC Special Investments Corporation. Mr. Tay previously served as the Head of Strategic Relations for Singapore Technologies Engineering, the President of Fortune Venture Management, and the Senior Vice President of ST Aerospace respectively. Mr. Tay has held a non-executive directorship of Ntegrator International Ltd from March 2003 to September 2007, which is a listed company in Stock Exchange of Singapore.

Mr. Tay graduated from Singapore Ngee Ann Polytechnic Institute. He also obtained a Bachelor's degree in Electrical Engineering from Imperial College, London of the United Kingdom and a Master degree in Electrical Engineering from Stanford University, USA.

Wing Chung Anders CHEUNG, aged 44, has been a non-executive Director of our Company since September 2004. He is also a Vice President of Lenovo Group Limited, a Hong Kong listed company. Mr. Cheung is responsible for the corporate development of Lenovo Group, including strategic investments, acquisitions, joint ventures and partnerships.

Mr. Cheung has been serving on the boards of several investment companies in the fields of telecom system integration service, software application and wireless technology and the board of directors of AsiaInfo Holdings, Inc.. He currently supervises several of Lenovo Group's networking and system integration subsidiaries. Mr. Cheung received an MBA degree from a joint program between Northwestern University in the United States and The Hong Kong University of Science and Technology in 2002.

Wai Ming WONG, aged 50, has been a non-executive Director of our Company since April 2007. Mr. Wong graduated from the Victoria University of Manchester in the United Kingdom with a bachelor's degree (with honours) in Management Sciences. Mr. Wong is a member of both the Hong Kong Institute of Certified Public Accountants and the Institute of Chartered Accountants in England and Wales. Mr. Wong is the Senior Vice President and the Chief Financial Officer of Lenovo Group Limited, a non-executive director of Linmark Group Limited, and an independent non-executive director of both China Unicom Limited and I.T. Limited, all of these companies are Hong Kong listed companies

Tuck Lye KOH, aged 36, has been a non-executive Director of our Company since August 2006 and Chairman of our Renumeration Committee since September 2007. He is also a Director of Starr International Company (Asia), Limited responsible for sourcing and making private equity investments in Asia. Prior to joining Starr, Mr. Koh held various positions with GIC Special Investments (Beijing) Company Limited. AIG Investment Corporation (Asia) Ltd. and Deutsche Bank. Mr. Koh is a Chartered Financial Analyst and a graduate of Stanford University and the National University of Singapore. Mr. Koh did not hold any directorship in any listed companies in the past three years.

Independent Non-executive Directors

Shun Tak WONG, aged 47, is an independent non-executive Director of our Company. Mr. Wong has a master degree in finance from the University of Lancaster in the United Kingdom and a master of 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., a New York Stock Exchange listed company, 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 & corporate controller at Alibaba Group. We appointed Mr. Wong as our independent non-executive Director in April 2007.

Guangming George LU, aged 43, is an independent non-executive Director of our Company. Mr. Lu graduated from Huazhong Normal University in 1984 and obtained a master degree of science from the University of Memphis in 1989. During the period from January 1998 to August 1999, Mr. Lu served as a founding executive and the chief technology officer of uBid, Inc., a leading U.S. based online auction company whose shares are publicly traded in the U.S. and which operates in a similar industry to ours.

Mr. Lu founded Surfmax Corporation in November 1997, a private investment firm in the U.S. Since April 2004, Mr. Lu has been the vice chairman of Xingda International Holdings Limited (one of Surfmax portfolio investment) whose shares are listed on the Hong Kong Stock Exchange. Mr. Lu also currently serves as the Chairman and CEO of 2020 ChinaCap Acquirco, Inc., a public acquisition vehicle whose shares are listed on the American Stock Exchange. Mr. Lu joined us in April 2007.

Mingming HUANG, aged 35, is an independent non-executive Director of our Company. Mr. Huang is a co-founder 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 our industry, including 265.com (since June 2006), Baitai Media (since September 2005) and Cheshi.com (since September 2006).

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 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 43, 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, and one of the ten most influential leaders in China's games industry at the inaugural China Game Industry Annual Conference in January 2005. Mr. Kau has never held directorship in any listed public companies. Mr. Kau was appointed as acting Chief Executive Officer of the company in December 2007.

Jian REN, aged 44, is currently our chief operating officer. Mr. Ren obtained a master degree from Peking University specialising in computer science. During the early years of his career, Mr. Ren worked for Lenovo, the Ministry of Science and Technology and Aldus Co. Mr. Ren worked at Microsoft from 1993 to 2000 and participated in the development and project management of Windows™ 95 and Windows™ NT.

He moved back to China in 1997 and served as the head of the Windows™ CE product Group in Microsoft's research and development center in China. From 2000 to 2004, Mr. Ren worked in TCL International Holdings Limited as the chief technology officer. Mr. Ren joined us at the beginning of 2005 and was appointed as our Chief Operating Officer.

Donghui WANG, aged 37, 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 for Ernst & Young Beijing office 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 Senior Vice President of the company in December 2007.

Ke GE, aged 34, is currently a Senior Vice President and has the overall responsibility for our applications 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.

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. He was appointed as a vice president in 2002. Mr. Ge became Senior Vice President of the company in December 2007.

Tao ZOU, aged 32, is currently a Senior Vice President responsible for the overall operations of our entertainment software business, including the research and development of our online games. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our PowerWord product. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became Senior Vice President of the company in December 2007.

Quanguo WANG, aged 42, is currently 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.

Ningning GAO, aged 50, has been a Vice President 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 large customers 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 42, is currently a Vice President 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.

Li WAN, aged 33, is currently a Vice President of our Group responsible for the research and development of our applications software products. He graduated from North West University in China with a bachelor degree in Chemical Engineering in 1997 and obtained a master degree in software engineering in 2006 from Harbin Institute of Technology. Mr. Wan joined us in 1998 and has been responsible for developing WPS Office products.

Fei Zhou CHEN, aged 30, is currently a Vice President of our Group and is responsible for the research and development of our online games in the entertainment software unit. 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.

Hai Yin SHEN, aged 34, is a Vice President of the company and CEO of Kingsoft Japan Inc. Mr. Shen was appointed as a director of Kingsoft Japan in March 2007, a vice president of the Company in January 2008 and CEO of Kingsoft Japan Inc. in March 2008. Mr. Shen graduated from Shanghai Jiao Tong University in 1993 with double Bachelor's degrees in Automation Control and Industry Management. He founded ACCESSPORT INC. in Japan in 2000 and was the CEO of the company. The company was later renamed JWord INC., which was the fourth largest web search service provider. The company was acquired by GMO Internet Group and Yahoo! Japan (both companies are listed on the Tokyo Stock Exchange). Mr. Shen has eight years of Internet experience.

Huan YANG, aged 35, is an assistant President at Kingsoft. 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 Project Director of Strategic Investment Department, in charge of investments and new business development. He assisted in the establishment of Lenovo Global Offshore Business Center in Singapore from 2005 to early 2007. Mr. Yang rejoined Kingsoft since 2007.

Peng LIU, aged 32, is the General Manager of the Kingsoft Blaze Studio and is responsible for the San Guo Online and Kingsoft Xiao Yao website (www.xoyo.com). Mr. Liu is a member of our senior management team. He joined us in early 2000 and has been a core member in the R&D team for some of Kingsoft's key products such as Kingsoft PowerWord and Kingsoft Instant Translator. In 2001, he established the KingPlayer team and was appointed the project and development manager to promote the video playing software. In 2002, he led the development of JX Online in Xishanju Studio, contributing to Kingsoft's transformation to online game development. In 2003, he established the second game unit at Kingsoft, the Blaze Studio. He was appointed Chief Technology Officer and Project Manager of the studio and spearheaded the development of The First Myth series. Mr. Liu graduated from the faculty of Industry Automation and Computer Application of Tianjin Polytechnic University. Mr. Liu was named a game industry expert by CSIP under Ministry of Information Industry and he is the head of the National 863 Program's Online Game Engineering Group in Kingsoft.

Xin WANG, aged 34, is currently an assistant President of the company, and Deputy General Manager of Kingsoft's Software Business Unit, she is responsible for the operation and 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. Ms Wang left Kingsoft in 2003 and joined MTone Wireless as General Manager of its handset game business unit and spearheaded the development and operation of the first handset online game in China. 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.

Yong ZHU, aged 32, is Kingsoft's General Manager of Chengdu Platform, Deputy General Manager of the Online Game Business Unit, Director of Online Game Customer Service Center, and Assistant President. He is responsible for Kingsoft's Chengdu branch company, including Adin Game Studio, Online Game Customer Service Center and Chengdu Platform. Mr. Zhu obtained a Bachelor's Degree in Engineering from Wuhan University of Hydraulic and Electric Engineering in 1998 and was granted a Master's Degree of Arts of Huazhong University of Science and Technology in 2005.

Mr.Zhu was employed by us in 2001, and he was responsible for R&D of applications software. Mr. Zhu worked as a business development manager in 2002, and he has been engaged in game operations since 2003.

Company Secretary and Qualified Accountant

Michelle Feng HARNETT, aged 38, is an assistant President of the Company, our Secretary of the Board, Qualified Accountant 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 was granted a National Vocational Qualification by the Association of Accounting Technicians in 2002 and is a member of the Association of Chartered Certified Accountants in the United Kingdom.

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.

CORPORATE GOVERNANCE REPORT

As a leading online game and applications software developer, distributor and service provider in China, based on market share, Kingsoft Corporation Limited dedicates to providing innovative and reliable products and services to its customers while achieving and maintaining the highest standards of corporate governance consistent with the needs and requirements of the business and all of its stakeholders, and in compliance with the code provisions (the "Code") set out 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").

The Company complied with all code provisions of the Code since the Company's shares were listed on the Stock Exchange on October 9, 2007 (the "Listing Date") to December 31, 2007 except for the deviation in respect of the code A.2.1 of the Code which provides that the roles of the chairman and chief executive officer ("CEO") should be separate and should not be performed by the same individual. The following summarizes the Company's corporate governance practices and explains the deviation from the Code.

BOARD OF DIRECTORS

Composition of the Board of Directors of the Company (the "Board")

The Board currently includes 9 directors, of which 2 are executive directors, 4 are non-executive directors and 3 are independent non-executive directors with business consultancy and accounting backgrounds. A list of all directors is set out in the Corporate Information section on page 3 of this annual report. A list of Directors respective biographies are set out on pages 21 to 22 of this annual report.

The Board's main responsibilities to the Company and its subsidiaries (collectively, the "Group"), and the Delegation of the Board's authority to the management of the Group.

The Board's main responsibilities to the Group are as the following:

- formulate strategic direction and policy of the Group;
- review and approve all transactions, arrangements and contracts that may have material impact to the current or future financial performance or operations of the Group;
- approve annual business plan and budget as proposed by the management and remain full control of the implementation of the approved annual budget and business plan;
- review all matters involving a conflict of interest for a substantial Shareholder or a Director of the Group;
- present a balanced, clear and understandable assessment of the financial reports, other price-sensitive announcements and financial disclosures required under the Listing Rules and reporting to regulators information required to be disclosed pursuant to statutory requirements; and
- ensure sound and effective internal controls to safeguard the shareholder's investment and the Group's assets.

The directors acknowledged their responsibilities for the preparation of the Group's financial statements, and ensured that the financial statements are prepared in accordance with the requirements of laws and regulations and applicable accounting standards. The directors also ensured the timely publication of the Group's financial statements.

The Board is 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 Board delegates the authority of the management of the Company's daily operation to the members of the senior management, whose scope of authority is clearly defined by the Board. The management is responsible for preparing strategic directions, budgets, business plans, and policies of the Group for Board's approval, and then carrying out and implementing those as approved by the Board. When the Board delegates aspects of its management and administration functions to management, it gives clear directions as to the powers of management, in particular, with respect to the circumstances where management should report back and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Company including all major acquisitions, disposals, investments, and other significant issues relating to the Group. The management reports to the Board on a regular basis and can communicate with the Board freely.

Independent Non-executive Directors

The Company's independent non-executive directors are professionals in the fields of accounting, finance, technology and management with extensive experience in their respective professional areas, and all of them 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.

Board Meetings

The Board meets regularly, at least four times a year, and additional meetings will be conducted if required. A Director may, and on the request of a Director the Secretary shall, at any time summon a meeting of the Board which may be held in any part of the world, but no such meeting shall be summoned to be held outside the territory in which the head office of the Company (the "Head Office") is situated without the prior approval of the Board. Directors can attend meetings in persons or through other electronic means of communication. A regular meeting does not include the practice of obtaining board consent through the circulation of written resolutions.

The Company Secretary is responsible for ensuring that the Board procedures and all applicable rules are complied. 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 within reasonable advance notice.

The senior vice presidents are invited as observers to attend board meetings. Other senior managements are invited to the board meetings from time to time to report on certain matters. Directors are encouraged to express their alternative views at the meetings. The directors have been reminded that they shall devote sufficient time and effort to the business of the Company and that they 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 at such board meeting.

In order to illustrate its focus on the Company's business management, the Board sets out the table below the attendance of meetings of the Board in 2007.

Meetings of the Board:

Number of meetings held by the Board and the attendance record of members is set out below:

Number of meetings	9*
Pak Kwan KAU	9/9
Jun LEI	9/9
Wing Chung Anders CHEUNG	7/7
Tuck Lye KOH	7/7
Wai Ming WONG (as from April 24, 2007)	3/5
Shun Tak WONG (as from April 30, 2007)	5/5
Guangming George LU (as from April 30, 2007)	5/5
Mingming HUANG (as from June 18, 2007)	4/4
Shuen Lung CHEUNG (from August 18, 2006 to April 24, 2007)	2/2
Yongqiang QIAN (from May 17, 2007 to June 18, 2007)	0/0

* Out of the 9 board meetings held during the year, two of them were held only by the members in the Board Committee which was set up for the IPO purpose on September 3, 2007. The members of this Board Committee were Mr. Pak Kwan KAU and Mr. Jun LEI. During the year, the Board had held 9 meetings, but as some of the directors joined the Board during the year, the number of board meetings which they should have attended varies based on when they joined the Board.

Supply of and access to information and resources

Management supplies the Board and its committees with adequate, complete and reliable information in a timely manner to enable it 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. The Board and the committees are provided with sufficient resources to discharge their duties including the retention of outside professional advisers at the Company's expense.

The Company has put in place a directors' and officers' liabilities insurance.

Chairman and Chief Executive Officer

Code provision A.2.1 provides that the roles of the chairman and CEO should be separate and should not be performed by the same person. The division of responsibilities between the chairman and CEO should be clearly established and set out in writing.

The chairman and chief executive officer("CEO") were Pak Kwan Kau and Jun Lei respectively until Mr. Lei officially relinquished his position as CEO and chief technology officer of the Company on December 20, 2007. Mr. Lei still remained his role in the Board as an executive director and vice chairman of the Board of the Company and took up the position as the chairman of the Board Strategy Committee. Pak Kwan Kau, chairman of the Company took up the position of acting CEO. The Board has set up a Board committee to recruit the next CEO, thus it is in the Company's interest to have roles of the chairman and CEO separate in the long term.

The Chairman is to provide leadership for the Board and to ensure that the Board works effectively and discharges its responsibilities, and that all key and appropriate issues are discussed by the Board in a timely manner, to encourage all Directors to make a full and active contribution to the Board's affairs and take the lead to ensure that the Board acts in the best interests of the Company; and to ensure that all Directors are properly briefed on issues arising at board meetings.

The Chief Executive Officer, supported by the Executive Directors, is responsible for the day-to-day management of the business of the Group. The responsibilities of the CEO are to implement and report to the Board on the Group's strategy; to provide leadership for the management of the Group; and to oversee all operational issues of the Group and discharge all duties and authority as may be delegated to him by the Board from time to time.

Appointment and re-election

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

The Company may from time to time in general meeting by Ordinary Resolution 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, 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 retires may fill the vacated office.

BOARD COMMITTEES

The Board has set up four specialized committees, namely the Audit Committee, Remuneration Committee, Nomination Committee and Strategy Committee. Audit Committee, Remuneration Committee and Nomination Committee proceed their business according to their terms of reference. Audit Committee, Remuneration Committee, and Nomination Committee are mainly consisted of the independent non-executive Directors and non-executive Directors.

Audit Committee

- **Audit Committee composition and primary duties**

The Company established an audit committee on September 3, 2007 and the Audit Committee currently consists of two Independent Non-executive Directors namely Mr. Shun Tak Wong (chairman), Mr. Guangming George Lu and one Non-executive Director namely Mr. Wai Ming Wong. None of the Audit Committee members are members of the previous or existing auditors of the Company.

The primary duties of the audit committee are mainly to review the draft of the Company's annual report and accounts, interim and quarterly reports before submission, and provide advice to the Board on these matters; to review the material investment, capital operation and material financial system of our Company; to review the accounting policy, financial position and financial reporting procedures of our Company; to consider the appointment of external auditors, their audit fees and questions of resignation or dismissal; to communicate with external audit firms with or without the absence of the management where necessary; to assess the performance of internal financial and audit personnel; and to assess the internal control of our Company.

- **Principal Work performed by the Audit Committee in 2007 include:**

Review quarterly results for the three months ended September 30, 2007 prior to their approval by the Board; review the effectiveness of the internal control systems; review findings and recommendations of the internal auditors and; monitor and ensure the independence, authorities and resource of the internal and external auditors; and review the appointment of external auditors yearly.

- **External Auditors**

Ernst & Young, Certified Public Accountants, Hong Kong, were engaged as the Company's external auditors respectively for the year ended December 31, 2007.

The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditor's Report on page 43.

In 2007, due to the initail public offering of the Company's shares in the Stock Exchange, the Company paid offering service fees in a total sum of RMB13.8 million to Ernst & Young. These fees were netted against the IPO proceeds and were accounted for in share premium.

In addition, the fee paid/payable in 2007 to Ernst & Young in respect of the audit of the financial statements amounted to approximately RMB5.6 million and the fee paid/payable to Ernst & Young for non-audit activities amounted to approximately RMB1.7 million.

- **Internal Control**

The Board is responsible for the Company's system of internal control so as to maintain sound and effective internal controls to safeguard the shareholders' investment and the assets of the Company.

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 Company's internal controls systems and procedures are designed to meet specific business needs and to minimize the risks exposed. The 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. Quarterly financial information is provided to the Board for discussions at Board meetings with explanations noted for any material variances and deviations between actual performances and budgets/targets.

- The company have set up an internal audit department in May, 2007 that performs independent reviews of the operational areas which are material to the business or identified by the management. The management will be notified for any issues for rectification and internal auditors will follow up with the implementation of audit recommendations. Any major internal control weaknesses and findings will be first reported to the Audit Committee whenever necessary.

- The Company has adopted the "Internal Control-Integrated Framework" of the Report of Committee of Sponsoring Organizations of the Treadway Committee (COSO) entitled ("the COSO internal control framework"), which is a recommended framework under HKICPA Corporate Governance guidelines. The COSO internal control framework leverages policies and procedures adopted at the company management, operational and financial reporting levels. The directors adopted the COSO internal control framework to assess the effectiveness of the system of internal control.

- In February 2007, the Company initiated a comprehensive self-evaluation of its internal controls. The scope covered:

  A. Entity Level Controls

  - Control Environment
  - Risk Assessment
  - Control Activities
  - Information and Communication
  - Monitoring

  B. Process Level Controls

  - Accounting Policy and Financial Statement related
  - Contract Management
  - Corporate Tax
  - Sales and Account Receivables
  - Fixed Assets
  - Expenses including Research and Development Costs
  - Human Resources and Payroll
  - Program Change Controls
  - Logical Access Controls
  - Other Information Technology General Controls
  - Information Technology Application Controls

  This self-evaluation process under the COSO internal control framework identified certain areas where the Company did not have adequate level of controls and which presented a risk to the company, therefore required remediation actions. Following the adoption of the COSO internal control framework, the Company carried out actions and adopted and improved several policies and procedures to rectify the above-mentioned areas.

  Besides, the internal audit department has monitored all those improvement and rectification since it was founded. In June 2007 and December 2007, the internal audit department conducted two rounds of follow-up review on all issues identified as above-mentioned to assess the rectification results, making sure all of the issues have been rectified and risks have been mitigated to an acceptable level.

  The Board, with the recommendation of the Audit Committee, have reviewed the effectiveness of the system of internal control and they consider the internal control systems effective and adequate;

- **Meetings of Audit Committee**

The audit committee held one meeting since September 3, 2007 when it was set up until December 31, 2007 and the attendance record of members is set out below:

Number of meetings	*1*
Shun Tak Wong *(Chairman)*	1/1
Guangming George Lu	1/1
Wai Ming Wong	1/1

Remuneration Committee

The remuneration committee was formed on September 3, 2007. At present, the remuneration committee consists of three members, and one of them is non-executive director Mr. Tuck Lye Koh (chairman), Mr. Shun Tak Wong and Mr. Mingming Huang are independent non-executive directors.

The primary duties of the remuneration committee mainly include review and determination of the terms of remuneration packages, bonuses and other compensation payable to our directors and other senior management, review and recommending to the Board the Company's annual remuneration policy and other findings after each meeting. The Remuneration policy is set to attract, motivate and retain high performing individuals who are essential to the success of the Company. The emolument package for the senior managers and key personals includes basic salary, performance bonus and incentive stock options. The basic salary depends 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 can be found under the subtitle of "Share Option Scheme" in the Directors' Report. The stock options 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 2007 are set out in Note 3 to the consolidated financial statements. When a meeting is convened to discuss certain directors' remuneration, the directors in discussion can not determine his own remuneration.

- **Meetings of Remuneration Committee**

Since September 2007 when it was set up until December 31, 2007, no meeting had been held by the Remuneration committee.

Nomination Committee

The nomination committee was established on September 3, 2007. At present, the nomination committee consists of three members, and two of them are independent non-executive directors namely Mr. Guangming George Lu (chairman) and Mr. Mingming Huang, and one non-executive director namely Mr. Wing Chung Anders Cheung.

The primary duties of the nomination committee are mainly to review the structure, size and composition (including the skills, knowledge and experience) of our Board regularly and make recommendations to our Board regarding any proposed changes, identify suitably qualified individuals as members of our Board and select or make recommendations to our Board on the selection of individuals nominated for directorships, assess the independence of our independent non-executive Directors and make recommendations to the Board on matters relating to appointment or reappointment of Directors, and succession planning for Directors, particularly the chairman and the chief executive officer.

- **Meetings of Nomination Committee:**

Since September 2007 when it was set up until December 31, 2007, no meeting had been held by the nomination committee.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Board of Directors 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 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 throughout the reporting period for 2007. Details of security interests in the Company held by the Directors are set out in the Directors' Report under the subtitle of "Directors' Interests in Securities" on page 36 to 37 of this annual report.

INFORMATION DISCLOSURE AND INVESTOR RELATIONS

In respect of any discloseable and significant events, the Company makes accurate and complete disclosure in a timely manner through the publication of annual and interim results announcements and press release as specified by the relevant supervisory authorities for information disclosure pursuant to the disclosure requirements under the Listing Rules. This is to safeguard the right to information and participation of the shareholders.

The Company places strong emphasis on its communications with investors, and considers that maintaining an ongoing and open communications with investors can promote investors' understanding and confidence in the Company.

The Company's investor relationship website, www.ir.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.

On behalf of the Board

Pak Kwan Kau

Chairman

PRC, March 31, 2008

The directors of the Company ("Directors") are pleased to present to the shareholders their first report together with the audited financial statements of Kingsoft Corporation Limited (the "Company", or "Kingsoft") and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended December 31, 2007.

Principal Activities

The principal activity of the Company is investment holding. The activities of the subsidiaries are set out in Note 1 to the consolidated financial statements.

There were no significant changes in the nature of the Group's principal activities during the year. The analysis of the Group's revenues and contribution results by business segments and by geographical area of segments are set out in Note 23 to the consolidated financial statements.

Change of Company Name

Pursuant to a special resolution passed at the extraordinary general meeting of the Company held on June 5, 2007, and approved by the Registrars of Companies of Cayman Islands, the name of the Company was changed from Kingsoft Corporation to Kingsoft Corporation Limited (金山軟件有限公司).

Use of IPO Proceeds

The application of the proceeds from the initial public offering of the Company (the "IPO") does not materially change from the allocation stated in the prospectus of the Company dated September 24, 2007. More details on the use of IPO proceeds are set out in the section of Management Discussion and Analysis in this annual report under the title of "Use of IPO Proceeds".

Results

The Group's profit for the year ended December 31, 2007 and the state of affairs of the Company and the Group at that date are set out in the consolidated income statement on page 44.

Reserves

In the year ended December 31, 2007, the profit attributable to equity holders of the Company amounted to RMB164.7 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, 2007, the Company had distributable reserves amounting to RMB933.2 million.

Details of movements in the reserves of the Group and the Company for the year ended December 31, 2007 are set out in the consolidated statement of changes in equity on page 47, and in Note 25(b) to the consolidated financial statements, respectively.

Charitable Contributions

During the year, the Group made charitable contributions totaling HK$1.0 million.

Final Dividend

The directors recommend the payment of a final dividend of HKD0.10 per ordinary share in respect of the year to shareholders whose names appear on the register of members of the Company on May 23, 2008. Such proposed dividend will be subject to approval of the shareholders at the forthcoming annual general meeting ("AGM") to be held on May 23, 2008. Such proposed dividend will be payable on June 6, 2008. This recommendation has been incorporated in the financial statements as an allocation of retained earnings within the equity section of the balance sheet.

Closure of Register

The register of members of the Company will be closed from Monday, May 19, 2008 to Friday, May 23, 2008 (both days inclusive), and during which period no transfer of shares will be processed. In order to be entitled to attend and vote at the forthcoming AGM and to qualify for the proposed final dividend, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, 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 Friday, May 16, 2008.

Subsidiaries

Details of the Company's principal subsidiaries as at December 31, 2007 are set out in Note 24 to the consolidated financial statements.

Material Investment and Acquisition

During the reporting period, the Group has no significant investment and acquisition activities.

Financial Summary

A summary of the published results, assets, and liabilities of the Group for the last four financial years as extracted from the consolidated financial statements and restated/reclassified as appropriate, is set out on page as bellow. The summary does not form part of the audited financial statements.

	YEAR ENDED DECEMBER 31,			
	2004	2005	2006	2007
	RMB'000	RMB'000	RMB'000	RMB'000
Profit for the year	3,782	34,432	99,110	**155,452**

	AS AT DECEMBER 31,			
	2004	2005	2006	2007
	RMB'000	RMB'000	RMB'000	RMB'000
Total assets	172,672	270,933	520,709	**1,499,921**
Total liabilities	189,525	229,180	252,882	**366,264**

Contract of significance

As of December 31, 2007, none of our directors was materially interested in any contract of significance to the Company and none of the controlling shareholders or its subsidiaries entered into any contracts of significance with the Group.

Bank Borrowings

There has been no bank borrowings of the Group as at December 31, 2007.

Fixed Assets

Details of the movements in the fixed assets of the Group for the year ended December 31, 2007 are set out in Note 8 to the consolidated financial statements.

Share Capital

Details of the movements in share capital of the Company for the year ended December 31, 2007 are set out in Note 22 to the consolidated financial statements.

Share Option Scheme

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 4 in the consolidated financial statements.

Movements of the Share Option

Details of the movements in the share option during the year are set out in Note 4 to the consolidated financial statements.

Valuation of Share Options

Details of the Valuation of share option during the year are set out in Note 4 to the consolidated financial statements.

The directors have estimated the values of the share options granted during the year, calculated using the Black-Scholes option pricing model as at the date of grant of the options:

GRANTEE	NUMBER OF OPTIONS GRANTED DURING THE YEAR	THEORETICAL VALUE OF SHARE OPTIONS RMB'000
Mr. Jun Lei	22,451,800	38,715
Other employees	90,195,600	156,123
	112,647,400	194,838

Share Award Scheme of the Company

The 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. No award was granted by the Company since the Adoption Date.

The purpose of the Share Award Scheme is to recognise the contributions by certain employees (including without limitation 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.

Directors

The directors of the Company during the year and up to the date of this report comprised 9 directors, of which 2 were executive directors, 4 were non-executive directors and 3 were independent non-executive directors, whose names are as follows:

	APPOINTMENT DATE	RESIGNATION DATE
EXECUTIVE DIRECTORS		
Mr. Pak Kwan KAU (求伯君)	July 27, 1998	N/A
Mr. Jun LEI (雷軍)	July 27, 1998	N/A
NON-EXECUTIVE DIRECTORS		
Mr. Wing Chung Anders CHEUNG (張榮宗)	September 22, 2004	N/A
Mr. Tuck Lye KOH (許達來)	August 18, 2006	N/A
Mr. Wai Ming WONG (黃偉明)	April 24, 2007	N/A
Mr. Choon Chong TAY (鄭俊聰)	January 27, 2008	N/A
Mr. Shuen Lung CHEUNG (張旋龍)	August 18, 2006	April 24, 2007
INDEPENDENT NON-EXECUTIVE DIRECTORS		
Mr. Shun Tak WONG (王舜德)	April 30, 2007	N/A
Mr. Guangming George LU (魯光明)	April 30, 2007	N/A
Mr. Mingming HUANG (黃明明)	June 18, 2007	N/A
Mr. Yongqiang QIAN (錢永強)	May 17, 2007	June 18, 2007

In accordance with Article 108 and Article 112 of the Articles of Association of the Company, Mr. Pak Kwan Kau, Mr. Jun Lei, Mr. Wing Chung Anders Cheung and Mr. Choon Chong Tay will retire at the forthcoming AGM of the Company to be held on May 23, 2008 and, being eligible, will offer themselves for re-election. In addition, Mr. Tuck Lye Koh and Mr. Wai Ming Wong will voluntarily retire from their directorship at the AGM and, being eligible, will offer themselves for re-election at the AGM.

The Company has received 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 21 to 25 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

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 or fellow subsidiaries was a party at the end of the year or at any time during the year ended December 31, 2007.

Directors' Interests in Securities

As at December 31, 2007, the interests and short positions of the Directors and the chief executive officer ("CEO") 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 for Securities Transactions by Directors of Listed Companies in the Listing Rules, to be notified to the Company and the Stock Exchange were as follows:

Long position 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	20.67%
Jun Lei	Corporate (Note 2)	158,230,280	14.90%

Long positions in share options of the Company:

NAME OF DIRECTOR	NUMBER OF OPTIONS DIRECTLY BENEFICIALLY OWNED
Jun Lei (Note 3)	27,763,300
Wing Chung Anders Cheung (Note 4)	500,000

Notes:

1. These shares are held by Topclick Holdings Limited, a BVI company wholly owned by Pak Kwan Kau.

2. There share are held by Color Link Management Limited, a BVI company wholly owned by Jun Lei.

3. 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 which price of USD$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 USD$0.0353.

4. The relevant interests are 500,000 number of share options which were granted on August 1, 2004. Its exercise period is from August 1, 2004 to August 1, 2014 and exercise price is USD$0.0353.

5. For further details on these share options, please refer to the paragraph headed "Share Option Scheme".

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, 2007.

Directors' Rights to Acquire Shares or Debentures

Save as disclosed in the sections "Directors' Interests in Securities", and "Share Option Scheme", 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.

Substantial Shareholders

As at December 31, 2007, as far as the Directors are aware of, the following, other than the directors or 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 SHARES HELD IN THE COMPANY	PERCENTAGE OF ISSUED SHARE AS AT DECEMBER 31, 2007
Topclick Holdings Limited(1)	Beneficial owner	219,489,800	20.67%
Tetrad Ventures Pte Ltd	Beneficial owner	165,143,115	15.55%
GIC Special Investments Pte. Ltd.(2)	Interest of a controlled corporation	165,143,115	15.55%
Government of Singapore Investment Corp. Pte. Ltd.(2)	Interest of a controlled corporation	165,143,115	15.55%
Minister for Finance(Incorporated(2))	Interest of a controlled corporation	165,143,115	15.55%
Government of Singapore Investment Corporation (Ventures) Pte Ltd(2)	Interest of a controlled corporation	165,143,115	15.55%
Color Link Management Limited(3)	Beneficial owner	158,230,280	14.90%
Super Faith International Limited	Beneficial owner	101,946,386	9.60%
Caprice Pacific Limited(4)	Interest of a controlled corporation	101,946,386	9.60%
Highland Crest Limited(4)	Interest of a controlled corporation	101,946,386	9.60%
World Conquest Limited(4)	Interest of a controlled corporation	101,946,386	9.60%
Pacific Star Overseas Limited(4)	Interest of a controlled corporation	101,946,386	9.60%
Shuen Lung Cheung(4)	Interest of a controlled corporation	101,946,386	9.60%
Nien Shian Chu(4)	Interest of a controlled corporation	101,946,386	9.60%
Siu Lung Cheung(4)	Interest of a controlled corporation	101,946,386	9.60%
Tung Ping Lau(4)	Interest of a controlled corporation	101,946,386	9.60%
Siu Ha Cheung(4)	Interest of a controlled corporation	101,946,386	9.60%
Ka Yeung Yip(4)	Interest of a controlled corporation	101,946,386	9.60%
Lenovo	Beneficial owner	78,920,796	7.43%
Lenovo Holdings (BVI) Limited(5)	Interest of a controlled corporation	78,920,796	7.43%
Lenovo Group Limited(5)	Interest of a controlled corporation	78,920,796	7.43%

1. Pak Kwan Kau is deemed to be interested in Topclick's interest in the Company by the SFO because Topclick is wholly owned by Pak Kwan Kau.

2. Government of Singapore Investment Corporation (Ventures) Pte Ltd is deemed to be interested in Tetrad's interest in the Company under the SFO because Tetrad is a wholly owned subsidiary of Government of Singapore Investment Corporation (Ventures) Pte Ltd.

3. Jun Lei is deemed to be interested in Color Link's interest in the Company by the SFO because Color Link is wholly owned by Jun Lei.

4. Each of Caprice Pacific Limited, Highland Crest Limited and World Conquest Limited is deemed to be interested in Super Faith'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. 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's interest in the Company by the SFO.

5. Lenovo Holdings (BVI) Limited is deemed to be interested in Lenovo's interest in the Company by the SFO because Lenovo is a wholly owned subsidiary of Lenovo Holdings (BVI) Limited, which is wholly owned by Lenovo Group Limited.

Save as disclosed above, the Directors confirm that they 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.

Public Float

As at the date of this report, the Company has maintained the prescribed public float under the Listing Rules, basing 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 passed by our shareholders on September 3, 2007, a general unconditional mandate was granted to our Directors 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 SFC 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 immediately following completion of the Global Offering without taking into account any shares purchased under the over-allotment option until:

(i) the conclusion of the Company's next AGM; or

(ii) the expiration of the period within which the next AGM of the Company required by the articles of association or any other applicable laws to be held; or

(iii) such mandate being revoked, varied or renewed by an ordinary resolution of the Company's shareholders in a general meeting, whichever is the earliest.

None of the Company or any of its subsidiaries had purchased, sold or redeemed any of its listed securities during the year ended December 31, 2007.

Competing Interest

As of December 31, 2007, none of the Directors 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 financial year ended December 31, 2007, the five largest customers of the Group accounted for 25% of the total revenue of the Group and the five largest suppliers of the Group accounted for 37% of the total purchases. The largest customer accounted for about 10% of the total revenue. The largest supplier accounted for 14% of the total purchases.

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

Related Party Transactions

Details of related party transactions for the year ended December 31, 2007 are set out in Note 28 to the consolidated financial statements.

Connected Transactions

Non-exempt Continuing Connected Transactions

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.

The structure contracts which were in place during the year ended December 31, 2007 are as follows:

Structure Contracts relating to Kingsoft Qijian

(i) A loan agreement dated March 30, 2007 between Weiqin Qiu 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") to Chengdu Digital Entertainment. The loans have no definite maturity date and Chengdu Digital 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, 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 any time, 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 licence 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 licence 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 Digital 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.

(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 secrutiy 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 Interative Entertainment agreed to enter into agreements to licence 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 our executive Director Jun Lei, 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, reporting 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 above structure contracts 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 from the Listing Date until the end of 2007; and

— apart from these structure contracts, there were no other new structure contracts entered into, renewed and/or "cloned" *during the year ended December 31, 2007.*

Save as disclosed above, there were no other transactions which need to be disclosed as connected transactions in accordance with the requirements of Chapter 14A of the Listing Rules.

Exempted Continuing Connected Transactions

The Group entered into an exempted continuing connected transaction with Guangzhou Huaduo Internet Technology Co. Ltd. (廣州華多網路科技有限公司) ("GHIT"), in which our executive Director, Jun Lei, has a controlling interest of 36.8%, and accordingly, GHIT is a connected person of our Company. GHIT is a website operator which principally operates the game website www.duowan.com. Pursuant to the agreements between GHIT and us, GHIT allows us to place our advertisements in agreed size at its website for a fixed period of time. In each of 2006 and the three months ended March 31, 2007, the transaction amount between GHIT and us were approximately RMB0.03 million and RMB0.05 million, respectively. We entered into a new agreement with GHIT on April 1, 2007 for a term of six months commenced from May 1, 2007 for a transaction value of approximately RMB0.06 million.

Beijing Kingsoft Software Co., Ltd. entered into a manufacturing agreement on March 1, 2007 with Beijing Yinhuihai Paper Product Dealer ("Beijing Paper") for a term of one year, pursuant to which Beijing Paper agreed to manufacture packages for software products of the Group. Beijing Paper is owned and operated by Shoudao Xiong, a cousin of Jun Lei and thus an associate of a connected person of the Company.

The transactions under the above two agreements constitute continuing connected transactions of the Company which are exempt from reporting, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules as they fall within the de minimis threshold under Rule 14A.33 of the Listing Rules.

The independent non-executive directors have reviewed all of the continuing connected transactions referred to above and have confirmed that the transactions have been entered into:

(i) in the ordinary and usual course of the Group's business;

(ii) either on normal commercial terms or on terms no less favourable than terms available to or from independent third parties; and

(iii) in accordance with the relevant agreements governing such transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company 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 reported their factual findings on these procedures to the board of Directors.

Compliance with the Code on Corporate Governance Practices

From the listing of the Company's shares on the Stock Exchange on October 9, 2007 to December 31, 2007, 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.

As to the deviation from code provision A.2.1 of Appendix 14 to the Listing Rules, the Board has set up a Board Committee to recruit the next CEO, therefore the Company has the intention to comply with the requirement to have the roles of chairman and CEO occupied by separate individuals.

Code of Conduct regarding Directors' Securities Transactions

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less than the required standard set out in Appendix 10 — Model Code for Securities Transactions by Directors of Listed Companies under the Listing Rules. All directors of the Company complied with such code of conduct during the financial year ended December 31, 2007.

Pre-Emptive Rights

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

Post balance sheet events

Details of the significant post balance sheet events of the Group are set out in Note 31 to the consolidated financial statement.

Audit and Remuneration Committees

Details of the audit and remuneration committees are set out in the Corporate Governance Report of this annual report.

Auditors

The consolidated financial statements of the Company for the year ended December 31, 2007 has been audited by Ernst & Young, Certified Public Accountants, Hong Kong who retire and, being eligible, offer themselves for re-appointment.

By order of the Board
Pak Kwan Kau
Chairman
PRC, March 31, 2008

INDEPENDENT AUDITORS' REPORT

ERNST & YOUNG

18th Floor
Two International Finance Centre
8 Finance Street, Central
Hong Kong

TO THE SHAREHOLDERS OF KINGSOFT CORPORATION LIMITED
(Continued into the Cayman Island with limited liability)

We have audited the financial statements of Kingsoft Corporation Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") set out on pages 44 to 104, which comprise the consolidated and company balance sheets as at December 31, 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and the disclosure requirements of Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these 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 as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements 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 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 financial statements give a true and fair view of the state of affairs of the Company and of the Group as at December 31, 2007 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
Hong Kong

March 31, 2008

CONSOLIDATED INCOME STATEMENT

Year ended December 31, 2007

	NOTES	2007 RMB'000	2006 RMB'000
Revenue:			
Entertainment software		**396,440**	215,356
Applications software		**156,521**	98,432
Others		**3,653**	2,643
		556,614	316,431
Cost of revenue		**(95,484)**	(44,671)
Gross profit		**461,130**	271,760
Research and development costs, net of government grants		**(68,450)**	(58,914)
Selling and distribution costs		**(108,723)**	(59,504)
Administrative expenses		**(65,785)**	(43,766)
Share-based compensation costs	3, 4	**(103,764)**	(6,852)
Other operating costs	3	**(2,249)**	(13,296)
Impairment of an associate	11	**—**	(6,000)
Other income and gains	3	**11,531**	28,316
Finance income	3	**22,775**	3,753
Finance costs	3	**(1,211)**	(6,271)
Share of loss of an associate	11	**(2,460)**	(527)
Profit before tax	3	**142,794**	108,699
Income tax credit/(expense)	5	**12,658**	(9,589)
Profit for the year		**155,452**	99,110
Attributable to:			
Equity holders of the Company		**164,678**	99,525
Minority interests		**(9,226)**	(415)
		155,452	99,110
Proposed final dividend	6	**95,710**	—
		RMB	**RMB**
Earnings per share attributable to ordinary equity holders of the Company	7		
Basic		**0.1815**	0.1245
Diluted		**0.1725**	0.1185

CONSOLIDATED BALANCE SHEET

December 31, 2007

	NOTES	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	8	**45,446**	32,790
Intangible assets	9	**14,281**	7,178
Lease prepayment	10	**7,304**	601
Interest in an associate	11	**1,014**	3,473
Loan receivables	12	**1,784**	1,403
Deferred tax assets	5	**52,814**	19,477
Deferred cost	13	**1,890**	2,087
		124,533	67,009
CURRENT ASSETS			
Inventories	14	**2,019**	1,726
Trade receivables	15	**60,226**	52,326
Prepayments and other receivables	16	**47,743**	55,050
Income tax receivable		**522**	2,988
Deferred cost	13	**8,939**	6,484
Due from related parties	28	**9,862**	1,618
Cash and cash equivalents	17	**1,246,077**	333,508
		1,375,388	453,700
CURRENT LIABILITIES			
Trade payables	18	**7,120**	5,450
Accrued expenses and other payables	19	**147,062**	91,110
Bank loans and government loans	20	**—**	2,000
Due to related parties	28	**—**	5,297
Deferred revenue	21	**162,002**	117,286
Income tax payable		**6,047**	690
		322,231	221,833
NET CURRENT ASSETS		**1,053,157**	231,867
TOTAL ASSETS LESS CURRENT LIABILITIES		**1,177,690**	298,876

CONSOLIDATED BALANCE SHEET (continued)

December 31, 2007

	NOTES	2007 RMB'000	2006 RMB'000
NON-CURRENT LIABILITIES			
Deferred revenue	21	**29,726**	22,040
Deferred tax liabilities	5	**14,307**	9,009
		44,033	31,049
NET ASSETS		**1,133,657**	267,827
Represented by:			
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT			
Issued capital	22	**4,322**	3,564
Share premium		**735,510**	110,539
Ordinary shares subscribed		**319**	—
Statutory reserves	25	**57,570**	52,140
Employee share-based capital reserve		**144,741**	40,160
Foreign currency translation reserve		**(28,918)**	(1,657)
Retained earnings		**101,953**	38,415
Proposed final dividend	6	**95,710**	—
		1,111,207	243,161
MINORITY INTERESTS		**22,450**	24,666
TOTAL EQUITY		**1,133,657**	267,827

Pak Kwan Kau
Director

Jun Lei
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended December 31, 2007

	ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY									
	ISSUED CAPITAL (Note 22) RMB'000	SHARE PREMIUM (Note 22) RMB'000	ORDINARY SHARES SUBSCRIBED RMB'000	STATUTORY RESERVES RMB'000	EMPLOYEE SHARE-BASED CAPITAL RESERVE RMB'000	FOREIGN CURRENCY TRANSLATION RESERVE RMB'000	RETAINED EARNINGS/ (ACCUMULATED LOSSES) RMB'000	TOTAL RMB'000	MINORITY INTERESTS RMB'000	TOTAL EQUITY RMB'000
AT JANUARY 1, 2006	2,951	234	11,149	22,635	33,486	(697)	(31,605)	38,153	3,600	41,753
Exchange realignment	—	—	—	—	—	(960)	—	(960)	—	(960)
Total income and expense for the year recognised directly in equity	—	—	—	—	—	(960)	—	(960)	—	(960)
Profit for the year	—	—	—	—	—	—	99,525	99,525	(415)	99,110
Total income and expense for the year	—	—	—	—	—	(960)	99,525	98,565	(415)	98,150
Capital contributions from minority interests	—	—	—	—	—	—	—	—	21,481	21,481
Repurchase of issued shares (Note 22(b))	(36)	(17,266)	—	—	—	—	—	(17,302)	—	(17,302)
Share-based compensation costs	—	—	—	—	6,674	—	—	6,674	—	6,674
Issuance of share certificates for ordinary shares subscribed	229	10,920	(11,149)	—	—	—	—	—	—	—
Exercise of share options	135	6,295	—	—	—	—	—	6,430	—	6,430
Issuance of shares	285	113,740	—	—	—	—	—	114,025	—	114,025
Profit appropriation (Note 25)	—	—	—	29,505	—	—	(29,505)	—	—	—
Share issuance expenses (Note 22(c))	—	(3,384)	—	—	—	—	—	(3,384)	—	(3,384)
AT DECEMBER 31, 2006 AND JANUARY 1, 2007	3,564	110,539	—	52,140	40,160	(1,657)	38,415	243,161	24,666	267,827

	ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY										
	ISSUED CAPITAL (NOTE 22) RMB'000	SHARE PREMIUM (NOTE 22) RMB'000	ORDINARY SHARES SUBSCRIBED RMB'000	STATUTORY RESERVES RMB'000	EMPLOYEE SHARE-BASED CAPITAL RESERVE RMB'000	FOREIGN CURRENCY TRANSLATION RESERVE RMB'000	RETAINED EARNINGS/ (ACCUMULATED LOSSES) RMB'000	PROPOSED FINAL DIVIDEND RMB'000	TOTAL RMB'000	MINORITY INTERESTS RMB'000	TOTAL EQUITY RMB'000
AT DECEMBER 31, 2006 AND JANUARY 1, 2007	**3,564**	**110,539**	**—**	**52,140**	**40,160**	**(1,657)**	**38,415**	**—**	**243,161**	**24,666**	**267,827**
Exchange realignment	**—**	**—**	**—**	**—**	**—**	**(27,261)**	**—**	**—**	**(27,261)**	**(299)**	**(27,560)**
Total income and expense for the year recognised directly in equity	**—**	**—**	**—**	**—**	**—**	**(27,261)**	**—**	**—**	**(27,261)**	**(299)**	**(27,560)**
Profit for the year	**—**	**—**	**—**	**—**	**—**	**—**	**164,678**	**—**	**164,678**	**(9,226)**	**155,452**
Total income and expense for the year	**—**	**—**	**—**	**—**	**—**	**(27,261)**	**164,678**	**—**	**137,417**	**(9,525)**	**127,892**
Capital contributions from minority interests	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**6,821**	**6,821**
Share-based compensation costs	**—**	**—**	**—**	**—**	**104,581**	**—**	**—**	**—**	**104,581**	**488**	**105,069**
Issuance of shares	**752**	**693,183**	**—**	**—**	**—**	**—**	**—**	**—**	**693,935**	**—**	**693,935**
Exercise of share options	**6**	**807**	**319**	**—**	**—**	**—**	**—**	**—**	**1,132**	**—**	**1,132**
Profit appropriation (Note 25)	**—**	**—**	**—**	**5,430**	**—**	**—**	**(5,430)**	**—**	**—**	**—**	**—**
Share issuance expenses (Note 22(f))	**—**	**(69,019)**	**—**	**—**	**—**	**—**	**—**	**—**	**(69,019)**	**—**	**(69,019)**
Proposed final 2007 dividend (Note 6)	**—**	**—**	**—**	**—**	**—**	**—**	**(95,710)**	**95,710**	**—**	**—**	**—**
AT DECEMBER 31, 2007	**4,322**	**735,510**	**319**	**57,570**	**144,741**	**(28,918)**	**101,953**	**95,710**	**1,111,207**	**22,450**	**1,133,657**

CONSOLIDATED CASH FLOW STATEMENT

Year ended December 31, 2007

	NOTES	2007 RMB'000	2006 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit for the year		**155,452**	99,110
Adjustments to reconcile profit for the year to net cash generated from operating activities:			
Depreciation	3	**18,185**	15,159
Amortisation of lease prepayment	3	**124**	40
Loss on disposal of items of property, plant and equipment	3	**113**	845
Impairment/write-off of receivables	3	**(2,549)**	9,839
Write-down/(write-back) of inventories	3	**458**	(139)
Amortisation of purchased software	9	**4,947**	2,092
Amortisation of capitalised software costs	9	**1,093**	948
Deferred income tax expense/(credit)	5	**(28,039)**	5,390
Share-based compensation costs		**105,069**	6,674
Impairment loss of an associate	11	**—**	6,000
Share of loss of an associate		**2,460**	527
Transaction costs related to sale of issued ordinary shares by existing shareholders and the listing of existing shares	3(f)	**1,211**	6,055
Changes in assets and liabilities:			
Trade receivables		**(5,350)**	(22,697)
Prepayments and other receivables		**(12,912)**	(20,257)
Income tax receivable		**2,466**	(2,988)
Loan receivables		**(381)**	(378)
Inventories		**(751)**	(1,223)
Balances with related parties		**(5,246)**	(256)
Deferred cost		**197**	(1,927)
Trade payables		**1,670**	642
Deferred revenue		**52,402**	35,094
Accrued expenses and other payables		**49,498**	664
Income tax payable		**5,357**	487
Net cash generated from operating activities		**345,474**	139,701
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from disposal of items of property, plant and equipment		**73**	178
Purchases of items of property, plant and equipment	8	**(31,027)**	(14,072)
Addition of lease prepayment	10	**(6,827)**	—
Deposit for construction project		**(2,580)**	—
Purchases of software	9	**(9,810)**	(7,370)
Capitalised software costs	9	**(3,333)**	(3,001)
Investment in an associate	11	**—**	(10,000)
Increase in time deposits with original maturity of over three months when acquired	17	**(342,155)**	(15,000)
Net cash used in investing activities		**(395,659)**	(49,265)

	NOTES	2007 RMB'000	2006 RMB'000
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of shares		**670,833**	114,025
Repurchase of shares		**—**	(17,302)
Repayment of borrowings		**(2,000)**	(21,558)
Share issuance expenses		**(30,941)**	(11,512)
Exercise of share options		**1,132**	6,430
Capital contributions from minority interests	24	**8,388**	21,381
Net cash generated from financing activities		**647,412**	91,464
NET INCREASE IN CASH AND CASH EQUIVALENTS		**597,227**	181,900
Cash and cash equivalents at the beginning of the year		**318,508**	137,568
Effect of foreign exchange rate changes, net		**(26,813)**	(960)
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	17	**888,922**	318,508
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS:			
Cash and bank balances	17	**171,801**	268,435
Time deposits with original maturity of less than three months when acquired	17	**717,121**	50,073
		888,922	318,508

BALANCE SHEET

December 31, 2007

	NOTES	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Investment in subsidiaries	24	**54,993**	49,271
Intangible assets	9	**5,615**	—
		60,608	49,271
CURRENT ASSETS			
Prepayments and other receivables	16	**1,621**	15,362
Due from related parties	28	**9,862**	—
Cash and cash equivalents	17	**683,070**	80,694
		694,553	96,056
CURRENT LIABILITIES			
Accrued expenses and other payables	19	**13,879**	7,873
Deferred revenue	21	**95**	8,889
Due to subsidiaries	24	**31,780**	30,983
		45,754	47,745
NET CURRENT ASSETS		**648,799**	48,311
NET ASSETS		**709,407**	97,582
EQUITY			
Issued capital	22	**4,322**	3,564
Share premium		**735,510**	110,539
Ordinary shares subscribed		**319**	—
Employee share-based capital reserve	25	**144,233**	40,160
Foreign currency translation reserve	25	**(35,098)**	(3,656)
Accumulated losses	25	**(235,589)**	(53,025)
Proposed final dividend	6	**95,710**	—
TOTAL EQUITY		**709,407**	97,582

Pak Kwan Kau
Director

Jun Lei
Director

1. CORPORATE INFORMATION AND REORGANISATION

(a) Corporate information

Kingsoft Corporation Limited was incorporated under the laws of the British Virgin Islands on March 20, 1998 as a tax exempted company with limited liability under the Companies Act. On November 15, 2005, it was redomiciled under the Company Law (2004 revision) of the Cayman Islands. The registered office of the Company is located at Clifton House, 75 Fort Street, P.O. Box 1350 GT, George Town, Grand Cayman, Cayman Islands.

The principal executive office of the Company is located at 21/F, Baiyan Building, No. 238 Beisihuan Zhong Road, Haidian District, Beijing, the People's Republic of China ("PRC").

(b) Principal activities

The Group's principal businesses are summarised as follows:

- entertainment software segment engages in the research, development, operation and distribution of online game, mobile game and casual game services; and
- applications software segment engages in the research, development, operation and distribution of internet security, dictionary and office applications software products.

The Company's and the Group's principal operations and geographic market are in the PRC.

(c) Reorganisation and Initial Public Offering

In 2007, Zhuhai Kingsoft Software Co., Ltd. ("Zhuhai Software") transferred its 50% of equity interests in Beijing Kingsoft Digital Entertainment Co., Ltd. ("Beijing Digital Entertainment") to Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian"), a domestic company held by close family members of the Company's executive directors. Meanwhile, a series of agreements were entered between Kingsoft Qijian and Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment"), pursuant to which Kingsoft Qijian was made a special purpose entity of the Group and hence was consolidated in the Group. In addition, two general license agreements were entered between Zhuhai Software and Beijing Digital Entertainment, Chengdu Interactive Entertainment and Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment") respectively. Thus, the Group has the right to obtain the majority of the benefits of Beijing Digital Entertainment and Chengdu Digital Entertainment through license fee and dividends.

The Company's shares have been listed on the Stock Exchange since October 9, 2007. The net proceeds from the listing were approximately 649 million Hong Kong dollars ("HK$") and were fully received on October 9, 2007.

On October 16, 2007, the Over-allotment Option was exercised and an additional 32,001,000 shares were sold to the public by the investing shareholders.

In the opinion of the directors, the Company does not have a holding company.

2. PRINCIPAL ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared under the historical cost convention. The consolidated financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

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 requirement of the Hong Kong Companies Ordinance.

Impact of issued but not yet effective IFRSs

The Group has not applied the following relevant new and revised IFRSs and IFRIC interpretations that have been issued but are not yet effective in these financial statements:

- IAS 1 Revised — Presentation of Financial Statements
- IAS 23 Revised — Borrowing Costs
- IAS 27 Revised — Consolidated and Separate Financial Statements
- IAS 28 Revised — Investments in Associates
- IAS 31 Revised — Interests in Joint Ventures
- IAS 32 Revised — Financial Instruments: Presentation
- IFRS 2 Revised — Share-based Payment
- IFRS 3 Revised — Business Combinations
- IFRS 8 — Operating Segments
- IFRIC-Int 11 — Group and Treasury Share Transactions
- IFRIC-Int 12 — Service Concession Arrangements
- IFRIC-Int 13 — Customer Loyalty Programmes

IAS 23 removes the option to immediately recognise as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. The revised standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after January 1, 2009.

Amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for annual periods beginning on or after January 1, 2009. The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity. The Group does not expect these amendments to impact the financial statements of the Group.

The amendment to IFRS 2 Share-based Payment was published in January 2008 and becomes effective for financial years beginning on or after January 1, 2009. The Standard restricts the definition of "vesting condition" to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation. The Group has not entered into share-based payment schemes with non-vesting conditions attached and, therefore, does not expect significant implications on its accounting for share-based payments.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impact of issued but not yet effective IFRSs (continued)

The revised IAS 27 and IFRS 3 were issued in January 2008 and become effective for financial years beginning on or after July 1, 2009. IFRS 3 Revised introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27 Revised requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give raise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3 Revised and IAS 27 Revised must be applied prospectively and will affect future acquisitions and transactions with minority interests.

The revised IFRS 3 resulted in a consequential amendment to IAS 28 and IAS 31, which become effective for financial years beginning on or after July 1, 2009.

IFRS 8 requires segment information to be disclosed based on the "management approach" which means using the information reviewed by the key decision makers of an entity. IFRS 8 shall be applied for annual periods beginning on or after January 1, 2009.

IFRIC-Int 11, IFRIC-Int 12, IFRIC-Int 13 shall be applied for annual periods beginning on or after March 1, 2007, January 1, 2008 and July 1, 2008 respectively.

The Group is in the process of making an assessment of the impact of these new and revised IFRSs upon initial application. So far, it is conclueded that while the adoption on IFRS 8 may result in new or amended disclosures, these new and revised IFRSs are unlikely to have a significant impact on the Group's result of operation and financial position.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries for the year ended December 31, 2007. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions, are eliminated in full.

Subsidiaries are fully 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.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Group's subsidiaries, and are presented separately in the income statement and within equity in the consolidated balance sheet, separately from parent shareholders' equity.

Subsidiaries

A subsidiary is an entity (including 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 interests in subsidiaries are stated at cost less any impairment losses.

Associate

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.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Associate (continued)

The Group's interests in associate are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

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 Company 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 holding company;

(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).

Foreign currencies

The consolidated financial statements and the Company's balance sheet are presented in RMB. The Company and its subsidiaries have determined their functional currencies to be their respective local currencies of HK$, Japanese Yen ("JPY") 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 are initially recorded in the functional currency rate ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. 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 an overseas subsidiary are currencies other than the RMB. Since the Company does not conduct any substantive operations of its own and conducts its primary business operations through its subsidiaries established in the PRC, the Company adopts RMB as the reporting currency of the Group. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the balance sheet date and, their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting exchange differences are included in the foreign currency translation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

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

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Property, plant and equipment

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 it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

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 the following estimated useful lives:

Buildings	20 years
Electronic equipment	3 years
Office equipment	5 years
Motor vehicles	5 years
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 each balance sheet date.

An item of property, plant and equipment 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 property, plant and equipment under construction or installation. It 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 installation. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets and financial assets), the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use 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. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to 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. Impairment losses of continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impairment of non-financial assets (continued)

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Investments and other financial assets

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. 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.

The Group assesses whether a contract contains an embedded derivative when the Group first becomes a party to it and assesses whether an embedded derivatives is required to be separated from the host contract when the analysis shows that the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

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.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; a discounted cash flow analysis; and option revenue models.

The Group only has financial assets classified as "loans and receivables" and "available-for-sale financial assets" during the year ended December 31, 2007.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost less any allowance for impairment using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets in listed and unlisted equity securities that are designated as available-for-sale. After initial recognition, available-for-sale financial assets are measured at fair value, with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

For equity securities where there is no active market and the range of reasonable fair value estimates is significant and the probabilities of various estimates cannot be reasonably assessed, the Group measured such equity securities at cost.

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.

Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. A provision for impairment is made when there is objective evidence that the Group will not be able to collect the debts. 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. In subsequent periods when a trade receivable is ascertained to be uncollectible, it is written off against the allowance account. The Group generally does not require collateral from its customers.

Cash and cash equivalents

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

Borrowing costs

Borrowing costs are recognised as expenses in the income statement in the period in which they are incurred.

Financial liabilities at amortised cost (including interest-bearing loans and borrowings)

Financial liabilities including trade and other payables, an amount due to the related parties and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost. The related interest expense is recognised within "financial cost" in the income statement.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Derecognition of financial assets and liabilities

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 where:

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

Where the Group has transferred its rights to receive cash flows from an asset 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. 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.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

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 in the respective carrying amounts is recognised in the income statement.

Impairment of financial assets

The Group assesses at each balance sheet date whether a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost 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) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognised in the income statement. 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 impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Assets carried at amortised cost (continued)

In relation to trade and other receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor and significant changes in the technological, market economic or legal environment that have an adverse effect on the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument 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 discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

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 transferred from equity to the income statement. A provision for impairment is made for available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or ''prolonged" requires judgement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

Provisions

A provision is recognised when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is included in finance cost 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").

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Share-based payment transactions (continued)

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date when they are granted. The fair value of the Company's ordinary shares on the dates of share option grants were assessed by an independent appraiser, American Appraisal China Limited. The fair values of share options are determined by management using the Black-Scholes valuation model (the "BS Model"), further details of which are set out in note 4. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ("market condition"), if applicable.

The cost of equity-settled transactions with employees is recognised, together with a corresponding increase in equity, presented as employee share-based capital reserve, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognised for equity-settled transactions at each reporting date 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 cumulative expense recognised as at the beginning and end of that period. In case the employees paid to exercise the options but the shares are not issued, such subscribed shares do not have the rights and responsibilities of the actual outstanding ordinary shares. Accordingly, the balance is credited to "ordinary shares subscribed" account instead of to the "issued capital" account until the issue of share certificates.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance 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. In addition, an expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, 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. 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.

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.

Leases

Leases are classified as either capital or operating.

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under capitalised finance leases are included in property, plant and equipment, and depreciated over the shorter of the lease terms and the estimated useful lives of the assets. The finance costs of such leases are charged to the income statement so as to provide a constant periodic rate of charge over the lease terms.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Leases (continued)

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rentals receivable under the operating leases are credited to the income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

The aggregate benefit of incentives provided by the lessor is recognised as a reduction of rental expense over the lease term on the straight-line basis.

Prepaid land lease payments under operating lease are initially stated at cost and subsequently recognised on the straight-line basis over the lease terms.

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, 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 that 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 fulfill certain criteria set by the relevant authorities and which 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.

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 applications software, the provision of online game services, and other revenue which mainly comprises the provision of software consultancy services.

(a) Applications software products

- Software license to original equipment manufacturers ("OEMs")

  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 license 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 license period upon the delivery of the software master copy.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(a) Applications software products (continued)

- Software license to original equipment manufacturers ("OEMs") (continued)

  In addition to multi-year licensing arrangements, the Group also sells perpetual information security and utilities software licenses to OEMs for them to install into their own products. Revenue from the license 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 involves virus definition updates to end users of OEM's products, revenue of this element is recognised over the period during which the virus definition updates service is provided.

- Security and utilities software license sold to non-OEM customers

  The Group sells information security and utilities packaged software products to non-OEM customers, most of which are for individual usage through distributors. The Group also sells information security and dictionary packaged software through electronic download, via the internet, directly to individual end users. The Group offers cash rebates (both contractual and non-contractual, which are determined by management on a discretionary basis) and rights of returns of its products under various policies and programs with its distributors, resellers and end users. Revenue related to packaged software products 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 is offset against revenue in the income statement, together with an accrual in the balance sheet. Besides, the Group determines the amount of returns, which is offset against revenue in the income statement, together with deferred revenue in the balance sheet.

  Starting from 2006, the Group sells Microsoft Window™-based perpetual information security software products to end users in Japan and these customers can obtain latest versions of information security software application upgrades for Windows™ XP, Windows™ 2000 and Windows™ Vista together with online virus definition updates for an unlimited period. These upgrades are accounted for as PCS and all the sales from such perpetual licensed products are deferred and recognised over the estimated practical usage of such products, which estimated to be 10 years.

  Upon expiry of prepaid service cards, any remaining amount is recognised immediately as revenue. The costs related to the production of prepaid services are also deferred until revenue for those prepaid amount is recognised.

- Software license to government agencies

  The Group sells information security and utilities packaged software and office applications licenses through direct sales to government agencies and indirect sales with resellers to government agencies. The license agreements to government agencies generally include services and PCS, such as when-and-if-available upgrades, training and product maintenance, for one to three years. Revenue 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. When the selling price includes an identifiable amount for subsequent servicing, the amount is deferred and recognised as revenue over the period during which the service is performed.

Starting from April 2005, the Group adopted online subscription model for all the 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.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(b) Entertainment software — Online game services

The Group earns revenue from the sale of either its prepaid game cards for its online game products, namely, a pay-to-play subscription-based model and an item-billing revenue model, to the distributors which in turn sell them to end users, or prepaid online points to end customers at the Group's website.

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 deposits. 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 will continue to monitor 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 amount is 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) 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 applications software revenue or other revenue, depending on the nature of project.

(d) Advertising services

Advertising revenues are derived principally from online advertising arrangements. Online advertising arrangements allow advertisers to place advertisements on particular areas of the Group's websites over a particular period of time. Advertising revenues from online advertising arrangements are recognised ratably over the displayed period of the contract when the collectibility is reasonably assured. Revenue from advertisement was reported as other revenue.

(e) Interest income

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

2. PRINCIPAL ACCOUNTING POLICIES (continued)

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, payment for online game services in advance of services being rendered and government grants received in advance of fulfilling the grant requirements.

The deferred revenue consists of the unamortised balance of the sale of software products, the unused balance of online game cards/prepaid service cards sold and deferral of government grants.

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. The income approach is adopted to recognise the government grants. 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.

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised 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 technical and financial resources to complete the project and the ability to measure reliably the expenditure during the development.

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

The carrying value of capitalised software development cost is reviewed for impairment annually when the asset is not yet frequently in use and when an indication of impairment arose during the reporting year. If impairment indication arises, the recoverable amount is estimated and an impairment loss is recognised if the recoverable amount is lower than the carrying amount.

Gains or losses arising from the derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

Upfront licensing fees

Upfront licensing fees paid to third party licensors are capitalised and amortised on a straight-line basis over the shorter of the useful economic life of the relevant online game or license period.

Website and internally used software development costs

The Group expenses all website and internally used software development costs that are incurred in connection with the planning and implementation phases of development and costs that are associated with repair or maintenance of the existing websites and software. Costs incurred in the development phase and satisfy the development costs capitalisation criteria listed above are capitalised and amortised over the estimated product life.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Purchased software

Purchased software is carried at cost less accumulated amortisation. Amortisation is computed using the straight-line method over the estimated economic life of the purchased software from one to three years.

The Group annually reviews the carrying value of the purchased software. If the review indicates that purchased software may not be recoverable, as determined based on an undiscounted cash flow analysis over the remaining amortisation period, the carrying value of the purchased software will be reduced by the estimated shortfall in discounted cash flows.

Taxes

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period 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.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date 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 goodwill or 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 taxable temporary differences associated with investments in subsidiaries, associates and interests in 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, associates and interests in 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 each balance sheet date 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. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

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 at the balance sheet date.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Taxes (continued)

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.

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 reporting date. 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 balance sheet date, 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) Impairment of an available-for-sale investment

The carrying amount of an investment is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. This requires an estimation of the undiscounted future cash flows expected to result from this investment and its eventual disposition. If the sum of the expected undiscounted future cash flow is less than its carrying amount, the Group would recognise an impairment loss based on the excess of its carrying value over the amount of estimated discounted future cash flows.

(b) Recognition of share-based compensation costs

As mentioned in note 4, the Company has granted share options to its employees. The directors have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgment, such as risk-free rate, dividend yield, expected volatility and expected life of options, is required to be made by the directors as the parameters for applying the BS Model. The Company engaged American Appraisal China Limited, independent appraiser, to perform an appraisal of the fair value of the Company's ordinary share.

Besides, the grant of equity instruments might be conditional upon satisfying specified vesting conditions, including service period, performance condition linked to financial performance measure and successful initial public offering. Significant management judgment 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. Determining the number of equity instruments that eventually vest requires management to make assumptions regarding the profit forecast and likelihood of successful initial public offering, and hence they are subject to uncertainty.

The fair value of options granted for the year ended December 31, 2007 determined using the BS Model was approximately RMB194,838 thousand (2006: RMB11,026 thousand). The fair value of options granted by Kingsoft Japan Inc. ("Kingsoft Japan") for the year ended December 31, 2007 determined using the BS Model was approximately RMB2,136 thousand (2006: Nil).

(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 management to make assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits. At December 31, 2007, the best estimate of the carrying amount of capitalised development costs was RMB3,988 thousand (2006: RMB1,748 thousand).

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Estimation uncertainty (continued)

(d) Revenue recognition

(i) Applications software — security and utilities software sold to non-OEM customers

Significant management judgement is required to determine the deferral of revenue of the software, which represents an expected cost for post contract support services, together with a reasonable profit on those services. Determining the amount of post contract support services requires management to estimate the product life cycle of the information security software which is subject to the frequency of changes to the product's functionality and potential termination of the provision of virus definition updates.

As the Group offers cash rebates (both contractual and non-contractual) and rights of returns of its products under various policies and programs with its distributors, resellers, significant management judgement is required to determine the amount of future rebates and returns. The amount of non-contractual rebates is based upon the past sales records of distributors and resellers together with future sales planning strategies, while the amount of returns is based upon the probability of return, and hence they are subject to uncertainty.

Revenue of perpetual information security products is deferred and recognised over the estimated practical usage of such products. Significant management judgement is required to determine the practical usage of perpetual products, which is subject to the emerging new versions of computer operating platforms and potential termination of the provision of virus definition updates.

(ii) 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/day, which is determined on a weighted average basis.

(e) 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. Significant management 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 for the year ended December 31, 2007 (2006: Nil). The amount of unrecognised tax losses as at December 31, 2007 was RMB10,892 thousand (2006: RMB3,123 thousand). Further details are contained in note 5.

(f) 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 judgment 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.

3. PROFIT BEFORE TAX

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

	NOTES	2007 RMB'000	2006 RMB'000
Employee benefits expense	(a)	**244,082**	109,035
Minimum lease payments		**25,554**	20,544
Depreciation	(b)	**18,185**	15,159
Amortisation of lease prepayment	(b)	**124**	40
Amortisation of intangible assets:			
Amortisation of capitalised software costs*		**882**	602
Amortisation of purchased software	(b)	**4,947**	2,092
Write-down/(write-back) of inventories	(c), 14	**458**	(139)
Write-off/(write-back) of receivables	(c)	**(2,549)**	9,839
Loss on disposal of items of property, plant and equipment	(c)	**113**	845
Foreign exchange differences	(c)	**1,053**	576
Donation	(c)	**1,123**	2,175
Auditors' remuneration		**5,600**	—
PRC statutory auditors' remuneration		**350**	231
Other income and gains	(d)	**(11,531)**	(28,316)
Finance income	(e)	**(22,775)**	(3,753)
Finance costs	(f)	**1,211**	6,271
Government grants**		**(18,788)**	(5,110)

* The amortisation of capitalised software costs is included in research and development costs.

** Government grants are granted to support the development of software and online game technology and recorded as a reduction to research and development expenses in the consolidated income statements in the respective years. Government grants received/receivable for which related expenditure has not yet been undertaken are included in deferred income in the consolidated balance sheets. There are no unfulfilled conditions or contingencies relating to these grants.

(a) Employee benefits expense

	2007 RMB'000	2006 RMB'000
Wages and salaries	**110,483**	80,777
Social insurance costs and staff welfare	**20,516**	14,775
Share-based compensation costs	**103,764**	6,852
Pension plan contributions	**9,319**	6,631
	244,082	109,035

3. PROFIT BEFORE TAX (continued)

(b) Depreciation of property, plant and equipment and amortisation of lease prepayment and purchased software

	2007 RMB'000	2006 RMB'000
Included in:		
Cost of revenue	**10,908**	9,777
Research and development costs	**4,467**	2,973
Selling and distribution costs	**468**	423
Administrative expenses	**7,413**	4,118
	23,256	17,291

(c) Other operating costs

	2007 RMB'000	2006 RMB'000
Write-down/(write-back) of inventories	**458**	(139)
Write-off/(write-back) of receivables	**(2,549)**	9,839
Loss on disposal of items of property, plant and equipment	**113**	845
Foreign exchange differences	**1,053**	576
Donation	**1,123**	2,175
Others	**2,051**	—
	2,249	13,296

(d) Other income and gains

	NOTES	2007 RMB'000	2006 RMB'000
Government grants	(i)	**7,171**	15,000
Waiver of reorganisation consideration		**—**	4,316
License fee	(ii)	**4,359**	8,718
Other gains		**1**	282
		11,531	28,316

(i) Various government grants, in aggregate of RMB7 million have been recognised by Chengdu Digital Entertainment and Beijing Digital Entertainment in 2007 according to agreements with the Administrative Committee of Chengdu and Zhongguancun Hi-tech Economic Zone, respectively (the "Agreements").

Chengdu Digital Entertainment holds the licenses and approvals necessary to engage in the entertainment software business and operates online games in the PRC. Pursuant to the Agreements, RMB5 million grant would be awarded to Chengdu Digital Entertainment when the 2007 revenue achieved a pre-determined target amount to RMB200 million. In 2007, Chengdu Digital Entertainment achieved the target and accordingly, the grant was recognised for the year ended December 31, 2007. There are no unfulfilled conditions or contingencies relating to the grant.

3. PROFIT BEFORE TAX (continued)

(d) Other income and gains (continued)

Moreover, Beijing Digital Entertainment received a grant of RMB2 million from Zhongguancun Hi-tech Economic Zone, to award the group's successful listing on The Hong Kong Stock Exchange.

The said grants were made for general business development and further expansion of Chengdu Digital Entertainment and Beijing Digital Entertainment. The above government grants of RMB7 million has been included in "other income and gains" as these immediate financial supports are awarded with no future related costs according to the Agreements.

(ii) The license fee arose from sale of entertainment software license to the minority equity holder of Dalian Kingsoft Interactive Entertainment Co., Ltd. ("Kingsoft Dalian"), which was payable by the minority equity holder prior to the Group's investment in Kingsoft Dalian.

(e) Finance income

	2007 RMB'000	2006 RMB'000
Bank interest income	**22,775**	3,753

(f) Finance costs

	2007 RMB'000	2006 RMB'000
Transaction costs related to sale of issued ordinary shares by existing shareholders and the listing of existing shares	**1,211**	6,055
Interest expenses on bank loans	**—**	216
	1,211	6,271

(g) Directors' and senior executives' remuneration

(A) Directors' remuneration

Details of directors' remuneration are as follows:

	2007 RMB'000	2006 RMB'000
Fees	**—**	—
Other emoluments:		
Salaries, allowances and benefits in kind	**2,976**	1,726
Pension plan contributions	**15**	43
Share-based compensation costs	**19,908**	1,292
	22,899	3,061

3. PROFIT BEFORE TAX (continued)

(g) Directors' and senior executives' remuneration (continued)

(A) Directors' remuneration (continued)

Year ended December 31, 2007

	SALARIES, ALLOWANCES AND BENEFITS IN KIND RMB'000	PENSION PLAN CONTRIBUTIONS RMB'000	SHARE-BASED COMPENSATION RMB'000	TOTAL RMB'000
Executive directors:				
Pak Kwan Kau	**704**	**—**	**—**	**704**
Jun Lei	**1,654**	**15**	**19,884**	**21,553**
Non-executive directors:				
Wing Chung Anders Cheung	**114**	**—**	**24**	**138**
Tuck Lye Koh	**114**	**—**	**—**	**114**
Wai Ming Wong	**104**	**—**	**—**	**104**
Independent non-executive directors:				
Guangming George Lu	**102**	**—**	**—**	**102**
Shun Tak Wong	**102**	**—**	**—**	**102**
Mingming Huang	**82**	**—**	**—**	**82**
	2,976	**15**	**19,908**	**22,899**

Year ended December 31, 2006

	SALARIES, ALLOWANCES AND BENEFITS IN KIND RMB'000	PENSION PLAN CONTRIBUTIONS RMB'000	SHARE-BASED COMPENSATION RMB'000	TOTAL RMB'000
Executive directors:				
Pak Kwan Kau	700	—	—	700
Jun Lei	1,026	43	1,134	2,203
Non-executive directors:				
Xue Zheng Ma	—	—	84	84
Wing Chung Anders Cheung	—	—	53	53
Siu Lung Cheung	—	—	—	—
Shuen Lung Cheung	—	—	21	21
Tuck Lye Koh	—	—	—	—
	1,726	43	1,292	3,061

During the year ended December 31, 2007, certain directors were granted share options, in respect of their services to the Group, under the share option scheme of the Company, further details of which are set out in note 4.

3. PROFIT BEFORE TAX (continued)

(g) Directors' and senior executives' remuneration (continued)

(B) Five highest paid individuals

The five highest paid individuals included Jun Lei for the years ended December 31, 2007 and 2006, details of whose remuneration are set out above. Details of the remuneration of the remaining non-director, highest paid employees for each of the years ended December 31, 2007 and 2006 are as follows:

	2007 RMB'000	2006 RMB'000
Salaries, allowances and benefits in kind	**2,383**	2,202
Bonus	**490**	840
Compensation for loss of office	**—**	1,800
Pension plan contributions	**16**	36
Share-based compensation	**18,079**	1,716
	20,968	6,594

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

	NUMBER OF EMPLOYEES 2007	2006
Nil to RMB1,000,000	**—**	1
RMB1,000,001 to RMB1,500,000	**—**	1
RMB2,000,001 to RMB2,500,000	**—**	2
RMB3,000,001 to RMB3,500,000	**1**	—
RMB3,500,001 to RMB4,000,000	**1**	—
RMB6,000,001 to RMB6,500,000	**1**	—
RMB7,000,001 to RMB7,500,000	**1**	—

During the year ended December 31, 2007, share options were granted to certain non-director, highest paid employees in respect of their services to the Group, under the share option scheme of the Company, further details of which are set out in note 4.

4. SHARE-BASED COMPENSATION COSTS

From 2000 to 2003, the Company entered into share option agreements with employees, chief executives and directors of the Company.

Pursuant to these share option agreements, options are granted with a vesting period over four years of continuous service, with one eighth of the options to vest after each six months of the grant date. Options granted expire in ten years. The ordinary shares acquired can only be sold after the effective date of a registration statement covering any public offering of the Company's securities and a certain period of time as the relevant regulations may require.

4. SHARE-BASED COMPENSATION COSTS (continued)

2004 Pre-IPO Share Option Scheme

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. The offer of a grant of share options under the 2004 Scheme must be accepted within 28 business days from the date of offer, upon payment of a consideration of one Hong Kong dollar in total by the grantee.

The Company has reserved 4,590,000 ordinary shares for issuance under the 2004 Scheme. The maximum number of ordinary shares in respect of which options may be granted under the 2004 Scheme shall not in aggregate exceed ten percent (the "General Mandate") 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. Options under the 2004 Scheme may be granted for periods of up to ten years. The exercise price of share options is determined by the directors. On July 15, 2006, the Company increased its authorised ordinary shares to 70,000,000. 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.

On August 1, 2004, the Company modified the terms of the original share options granted before 2004 and the number of share options increased at a ratio of 1:1.180333. The renewed options were granted at an exercise price of US$0.424 and US$0.565 per share in replacement of the original share options granted before 2004. The renewed options substantially vest fully on the first anniversary of the grant date.

The Company has accounted for this modification in accordance with IFRS 2. Under IFRS 2, the calculation of the incremental value is based on the excess of the fair value of the new (modified) award at the date of modification over the fair value of the original option measured immediately before its terms are modified at the date of modification. The original (pre-modification) option will be valued at the date of modification, without regard to the assumptions made on the grant date. The total incremental compensation cost resulting from the modification amounted to RMB5,834 thousand, which is recognised over the new vesting period.

2007 Pre-IPO Share Option Scheme

Pursuant to a directors' resolution dated January 22, 2007, the Company adopted 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 Pre-IPO Share Option Scheme are the same as the 2004.

The maximum number of ordinary shares in respect of which options may be granted under the 2007 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 Scheme. The exercise price shall be determined and notified by the directors from time to time.

5,632,370 share options were granted to certain employees, senior management and directors of the Group for the year ended on December 31, 2007; out of which 1,109,036 of the share options are conditional upon a successful initial public offering occurring on or before February 1, 2008 and 224,518 options will be fully vested and exercisable on April 30, 2009 if the Group achieves certain net profit target for the year ending December 31, 2008.

The expenses recognised for employee services received in respect of 2004 and 2007 Pre-IPO Share Option Schemes for the year ended December 31, 2007 were RMB102,769 thousand (2006: RMB6,852 thousand).

4. SHARE-BASED COMPENSATION COSTS (continued)

2004 and 2007 Pre-IPO Share Option Schemes

The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of, and movements in, the Company's share options for the years ended December 31, 2007 and 2006, all numbers/per share data of ordinary share of the Company have been presented after the effect of the share split, which is mentioned in note 22(d), except where otherwise indicated.

	COMPANY			
	2007 NO.	**2007 WAEP US$**	**2006 NO.**	**2006 WAEP US$**
Outstanding at January 1	**36,077,960**	**0.1062**	68,597,040[1]	0.0537
Granted during the year	**112,647,400**	**0.2411**	5,796,000	0.2323
Forfeited during the year	**(4,566,000)**	**0.2148**	(4,440,500)	0.0845
Exercised during the year	**(2,481,680)[2]**	**0.0615**	(33,874,580)[2]	0.0242
Expired during the year	**—**	**—**	—	—
Outstanding at December 31	**141,677,680**	**0.2108**	36,077,960	0.1062
Exercisable at December 31	**15,553,660**	**0.1008**	4,904,840	0.1326

1 Included within these balances are options over 23,995,440 shares that have not been recognised in accordance with IFRS 2 as the options were granted on or before November 7, 2002.

2 The weighted average share price at the date of exercise for the options exercised in 2007 was US$0.5180 (2006: US$0.2510).

The weighted average remaining contractual life for the Company's share options outstanding as at December 31, 2007 was 8.64 years (2006: 8.09 years). The weighted average fair value of the Company's options granted during 2007 was US$0.2292 each (2006: US$0.2394 each). The range of exercise prices for options outstanding at the end of 2007 was US$0.0005 to US$0.4616 (2006: US$0.0005 to US$0.2400).

The fair value of equity-settled share options granted is estimated as at the date of grant using the BS Model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the years ended December 31, 2007 and 2006.

	2007	**2006**
Dividend yield (%)	**0%**	0%
Expected volatility (%)	**70%**	70%–100%
Risk-free interest rate (%)	**4.4%–5.2%**	4.1%
Expected forfeiture rate (%)	**0–20.59%**	0–16.7%
Expected life of option (years)	**3–6**	5–8
Weighted average share price (US$)	**0.4380**	0.2335

4. SHARE-BASED COMPENSATION COSTS (continued)

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

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility is determined based on the historical or implied volatility of comparable listed companies, which may also not necessarily be the actual outcome.

No other features of options grant were incorporated into the measurement of fair value.

The following share options are outstanding under the 2004 and 2007 Schemes during the years ended December 31, 2007 and 2006, all numbers/per share data of ordinary share of the Company have been presented after the effect of the share split, which is mentioned in note 22(d), except where otherwise indicated.

	NUMBER OF SHARE OPTIONS						
NAME OR CATEGORY OF PARTICIPANT	**AT JANUARY 1, 2007**	**GRANTED DURING THE YEAR**	**EXERCISED DURING THE YEAR**	**FORFEITED DURING THE YEAR**	**AT DECEMBER 31, 2007**	**DATE OF GRANT OF SHARE OPTIONS**	**EXERCISE PRICE OF SHARE OPTIONS US$ PER SHARE**
EXECUTIVE DIRECTORS							
Jun Lei	5,311,500	—	—	—	5,311,500	August 1, 2004	0.0353
	—	22,451,800	—	—	22,451,800	February 1, 2007	0.2400
	5,311,500	22,451,800	—	—	27,763,300		
NON-EXECUTIVE DIRECTORS							
Shuen Lung Cheung	1,000,000	—	—	—	1,000,000	August 1, 2004	0.0353
Wing Chung Anders Cheung	500,000	—	—	—	500,000	August 1, 2004	0.0353
OTHER EMPLOYEES							
In aggregate	1,770,500	—	—	—	1,770,500	January 1, 2000	0.0005
	212,460	—	(60,000)	—	152,460	January 1, 2001	0.0283
	13,099,500	—	(2,051,680)	(500,000)	10,547,820	August 1, 2004	0.0353
	3,541,000	—	—	—	3,541,000	January 1, 2005	0.2118
	800,000	—	—	—	800,000	March 1, 2005	0.2118
	380,000	—	(110,000)	(20,000)	250,000	April 1, 2005	0.2118
	3,767,000	—	(260,000)	(290,000)	3,217,000	August 1, 2005	0.2118
	696,000	—	—	(140,000)	556,000	January 1, 2006	0.2118
	800,000	—	—	—	800,000	August 1, 2006	0.2118
	4,200,000	—	—	—	4,200,000	December 1, 2006	0.2400
	—	87,957,600	—	(3,616,000)	84,341,600	February 1, 2007	0.2400
	—	1,008,000	—	—	1,008,000	April 1, 2007	0.2400
	—	680,000	—	—	680,000	May 8, 2007	0.2400
	—	550,000	—	—	550,000	August 1, 2007	0.4616
	29,266,460	90,195,600	(2,481,680)	(4,566,000)	112,414,380		
	36,077,960	112,647,400	(2,481,680)	(4,566,000)	141,677,680		

4. SHARE-BASED COMPENSATION COSTS (continued)

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

	NUMBER OF SHARE OPTIONS						
NAME OR CATEGORY OF PARTICIPANT	AT JANUARY 1, 2006	GRANTED DURING THE YEAR	EXERCISED DURING THE YEAR	FORFEITED DURING THE YEAR	AT DECEMBER 31, 2006	DATE OF GRANT OF SHARE OPTIONS	EXERCISE PRICE OF SHARE OPTIONS US$ PER SHARE
EXECUTIVE DIRECTORS							
Jun Lei	7,967,260	—	(2,655,760)	—	5,311,500	August 1, 2004	0.0353
NON-EXECUTIVE DIRECTORS							
Xue Zheng Ma	500,000	—	(500,000)	—	—	August 1, 2004	0.0353
Wing Chung Anders Cheung	500,000	—	—	—	500,000	August 1, 2004	0.0353
Shuen Lung Cheung	1,000,000	—	—	—	1,000,000	August 1, 2004	0.0353
OTHER EMPLOYEES							
In aggregate	10,623,000	—	(7,082,000)	(1,770,500)	1,770,500	January 1, 2000	0.0005
	6,290,500	—	(6,290,500)	—	—	January 1, 2000	0.0212
	6,069,280	—	(5,856,820)	—	212,460	January 1, 2001	0.0283
	25,724,000	—	(11,484,500)	(1,140,000)	13,099,500	August 1, 2004	0.0353
	3,541,000	—	—	—	3,541,000	January 1, 2005	0.2118
	800,000	—	—	—	800,000	March 1, 2005	0.2118
	380,000	—	—	—	380,000	April 1, 2005	0.2118
	140,000	—	—	(140,000)	—	April 1, 2005	0.2824
	5,062,000	—	(5,000)	(1,290,000)	3,767,000	August 1, 2005	0.2118
	—	796,000	—	(100,000)	696,000	January 1, 2006	0.2118
	—	800,000	—	—	800,000	August 1, 2006	0.2118
	—	4,200,000	—	—	4,200,000	December 1, 2006	0.2400
	58,629,780	5,796,000	(30,718,820)	(4,440,500)	29,266,460		
	68,597,040	5,796,000	(33,874,580)	(4,440,500)	36,077,960		

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 to exchange for Kingsoft Japan's ordinary shares and the maximum number of Kingsoft Japan's ordinary shares in respect of which options may be granted shall be 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 are 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 are exercisable upon the Condition. 210 options out of such 410 options have already been forfeited.

4. **SHARE-BASED COMPENSATION COSTS** (continued)

Kingsoft Japan Share Options (continued)

(b) Pursuant to a directors' resolution on March 30, 2007, 90 options are 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 after each three months; 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 expenses recognised in respect of Kingsoft Japan share options during the year ended December 31, 2007 were RMB995 thousand.

5. **INCOME TAX**

(a) The Company is a tax exempted company registered in the Cayman Islands and conducts substantially all of its business through its PRC subsidiaries.

(b) Before 2008, the Company's PRC subsidiaries, Zhuhai Software, Beijing Kingsoft Software Co., Ltd. ("Beijing Software"), Beijing Digital Entertainment, Kingsoft Dalian, Chengdu Digital Entertainment and Kingsoft Qijian are governed by the Corporate Income Tax Law (the "Old CIT Law"), and are subject to corporate income tax at a rate of 33%.

(i) Zhuhai Software, as a software enterprise in the City of Zhuhai, is subject to a reduced income tax rate of 15% on its taxable income. In 2007 and 2006, Zhuhai Software was certified as an important software enterprise (國家規劃布局內重點軟件企業), and was subject to an income tax rate of 10% for the years.

(ii) Beijing Software, as an advanced (高新) technology enterprise, is entitled to enjoy a reduced income tax rate of 15%.

(iii) Beijing Digital Entertainment, as an advanced (高新) technology enterprise, is entitled to enjoy a reduced income tax rate of 15%, exempted from corporate income tax for 2003 to 2005, and entitled to a 50% tax reduction for the two years from 2006 to 2007.

(iv) As an advanced (高新) technology enterprise, Chengdu Digital Entertainment is subject to a reduced income tax rate of 15%, and exempted from corporate income tax from 2006 to 2007.

(v) Kingsoft Qijian with minimal profit that was qualified was subject to the applicable enterprise income tax rate with a reduction of 18% in 2007.

(c) Before 2008, Zhuhai Xishanju Software Co., Ltd. ("Zhuhai Xishanju"), Zhuhai Kingsoft Digital Technology Co., Ltd. ("Zhuhai Digital Technology"), Zhuhai Juntian Electronic Technology Co., Ltd. ("Zhuhai Juntian") and Chengdu Interactive Entertainment are governed by the Income Tax Law of the PRC concerning Foreign Investment and Foreign Enterprises (the "Old CIT Law"), and are subject to a 30% state income tax and a 3% local income tax.

(i) As foreign investment enterprises in the City of Zhuhai, Zhuhai Xishanju, Zhuhai Digital Technology and Zhuhai Juntian are entitled to enjoy a reduced income tax rate of 15% upon expiry of their tax holiday, as well as exemption from local income tax.

5. **INCOME TAX** (continued)

(ii) As an advanced (高新) technology enterprise, Chengdu Interactive Entertainment is entitled to enjoy a reduced state income tax rate of 15%. As a software enterprise, it is also exempted from state income tax of 15% from 2006 to 2007. Therefore, Chengdu Interactive Entertainment is subject to an income tax rate of 3% from 2006 to 2007.

(d) On January 1, 2008, the People's Republic of China Corporate Income Tax Law (the "New CIT Law") became effective, which was concluded and approved in the 5th Session of the 10th National People's Congress on March 16, 2007. The New CIT Law introduces a wide range of changes which include, but are not limited to, the unification of the corporate income tax rate of 25% for both domestic enterprises and foreign-invested enterprises ("FIE"), tax concessions and tax treatment on certain expenses, etc.

Moreover, Zhuhai Software, Zhuhai Xishanju, Zhuhai Digital Technology and Zhuhai Juntian which are located in Zhuahai can enjoy lower tax rates in accordance to the old CIT Laws. They are eligible for transitional arrangements to adopt expected applicable tax rates of 18%, 20%, 22%, 24%, and 25% for the 2008, 2009, 2010, 2011 and the years after 2011 respectively.

(e) In accordance with Japanese tax laws, the income tax rate applicable to Kingsoft Japan is 40.69%.

The major components of income tax expense/(credit) for the years ended December 31, 2007 and 2006 are:

	GROUP	
	2007	**2006**
	RMB'000	**RMB'000**
Current income tax		
Current income tax charge	**15,381**	4,199
Deferred income tax		
Relating to origination and reversal of temporary differences	**(28,039)**	5,390
Income tax expense/(credit) reported in the consolidated income statement	**(12,658)**	9,589

The reconciliation between tax expense and the product of the accounting profit multiplied by the PRC's domestic tax rate for the years ended December 31, 2007 and 2006 is as follows:

	GROUP	
	2007	**2006**
	RMB'000	**RMB'000**
Accounting profit before tax	**142,794**	108,699
At the PRC statutory income tax rate of 33% during the years ended December 31	**47,122**	35,871
Tax holiday or lower tax rate for PRC subsidiaries	**(89,759)**	(33,179)
Effect on deferred tax of change in rates	**(15,103)**	2,640
Non-deductible expenses	**41,229**	9,318
Non-taxable income	**(1,654)**	(5,197)
Unrecognised deferred income tax assets	**5,507**	136
Income tax expense/(credit) reported in the consolidated income statements	**(12,658)**	9,589
Effective income tax rate	**(9%)**	9%

5. INCOME TAX (continued)

Deferred income tax relates to the following:

	CONSOLIDATED BALANCE SHEET		CONSOLIDATED INCOME STATEMENT	
	2007 RMB'000	**2006 RMB'000**	**2007 RMB'000**	**2006 RMB'000**
Deferred income tax liabilities				
Government grants	**(7,747)**	(5,047)	**2,700**	3,580
Deferred cost	**(5,511)**	(3,337)	**2,174**	2,301
Waiver of reorganisation consideration	**(583)**	(475)	**108**	200
Others	**(466)**	(150)	**316**	(88)
	(14,307)	(9,009)	**5,298**	5,993
Deferred income tax assets				
Property, plant and equipment	**698**	479	**(219)**	(196)
Deferred revenue	**39,549**	10,471	**(29,078)**	2,130
Accrued expenses	**6,577**	4,534	**(2,043)**	(405)
Provisions	**3,915**	2,677	**(1,238)**	(1,855)
Capitalised software costs	**2,075**	1,316	**(759)**	(277)
	52,814	19,477	**(33,337)**	(603)
Deferred income tax expense/(credit)			**(28,039)**	5,390

The Group has tax losses arising in the PRC and Japan of RMB10,892 thousand (2006: RMB3,123 thousand) 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:

	2007 RMB'000	**2006 RMB'000**
Tax losses	**10,892**	3,123
Deductible temporary differences	**25,188**	20,259
	36,080	23,382

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.

5. INCOME TAX (continued)

The amounts and expiration dates of the operating loss carryforward at December 31, 2007 and 2006 are listed below:

EXPIRATION DATE	2007 RMB'000	2006 RMB'000
December 31, 2007	**—**	152
December 31, 2008	**37**	37
December 31, 2009	**37**	37
December 31, 2010	**42**	42
December 31, 2011	**491**	491
After December 31, 2011	**10,285**	2,364

6. DIVIDEND

	2007 RMB'000	2006 RMB'000
Proposed final — HK$0.1 per ordinary share	**95,710**	—

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

7. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY

The calculation of basic earnings per share amounts is based on the profit for the year attributable to ordinary equity holders of the Company, and the weighted average number of ordinary shares in issue during the year.

The calculation of diluted earnings per share amounts is based on the profit for the year attributable to ordinary equity holders of the Company. 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 or conversion of all dilutive potential ordinary shares relating to the Group's Share Option Schemes into ordinary shares.

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

	2007 RMB'000	2006 RMB'000
EARNINGS		
Profit attributable to ordinary equity holders of the Company, used in the basic earnings per share calculation	**164,678**	99,525

7. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY (continued)

	NUMBER OF SHARES 2007	2006
SHARES		
Weighted average number of ordinary shares in issue during the year used in the basic earnings per share calculation*	**907,336,598**	799,348,984
Effect of dilution:		
Share options	**47,376,651**	40,540,157
Weighted average number of ordinary shares in issue during the year adjusted for the effect of dilution	**954,713,249**	839,889,141

The weighted average number of ordinary shares in issue for year ended Dec 31, 2006, has been retrospectively adjusted for the effects of the share split of the ordinary shares took place as set out in note 22(d).

* *Weighted average number of ordinary shares in issue included Ordinary Shares Subscribed as the issuance of the related shares are mandatory to the Company and subscriptions were paid by subscribers.*

8. PROPERTY, PLANT AND EQUIPMENT

GROUP	BUILDINGS RMB'000	ELECTRONIC EQUIPMENT RMB'000	OFFICE EQUIPMENT RMB'000	MOTOR VEHICLES RMB'000	LEASEHOLD IMPROVEMENTS RMB'000	CONSTRUCTION IN PROGRESS RMB'000	TOTAL RMB'000
At January 1, 2006, net of accumulated depreciation and impairment	724	29,796	1,200	247	2,933	—	34,900
Additions	—	7,489	1,067	1,068	4,332	116	14,072
Disposals	(706)	(205)	(78)	(14)	(20)	—	(1,023)
Depreciation charge for the year	(18)	(12,430)	(417)	(141)	(2,153)	—	(15,159)
At December 31, 2006, and January 1, 2007, net of accumulated depreciation and impairment	**—**	**24,650**	**1,772**	**1,160**	**5,092**	**116**	**32,790**
Additions	**—**	**20,842**	**312**	**—**	**1,730**	**8,143**	**31,027**
Disposals	**—**	**(186)**	**—**	**—**	**—**	**—**	**(186)**
Depreciation charge for the year	**—**	**(13,978)**	**(587)**	**(240)**	**(3,380)**	**—**	**(18,185)**
At December 31, 2007, net of accumulated depreciation and impairment	**—**	**31,328**	**1,497**	**920**	**3,442**	**8,259**	**45,446**
AT DECEMBER 31, 2007							
Cost	**—**	**68,719**	**4,076**	**1,595**	**13,454**	**8,259**	**96,103**
Accumulated depreciation and impairment	**—**	**(37,391)**	**(2,579)**	**(675)**	**(10,012)**	**—**	**(50,657)**
Net carrying amount	**—**	**31,328**	**1,497**	**920**	**3,442**	**8,259**	**45,446**
AT DECEMBER 31, 2006							
Cost	—	48,747	3,764	1,595	14,588	116	68,810
Accumulated depreciation and impairment	—	(24,097)	(1,992)	(435)	(9,496)	—	(36,020)
Net carrying amount	—	24,650	1,772	1,160	5,092	116	32,790

9. INTANGIBLE ASSETS

GROUP	PURCHASED SOFTWARE RMB'000	CAPITALISED SOFTWARE COSTS RMB'000	TOTAL RMB'000
At January 1, 2006	152	1,100	1,252
Addition of software costs	7,370	3,001	10,371
Net of government grants	—	(1,405)	(1,405)
Amortisation, net	(2,092)	(948)	(3,040)
At December 31, 2006 and January 1, 2007	**5,430**	**1,748**	**7,178**
Addition of software costs	**9,810**	**3,333**	**13,143**
Amortisation, net	**(4,947)**	**(1,093)**	**(6,040)**
At December 31, 2007	**10,293**	**3,988**	**14,281**
AT DECEMBER 31, 2007			
Cost	**17,852**	**9,103**	**26,955**
Accumulated amortisation and impairment	**(7,559)**	**(5,115)**	**(12,674)**
Net carrying amount	**10,293**	**3,988**	**14,281**
AT DECEMBER 31, 2006			
Cost	8,042	5,770	13,812
Accumulated amortisation and impairment	(2,612)	(4,022)	(6,634)
Net carrying amount	5,430	1,748	7,178

During the years ended December 31, 2007 and 2006, capitalised software costs are related to development expenditure on applications software products.

The Company's intangible assets represent the purchased online game engine.

10. LEASE PREPAYMENT

	GROUP	
	2007 RMB'000	2006 RMB'000
Carrying amount at the beginning of the year	**601**	641
Addition	**6,827**	—
Amortisation, net	**(124)**	(40)
Carrying amount at the end of the year	**7,304**	601

The leasehold land is held under a long leasehold (50 years) and is situated in Zhuhai.

11. INTEREST IN AN ASSOCIATE

	GROUP 2007 RMB'000	2006 RMB'000
Shares of net assets	**1,014**	3,473

The Group applies the requirement of IAS 39 Financial Instruments: Recognition and Measurement to determine whether it is necessary to recognise any additional impairment loss with respect to the Group's net investment in the associate. The impairment loss recognised in the income statement during the year ended December 31, 2007 was Nil (2006: RMB6 million). No impairment loss with regard to the interests in an associate was recognised for the year ended December 31, 2007.

Particulars of the associate are as follows:

NAME	PLACE AND DATE OF REGISTRATION AND PLACE OF OPERATIONS	NOMINAL VALUE OF REGISTERED CAPITAL	PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE GROUP	PRINCIPAL ACTIVITIES
Guangzhou Kingsoft Duoyi Internet Technology Co., Ltd. ("Kingsoft Guangzhou")*	PRC July 14, 2006	RMB 10,000,000	40	Research, development and provision of online game service

* Indirectly held by the Company

The following table illustrates the summarised financial information of the Group's associate extracted from its financial statements:

	2007 RMB'000	2006 RMB'000
Assets	**8,271**	8,823
Liabilities	**(5,737)**	(140)
Revenue	**2,292**	—
Loss	**(6,150)**	(1,317)

Pursuant to the cooperative agreement, the Company is required to transfer up to 20% of its equity interest in Kingsoft Guangzhou at a consideration of RMB1 to the only other equity holder of Kingsoft Guangzhou should Kingsoft Guangzhou's revenue achieve certain pre-determined revenue targets in the coming years.

12. LOAN RECEIVABLES

The loan receivables are interest-free housing loans granted to employees, which were carried at amortised cost with effective interest rates of 7.38% and 6.48% per annum during the years ended December 31, 2007 and 2006. The general terms of the loan receivables are three to five years and they are repaid monthly by employees.

13. DEFERRED COST

Deferred cost represents costs of packaging materials, computer disks and cards in relation to provision of entertainment software and applications software service and sale of applications software products in advance of the revenue being recognised.

14. INVENTORIES

	GROUP	
	2007 RMB'000	2006 RMB'000
Raw materials	**551**	368
Finished goods	**1,375**	1,342
Consignment	**93**	16
	2,019	1,726

The amounts of the write-down/(write-back) of inventories recognised as an expense for the year ended December 31, 2007 was RMB458 thousand (2006: RMB(139) thousand). This expense is included in "other operating costs", which is disclosed in note 3.

15. TRADE RECEIVABLES

Trade receivables, which are non-interest bearing and generally on terms of 30 to 90 days credit, are recognised and carried at original invoiced amount 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. 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 balance sheet dates, based on the invoice date, is as follows:

	GROUP	
	2007 RMB'000	2006 RMB'000
0–30 days	**51,147**	31,130
31–60 days	**1,141**	13,790
61–90 days	**1,926**	1,007
91–365 days	**2,555**	4,788
Over one year	**3,457**	1,611
	60,226	52,326

16. PREPAYMENTS AND OTHER RECEIVABLES

		GROUP	
	NOTE	2007 RMB'000	2006 RMB'000
Government grants receivable		**5,830**	15,530
Prepayment related to the listing of the Company's shares		**—**	14,739
Prepaid license fee		**9,889**	7,269
Prepaid corporate income tax		**3,980**	4,809
Value-added tax receivable		**10,427**	3,674
Prepaid value-added tax		**691**	1,101
Advances to staff	(a)	**3,317**	2,265
Deposits		**3,783**	2,596
Accrued interest income		**5,056**	1,541
Advances to suppliers		**172**	712
Deposits for construction project		**2,580**	—
Prepaid expenses		**1,457**	537
Other current assets		**561**	277
		47,743	55,050

	COMPANY	
	2007 RMB'000	2006 RMB'000
Prepayment related to issuance of equity securities	**—**	14,739
Other current assets	**1,621**	623
Total	**1,621**	15,362

(a) Advances to staff are for the purpose of payment of daily operating expenditures. In general, the Group's policy requests the advances to be settled by staff within one month. The advances are unsecured and interest free.

17. CASH AND CASH EQUIVALENTS

	GROUP	
	2007 RMB'000	2006 RMB'000
Cash and bank balances	**171,801**	268,435
Time deposits with original maturity of less than three months when acquired	**717,121**	50,073
	888,922	318,508
Time deposits with original maturity of over three months when acquired	**357,155**	15,000
	1,246,077	333,508

17. CASH AND CASH EQUIVALENTS (continued)

	COMPANY	
	2007	**2006**
	RMB'000	**RMB'000**
Cash and bank balances	**16,649**	80,694
Time deposits	**666,421**	—
	683,070	80,694

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, 2007 and 2006 approximate to their fair values.

At the balance sheet date, the cash and cash equivalents balances of the Group denominated in RMB amounted to RMB537,006 thousand and RMB238,249 thousand as at December 31, 2007 and 2006, respectively. 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.

18. TRADE PAYABLES

An aged analysis of the Group's trade payables is as follows:

	GROUP	
	2007	**2006**
	RMB'000	**RMB'000**
0–30 days	**2,328**	2,507
31–60 days	**1,307**	852
61–90 days	**1,192**	333
91–365 days	**773**	570
Over one year	**1,520**	1,188
	7,120	5,450

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

19. ACCRUED EXPENSES AND OTHER PAYABLES

	GROUP	
	2007	**2006**
	RMB'000	**RMB'000**
Deposits received from customers	**10,621**	7,845
Staff costs and welfare accruals	**41,385**	34,210
Marketing and administrative expense accruals	**72,125**	38,531
Other taxes payable	**19,118**	9,869
Others	**3,813**	655
	147,062	91,110

Other payables are non-interest-bearing.

The Company's accruals are related to administrative expenses.

20. BANK LOANS AND GOVERNMENT LOANS

GROUP	NOTES	EFFECTIVE INTEREST RATE %	MATURITY	2007 RMB'000	2006 RMB'000
CURRENT					
RMB1 million interest-free government loan	(a)	5.49	December 31, 2005	—	1,000
RMB1 million interest-free government loan	(b)	5.76	December 30, 2006	—	1,000
				—	2,000

(a) RMB1 million interest-free government loan

As at December 31, 2005, the Group was provided with an interest-free loan of RMB1 million from the local government. The interest-free loan was unsecured and was repayable in full on December 31, 2005. The loan was repaid in 2007.

(b) RMB1 million interest-free government loan

As at December 31, 2005, the Group was provided with an interest-free loan of RMB1 million from the local government. The interest-free loan was unsecured and was repayable in full on December 30, 2006. The loan was repaid in 2007.

21. DEFERRED REVENUE

	GROUP	
	2007 RMB'000	2006 RMB'000
Entertainment software	**82,055**	57,444
Applications software	**104,816**	73,238
Government grants	**4,657**	8,444
Others	**200**	200
	191,728	139,326
Less: Current portion	**(162,002)**	(117,286)
Non-current portion	**29,726**	22,040

21. DEFERRED REVENUE (continued)

	COMPANY	
	2007	**2006**
	RMB'000	**RMB'000**
Applications software	**95**	8,889
Less: Current portion	**(95)**	(8,889)
Non-current portion	**—**	—

22. AUTHORISED AND ISSUED CAPITAL

	GROUP AND COMPANY	
	2007	**2006**
	RMB'000	**RMB'000**
Authorised:		
2,400,000,000 ordinary shares of US$0.0005 each (2006: 70,000,000 ordinary shares of US$0.01 each)	**9,260**	5,601
Issued and fully paid:		
1,061,726,020 ordinary shares of US$0.0005 each (2006: 43,065,777 ordinary shares of US$0.01 each)	**4,322**	3,564

During the years ended December 31, 2006 and 2007, the movements in share capital were as follows:

(a) On August 18, 2006, 3,571,429 shares of US$0.01 each were issued for cash at a subscription price of US$4.00 per share (the "Private Placement"). Pursuant to the Share Subscription and Purchase Agreement, the purchase price for the newly issued shares is subject to a future upward adjustment if the adjusted audited 2007 net profit of the Group exceeds US$25 million according to a pre-determined formula, with a cap at US$5.60. Adjusted audited 2007 net profit is the profit for the year shown in the 2007 audited financial statements adjusted by adding back charges incurred as a result of issuance of employee stock options pursuant to the employee stock option plan and subtracting the following items:

i) any increase in net profit of the Company attributable to any pay-down of existing debt in excess of contractually required payments;

ii) any profit resulting from the disposal of a significant portion of the assets or investments reflected in the consolidated financial statements of the Company; and

iii) any income attributable to equity pick-up from an unconsolidated investee company relating to events described in (i) or (ii) above.

The management anticipates that the adjusted audited 2007 net profit would be above the threshold amount of US$25 million, and expects for an additional contribution from shareholders. However, as the adjusted price is based on the adjusted audited 2007 net profit, and the additional consideration is merely a contingent asset which did not fulfill the recognition per IASB framework, this additional contribution is neither recognised as an asset, nor recognised as additional share premium.

22. AUTHORISED AND ISSUED CAPITAL (continued)

(b) On August 28, 2006, the Company entered into share repurchase agreements with certain employees, who had exercised their options before or on that day, and had used US$2,168 thousand (equivalent to RMB17,302 thousand) to repurchase 451,595 ordinary shares. The purchase price was US$4.80 per share. The excess of US$2,163 thousand (equivalent to RMB17,266 thousand) of purchase price over par value was set off against share premium.

(c) In connection with the share issuance as mentioned in note (a) above, 9,285,715 issued ordinary shares were transferred from two existing equity holders to the new equity holders and another two existing equity holders at a consideration of RMB296,465 thousand. The total costs borne by the Group in relation to share issuance and transfer of shares between equity holders was RMB9,439 thousand, of which RMB6,055 thousand and RMB3,384 thousand was charged to the income statement and shareholders' equity, respectively, based on the ratio of the transferred shares and newly issued shares.

(d) Pursuant to a resolution passed on September 3, 2007, the Company undertook a share split whereby each of the then issued ordinary share was split into 20 ordinary shares. Accordingly, the total number of issued shares as of September 3, 2007 increased from 43,069,777 shares to 861,395,540 shares and the nominal value of each share was changed from US$0.01 each to US$0.0005 each. The authorised share capital of the Company of 70,000,000 shares of US$0.01 each has been increased to 1,400,000,000 shares of US$0.0005 each.

Following the share split, the authorised share capital of the Company is increased from US$700,000 divided into 1,400,000,000 ordinary shares of US$0.0005 each to US$1,200,000 divided into 2,400,000,000 ordinary shares of US$0.0005 each.

(e) The Company's shares have been listed on the Stock Exchange since October 9, 2007. The initial public offering consisted of 213,337,000 shares, among which 198,823,800 shares were newly issued by the Company and 14,513,200 shares was offered by Lenovo Manufacturing Limited ("Lenovo"), an existing shareholder. The net proceeds from the listing were approximately HK$649,083 thousand and were fully received on October 9, 2007.

(f) Transaction costs amounted to RMB69,019 thousand that relate to the issue of new shares, which is mentioned in note (e) above, is recorded as a reduction of share premium.

22. AUTHORISED AND ISSUED CAPITAL (continued)

A summary of the transactions during the years ended December 31, 2006 and 2007, with reference to the above movements in the Company's issued capital is as follows:

GROUP	NOTES	NUMBER OF SHARES IN ISSUE	ISSUED SHARE CAPITAL RMB'000	SHARE PREMIUM ACCOUNT RMB'000	TOTAL RMB'000
At January 1, 2006		35,410,000	2,951	234	3,185
Issuance of shares	(a)	3,571,429	285	113,740	114,025
Exercise of share options		4,535,943	364	17,215	17,579
Repurchase of shares	(b)	(451,595)	(36)	(17,266)	(17,302)
Share issuance expenses	(c)	—	—	(3,384)	(3,384)
At December 31, 2006 and January 1, 2007		43,065,777	3,564	110,539	114,103
Exercise of share options before share split		**4,000**	**—**	**21**	**21**
Share split at 1:20	(d)	**818,325,763**	**—**	**—**	**—**
Issuance of shares	(e)	**198,823,800**	**752**	**693,183**	**693,935**
Exercise of share options after share split		**1,506,680**	**6**	**786**	**792**
Share issuance expenses	(f)	**—**	**—**	**(69,019)**	**(69,019)**
At December 31, 2007		**1,061,726,020**	**4,322**	**735,510**	**739,832**

23. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of our operations and the products and services we provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Details of the business segments are summarised as follows:

(a) the entertainment software segment provides online game, mobile game and casual game services;

(b) the applications software segment engages in the research, development and distribution of internet security software, dictionary software and office applications software products; and

(c) The "others" segment comprises, principally the Group's software consultancy services and advertising services.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. Over 97% of the Group's assets are located in the Mainland China and Hong Kong as at December 31, 2007.

23. SEGMENT INFORMATION (continued)

(a) Business segments

	ENTERTAINMENT SOFTWARE RMB'000	APPLICATIONS SOFTWARE RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
YEAR ENDED DECEMBER 31, 2007					
REVENUE					
Sales to external customers	396,440	156,521	3,653	—	556,614
TOTAL REVENUE	396,440	156,521	3,653	—	556,614
RESULTS					
Segment results	233,326	57,688	3,653	—	294,667
Unallocated expenses					(170,977)
Finance income					22,775
Finance costs					(1,211)
Share of loss of an associate	(2,460)	—	—	—	(2,460)
Profit before tax					142,794
Income tax credit					12,658
PROFIT FOR THE YEAR					155,452
AS AT DECEMBER 31, 2007					
ASSETS AND LIABILITIES					
Segment assets	504,061	189,111	—	—	693,172
Interest in an associate	1,014	—	—	—	1,014
Corporate and other unallocated assets					805,735
TOTAL ASSETS					1,499,921
Segment liabilities	136,273	123,899	—	—	260,172
Corporate and other unallocated liabilities					106,092
TOTAL LIABILITIES					366,264
OTHER SEGMENT INFORMATION					
Depreciation and amortisation	15,621	6,147	—	—	21,768
Corporate and other unallocated amounts					2,581
TOTAL DEPRECIATION AND AMORTISATION					24,349
CAPITAL EXPENDITURE					
Tangible assets	15,512	14,742	—	—	30,254
Intangible assets	958	4,881	—	—	5,839
Other unallocated amounts					14,904
TOTAL CAPITAL EXPENDITURE					50,997
Impairment loss/(reversal of impairment loss) recognised in the income statement	(14)	472	—	—	458
Write-back of receivables	(18)	(2,531)	—	—	(2,549)

23. SEGMENT INFORMATION (continued)

(a) Business segments (continued)

	ENTERTAINMENT SOFTWARE RMB'000	APPLICATIONS SOFTWARE RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
YEAR ENDED DECEMBER 31, 2006					
REVENUE					
Sales to external customers	215,356	98,432	2,643	—	316,431
TOTAL REVENUE	215,356	98,432	2,643	—	316,431
RESULTS					
Segment results	126,007	27,960	2,643	—	156,610
Unallocated expenses					(44,866)
Finance income					3,753
Finance costs					(6,271)
Share of loss of an associate	(527)	—	—	—	(527)
Profit before tax					108,699
Income tax expense					(9,589)
PROFIT FOR THE YEAR					99,110
AS AT DECEMBER 31, 2006					
ASSETS AND LIABILITIES					
Segment assets	239,344	124,821	—	—	364,165
Interest in an associate	3,473	—	—	—	3,473
Corporate and other unallocated assets					153,071
TOTAL ASSETS					520,709
Segment liabilities	81,188	98,476	—	—	179,664
Corporate and other unallocated liabilities					73,218
TOTAL LIABILITIES					252,882
OTHER SEGMENT INFORMATION					
Depreciation and amortisation	13,313	4,246	—	—	17,559
Corporate and other unallocated amounts					680
TOTAL DEPRECIATION AND AMORTISATION					18,239
CAPITAL EXPENDITURE					
Tangible assets	7,191	6,373	—	—	13,564
Intangible assets	5,554	3,412	—	—	8,966
Other unallocated amounts					508
TOTAL CAPITAL EXPENDITURE					23,038
Impairment loss/(reversal of impairment loss) recognised in the income statement	6,053	(192)	—	—	5,861
Write-off of receivables	324	9,515	—	—	9,839

23. SEGMENT INFORMATION (continued)

(b) Geographical segments

The following tables present revenue and certain asset and expenditure information for the Group's geographical segments:

YEAR ENDED DECEMBER 31, 2007	MAINLAND CHINA AND HONG KONG RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
SEGMENT REVENUE				
Sales to external customers	**481,676**	**74,938**	**—**	**556,614**
OTHER SEGMENT INFORMATION				
Segment assets	**1,468,478**	**31,443**	**—**	**1,499,921**
Capital expenditure	**49,897**	**1,100**	**—**	**50,997**

YEAR ENDED DECEMBER 31, 2006	MAINLAND CHINA AND HONG KONG RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
SEGMENT REVENUE				
Sales to external customers	270,226	46,205	—	316,431
OTHER SEGMENT INFORMATION				
Segment assets	500,418	20,291	—	520,709
Capital expenditure	21,881	1,157	—	23,038

24. INVESTMENT IN SUBSIDIARIES AND AMOUNTS WITH SUBSIDIARIES

	COMPANY	
	2007 RMB'000	2006 RMB'000
Unlisted shares, at cost	**54,993**	49,271
Less: Impairment	**—**	—
	54,993	49,271

The amounts due from and to subsidiaries are unsecured, interest-free and are repayable on demand.

24. INVESTMENT IN SUBSIDIARIES AND AMOUNTS WITH SUBSIDIARIES (continued)

The consolidated financial statements include the financial statements of the Company and the subsidiaries listed in the following table.

	NOTES	COUNTRY OF INCORPORATION/ REGISTRATION AND OPERATIONS	PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2007	2006
Zhuhai Digital Technology		PRC	**100%**	100%
Zhuhai Juntian		PRC	**100%**	100%
Zhuhai Software		PRC	**100%**	100%
Beijing Software		PRC	**100%**	100%
Beijing Digital Entertainment	(a), (d)	PRC	**100%**	100%
Zhuhai Xishanju		PRC	**100%**	100%
Kingsoft Japan	(b)	Japan	**51%**	51%
Kingsoft Dalian		PRC	**51%**	51%
Chengdu Digital Entertainment	(c)	PRC	**100%**	100%
Chengdu Interactive Entertainment		PRC	**100%**	100%
Kingsoft Qijian	(d)	PRC	**100%**	—

All the companies are with Limited Liability. They are indirectly held by the Company, except for Zhuhai Digital Technology, Chengdu Interactive Entertainment, Zhuhai Juntian and Kingsoft Japan, which are directly held by the Company.

(a) As of December 31, 2006, Beijing Digital Entertainment is 50% indirectly owned by the Company. Zhuhai Software is granted an exclusive call option to buy at its sole discretion at any time part or all of the equity holding in Beijing Digital Entertainment. The equity holders of Kingsoft Qijian borrowed loans from Zhuhai Software for their investment and the loans are secured by equity interests in Beijing Digital Entertainment. During the pledge period, Kingsoft Qijian forfeits the right to dividend from Beijing Digital Entertainment, and Zhuhai Software is entitled to 100% of the dividends from Beijing Digital Entertainment. The Company has rights to obtain the majority of the benefits from Beijing Digital Entertainment's operations, and therefore may be exposed to risk incident to the activities of Beijing Digital Entertainment. Accordingly, Beijing Digital Entertainment is accounted for as a subsidiary by virtue of the Company's control over it.

(b) Pursuant to the shareholders' agreement of Kingsoft Japan, the Group may purchase shares to give the Group voting power over the financial and operating policies of Kingsoft Japan (potential voting rights). Accordingly, Kingsoft Japan is accounted for as a subsidiary by virtue of the Company's control over it.

(c) As at December 31, 2006, Chengdu Digital Entertainment is 99% owned by Beijing Digital Entertainment, which is accounted for as subsidiary as detailed in note (a) above. The minority equity holder borrowed a loan from Chengdu Interactive Entertainment for its investment in Chengdu Digital Entertainment and the loan is secured by its equity interests 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 holding held by the minority equity holder in Chengdu Digital Entertainment. During the pledge period, the minority equity holder forfeits the right to dividend from Chengdu Digital Entertainment and Chengdu Interactive Entertainment is entitled to this portion of dividends from Chengdu Interactive Entertainment. Chengdu Digital Entertainment entered into license agreement with Chengdu Interactive Entertainment and the Company, via Chengdu Interactive Entertainment, has rights to obtain the majority of the benefits from Chengdu Digital Entertainment's operations, and therefore may be exposed to risk incident to the activities of Chengdu Digital Entertainment. Accordingly, Chengdu Digital Entertainment is accounted for as a subsidiary by virtue of the Company's control over it.

24. INVESTMENT IN SUBSIDIARIES AND AMOUNTS WITH SUBSIDIARIES (continued)

(d) In March 2007, the two individual equity holders of Kingsoft Qijian ("Kingsoft Qijian's equity holders") entered into loan agreement with Chengdu Interactive Entertainment, which repaid the loan provided by Zhuhai Software in August 2005. The loans are secured by the respective equity interests in Kingsoft Qijian. Besides, Chengdu Interactive Entertainment has been granted an exclusive irrevocable option to purchase the equity interests in Kingsoft Qijian held by Kingsoft Qijian's equity holders. Kingsoft Qijian's equity holders entrusts all of their respective voting 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 therefore may be exposed to risk incident to the activities of Kingsoft Qijian. Accordingly, Kingsoft Qijian is accounted for as a subsidiary by virtue of the Company's control over it.

In March 2007, Kingsoft Qijian and Zhuhai Software entered into an equity transfer agreement pursuant to which Zhuhai Software transferred its 50% equity interest in Beijing Digital Entertainment to Kingsoft Qijian. As a result of the equity transfer, Kingsoft Qijian wholly owns Beijing Digital Entertainment. Further to the contractual arrangements stated in the above paragraph, Beijing Digital Entertainment entered into license agreement with Zhuhai Software and the Company, via Zhuhai Software, has rights to obtain the majority of the benefits from Beijing Digital Entertainment's operations. Therefore, the Company may be exposed to risk incident to the activities of Beijing Digital Entertainment. Accordingly, Beijing Digital Entertainment continues to be accounted for as a subsidiary by virtue of the Company's control over it.

25. RESERVES

(a) Group

The amount of the Group's reserves and the movement therein for the year ended December 31, 2007 are presented in the consolidated statement of changes in equity.

In accordance with the regulations in the PRC and the respective articles of association, Zhuhai Digital Technology, Zhuhai Juntian, Zhuhai Software, Zhuhai Xishanju, Beijing Software, Beijing Digital Entertainment, Chengdu Digital Entertainment, Kingsoft Dalian and Chengdu Interactive Entertainment 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. Appropriations are classified in the consolidated balance sheet 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 capitals of the respective companies.

In addition, at the discretion of the respective boards of directors: (1) the subsidiaries as foreign invested enterprises may allocate a portion of their after-tax profits to the staff welfare and bonus reserve, (2) the subsidiaries as domestic companies may allocate a portion of their respective after-tax profits to the discretionary surplus reserve, and (3) the subsidiary as a Chinese-foreign equity joint venture may allocate a portion of its after-tax profit to the reserve fund, enterprise expansion fund or staff welfare and bonus reserve. The use of the staff welfare and bonus reserve is restricted to employees' welfare benefits and is not available for distribution to equity owners except in liquidation. Appropriations to the staff welfare and bonus reserve are charged to the income statements as administrative expense, and any unutilised balance is included in current liabilities.

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.

25. RESERVES (continued)

(b) Company

	NOTES	SHARE PREMIUM RMB'000	EMPLOYEE SHARE-BASED CAPITAL RESERVE RMB'000	FOREIGN CURRENCY TRANSLATION RESERVE RMB'000	ACCUMULATED LOSSES RMB'000	TOTAL RMB'000
At January 1, 2006		234	33,486	(1,045)	(43,285)	(10,610)
Exchange realignment		—	—	(2,611)	—	(2,611)
Total income and expense for the year recognised directly in equity		—	—	(2,611)	—	(2,611)
Loss for the year		—	—	—	(9,740)	(9,740)
Total income and expense for the year		—	—	(2,611)	(9,740)	(12,351)
Exercise of share options		6,295	—	—	—	6,295
Share-based compensation costs		—	6,674	—	—	6,674
Issuance of share certificates for ordinary shares subscribed		10,920	—	—	—	10,920
Issuance of shares		113,740	—	—	—	113,740
Repurchase of issued shares	22(b)	(17,266)	—	—	—	(17,266)
Share issuance expenses	22(c)	(3,384)	—	—	—	(3,384)
At December 31, 2006 and January 1, 2007		110,539	40,160	(3,656)	(53,025)	94,018
Exchange realignment		**—**	**—**	**(31,442)**	**—**	**(31,442)**
Total income and expense for the year recognised directly in equity		**—**	**—**	**(31,442)**	**—**	**(31,442)**
Loss for the year		**—**	**—**	**—**	**(86,854)**	**(86,854)**
Total income and expense for the year		**—**	**—**	**(31,442)**	**(86,854)**	**(118,296)**
Exercise of share options		**807**	**—**	**—**	**—**	**807**
Share-based compensation costs		**—**	**104,073**	**—**	**—**	**104,073**
Issuance of shares		**693,183**	**—**	**—**	**—**	**693,183**
Share issuance expenses	22(f)	**(69,019)**	**—**	**—**	**—**	**(69,019)**
Proposed final 2007 dividend	6	**—**	**—**	**—**	**(95,710)**	**(95,710)**
At December 31, 2007		**735,510**	**144,233**	**(35,098)**	**(235,589)**	**609,056**

26. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENTS

Supplemental cash flow information

	2007 RMB'000	2006 RMB'000
Cash paid for interest	**—**	(216)
Cash received from interest	**17,719**	2,652
Cash paid for income tax	**(2,357)**	(3,778)

27. COMMITMENTS

Operating lease commitments-Group as lessee

The Group has entered into commercial leases for office premises and electronic equipment. These non-cancelable leases have remaining terms of between one and four years. There are no restrictions placed upon the lessee by entering into these leases. Future minimum lease payments under these leases as at December 31, are as follows:

	GROUP	
	2007 RMB'000	2006 RMB'000
Within one year	**15,273**	13,845
After one year but not more than five years	**1,138**	9,227
	16,411	23,072

As at December 31, 2006, some of the operating lease arrangements for electronic equipment provide for the calculation of lease payments based on the actual number of users of the relevant servers. The rental expense under these operating leases was RMB403 thousand for the year ended December 31, 2007 (2006: RMB1,442 thousand). 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.

Capital commitments

At December 31, 2007 and 2006, the Group had commitments of RMB3,230 thousand and RMB1,031 thousand, respectively, for the purchase of electronic equipment; At December 31, 2007, the Group had commitments of RMB18,804 thousand for the construction of building.

	GROUP	
	2007 RMB'000	2006 RMB'000
Contracted, but not provided, for:		
Electronic equipment	**3,230**	1,031
Building	**18,804**	—
Total	**22,034**	1,031
Authorised, but not contracted for:		
Building	**—**	10,000

28. RELATED PARTY DISCLOSURES

The following table provides the total amount of material transactions, which have been entered into with related parties during the years ended December 31, 2007 and 2006.

		GROUP	
	NOTES	2007 RMB'000	2006 RMB'000
Sales to related parties:			
Entity with significant influence over a non-wholly owned subsidiary		**4,359**	8,727
Purchase from related parties:			
Entity with significant influence over a non-wholly owned subsidiary		**—**	380
Company with a common shareholder of the Company	(a)	**279**	30
Total		**279**	410
Loan from related parties:			
Company with a common shareholder of the Company		**—**	8,258
Loan to related parties:			
Family member of shareholder of the Company		**—**	100
Waiver of amount due from a shareholder and a director of the Company		**—**	68
Waiver of reorganization consideration from shareholders of subsidiaries		**—**	4,316
Transaction costs related to sale of issued ordinary shares by existing shareholders	(b)	**9,862**	—

		COMPANY	
	NOTES	2007 RMB'000	2006 RMB'000
Loan from related parties:			
Company with a common shareholder of the Company		**—**	8,258
Waiver of reorganisation consideration from shareholders of subsidiaries		**—**	1,150
IPO expenses allocated to Selling Shareholders of the Company	(b)	**9,862**	—

28. RELATED PARTY DISCLOSURES (continued)

Notes:

(a) These related party transactions also constitute connected party transactions or continuing connected transactions as defined in Chapter 14A of the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange.

(b) Before the IPO, an agreement was entered into between the Company and Lenovo, New Horizon Goldensoft Investment Co., Ltd., Super Faith International Limited and Tetrad Ventures Pte Ltd (collectively known as the "Selling Shareholders"), according to which, the IPO expenses should be borne by each of the Company and the Selling Shareholders in proportions according to the percentage of shares issued or sold in the IPO and the over-allotment.

	NOTES	GROUP 2007 RMB'000	GROUP 2006 RMB'000
Due from related parties:			
Shareholders and directors of the Company	(a)	**9,862**	11
Family members of shareholders of the Company	(b)	**—**	1,600
Entity with a significant interest held by shareholder's family members		**—**	7
Total		**9,862**	1,618
Due to related parties:			
Family member of a shareholder of the Company		**—**	20
Entity with significant influence over a non-wholly owned subsidiary	(c)	**—**	5,100
Entity with significant interest held by key management of the Company		**—**	177
Total		**—**	5,297

	NOTES	COMPANY 2007 RMB'000	COMPANY 2006 RMB'000
Due from related parties:			
Shareholders and directors of the Company	(a)	**9,862**	—
Total		**9,862**	—

Notes:

(a) The balance represented the IPO expenses allocated to the Selling Shareholders. Before the IPO, the Company and the Selling Shareholders entered into an agreement, according to which, the IPO expenses should be borne by each of the Company and the Selling Shareholders in proportions according to the percentage of shares issued or sold in the IPO and the over-allotment.

(b) The balance as of December 31, 2006 represented the loan of RMB1,300K and RMB300K to Weiqin Qiu and Peili Lei, respectively, for their capital contribution of Kingsoft Qijian and 1% equity interest of Chengdu Digital Entertainment. The loans were in substance investment cost to the two subsidiaries. Since the Group consolidated Kingsoft Qijian as a subsidiary as of December 31, 2007, the Group eliminated the balance with minority interest of Kingsoft Qijian.

(c) The balance as of December 31, 2006 represented advance from Dalian Shang Shang Wang Digital Technology Co., Ltd., minority equity holder of Kingsoft Dalian, for license of online game software engine. The Group delivered the online game software engine, and the balance was fully settled in 2007.

28. RELATED PARTY DISCLOSURES (continued)

Terms and conditions of transactions with related parties

Outstanding balances at each of the balance sheet dates were unsecured and interest-free. There are no fixed terms of repayment and settlement that will occur in cash. There have been no guarantees provided or received for any related party receivable or payable.

Compensation of key management personnel of the Group

	GROUP	
	2007 RMB'000	2006 RMB'000
Salaries, allowances and benefits in kind	**9,047**	8,956
Pension plan contributions	**80**	145
Share-based compensation costs	**46,225**	3,976
Total compensation paid to key management personnel	**55,352**	13,077

Further details of the directors' remuneration are included in note 3(g).

29. FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of each of the categories of financial instruments as at the balance sheet date are as follows:

	GROUP			
	2007		2006	
FINANCIAL ASSETS	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000
Loan receivables	**1,784**	**1,784**	1,403	1,403
Trade receivables	**60,226**	**60,226**	52,326	52,326
Financial assets included in prepayments and other receivables	**27,676**	**27,676**	23,341	23,341
Due from related parties	**9,862**	**9,862**	1,618	1,618
Cash and cash equivalents	**1,246,077**	**1,246,077**	333,508	333,508
Total	**1,345,625**	**1,345,625**	412,196	412,196

	GROUP			
	2007		2006	
FINANCIAL LIABILITIES	FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	TOTAL RMB'000	FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	TOTAL RMB'000
Trade payables	**7,120**	**7,120**	5,450	5,450
Financial liabilities included in accrued expenses and other payables	**117,351**	**117,351**	65,429	65,429
Due to related parties	**—**	**—**	5,297	5,297
Bank loans and government loans	**—**	**—**	2,000	2,000
Total	**124,471**	**124,471**	78,176	78,176

29. FINANCIAL INSTRUMENTS BY CATEGORY (continued)

The carrying amounts of each of the categories of financial instruments as at the balance sheet date are as follows: (continued)

	COMPANY			
	2007		2006	
FINANCIAL ASSETS	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000
Financial assets included in prepayments and other receivables	**1,227**	**1,227**	—	—
Due from related parties	**9,862**	**9,862**	—	—
Cash and cash equivalents	**683,070**	**683,070**	80,694	80,694
Total	**694,159**	**694,159**	80,694	80,694

	COMPANY			
	2007		2006	
FINANCIAL LIABILITIES	FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	TOTAL RMB'000	FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	TOTAL RMB'000
Financial liabilities included in accrued expenses and other payables	**13,879**	**13,879**	7,873	7,873
Due to subsidiaries	**31,780**	**31,780**	30,983	30,983
Total	**45,659**	**45,659**	38,856	38,856

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

(i) Financial risk management objectives and policies

The Group operates in the PRC and other Asian countries, which generates revenue and incurs expenses in United States dollars ("US$"), JPY, HK$ and RMB. The Group's operations are exposed to business risk, 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, 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.

(ii) Liquidity risk

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

The Group recorded net cash inflows from operating activities of approximately RMB345 million and RMB140 million for the years ended December 31, 2007 and 2006. For the same period, the Group had net cash outflows from investing activities of approximately RMB396 million and RMB49 million, respectively. The Group also recorded net cash inflow from financing activities of approximately RMB647 million and RMB91 million for the years ended December 31, 2007 and 2006, respectively.

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Liquidity risk (continued)

The Group recorded increases in cash and cash equivalents of approximately RMB597 million and RMB182 million for the years ended December 31, 2007 and 2006, respectively.

The contractual maturities of financial liabilities including trade payables and amount due to related parties have been disclosed in note 18 and 28, respectively. For trade payables, they are generally on credit terms of one to three months after the invoice date. For accrued expenses, other payables and amount due to related parties, there are generally no specified contractual maturities for these liabilities, and they are paid on a regular basis or upon counterparty's formal notification.

With regard to 2007 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 settlement from clients and the subsequent payment to vendors.

(iii) 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. RMB against US$, HK$ and JPY 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$. The exchange rate of the US$ against the RMB was adjusted to RMB8.11 per US$ as at July 21, 2005, representing an appreciation of approximately 2%.

The People's Bank of China announces the closing prices of foreign currencies such as the US$ traded against the RMB in the interbank foreign exchange market after the closing of the market on each business day, and makes these prices the central parity for trading against the RMB on the following business day.

Conversely, if the RMB had strengthened (weakened) 5% against the US$, HK$ and JPY with all other variables held constant, profit would have been RMB955 thousand and 869 thousand lower (higher) for years ended December 31, 2007 and 2006, respectively; equity would have been RMB37,736 thousand and RMB4,447 thousand lower (higher) as at December 31, 2007 and 2006, respectively.

(iv) Interest rate risk

The Group's earnings are affected by changes in interest rates due to the impact of such changes on interest income and expense from interest-bearing financial assets and liabilities. The Company's interest-bearing financial assets and liabilities are predominately denominated in RMB. The Group's financial assets comprised primarily of cash deposits with fixed interest rates and loans and receivables, and the Group does not have any interest-bearing debt obligations as of December 31, 2007. Therefore, the Group considers that the exposure to interest rate risks is insignificant.

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(v) 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, other receivables and amounts due from related parties, 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. The table below shows an analysis of credit risk exposures of trade receivables which constitute 4% of the Group's total financial assets:

	2007 RMB'000	2006 RMB'000
Counterparty profiles		
By business:		
— Entertainment software	**17,088**	12,397
— Applications software	**43,138**	39,929
By location:		
— Mainland China	**45,339**	42,003
— Others	**14,887**	10,323

For trade receivables that were past due but not impaired 69% and 86% were aged within one year as at December 31, 2007 and 2006, 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.

(vi) Fair values

Financial assets of the Group mainly include cash and cash equivalents, trade receivables, other receivables, loan receivables and amounts due from related parties. Financial liabilities of the Group mainly include trade payables, accrued expenses and other payables, loans and amounts due to related parties.

The carrying amounts of the Group's financial instruments approximate to their fair values as at balance sheet date. 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 judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(vii) Capital management

The primary objective of the Group's capital management is to ensure that it maintains healthy capital ratio in order to support its business. The Group monitors capital using the net cash over debt position, which is trade and other payables, due to related parties and loans, less cash and cash equivalents.

	GROUP	
	2007	**2006**
	RMB'000	**RMB'000**
Cash and cash equivalents	**1,246,077**	333,508
Trade payables	**(7,120)**	(5,450)
Other payables	**(33,552)**	(18,369)
Due to related parties	**—**	(5,297)
Bank loans and government loans	**—**	(2,000)
Net cash over debt position	**1,205,405**	302,392

31. POST BALANCE SHEET EVENTS

(a) On March 31, 2008 ("Adoption Date"), the Board approved and adopted the Share Award Scheme in which selected employees of the Group are entitled to participate. Unless early terminated by the Board, the Share Award Scheme shall be valid and effective for a term of five years commencing on the Adoption Date. 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 capital of the Company as at the date of such grant.

(b) On March 31, 2008, the Board approved the acquisition of a property worth approximates RMB175 million in Beijing.

32. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on March 31, 2008.