Shanda Games Ltd
Form 20-F
April 17, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2014

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ____________ to ____________.

OR

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

Commission file number: 001-34454

Shanda Games Limited

(Exact name of Registrant as specified in its charter)

N/A
(Translation of Registrant's name into English)

Cayman Islands
(Jurisdiction of incorporation or organization)

No. 1 Office Building
No. 690 Bibo Road
Pudong New Area
Shanghai 201203
The People's Republic of China
(Address of principal executive offices)

Yingfeng Zhang, Acting Chief Executive Officer
No. 1 Office Building
No. 690 Bibo Road
Pudong New Area
Shanghai 201203
The People's Republic of China
Telephone: +(86 21) 5050-4740

Facsimile: +(86 21) 5050-4740-897286

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
Class A ordinary shares, par value US$0.01 per share	The NASDAQ Stock Market* (The NASDAQ Global Select Market)

* Not for trading, but only in connection with the listing on the NASDAQ Global Select Market of American Depositary Shares representing such Class A Ordinary Shares

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

None

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

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report. 440,313,944 Class A ordinary shares, par value US$0.01 per share, and 97,518,374 Class B ordinary shares, par value US$0.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes x No ¨

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.:

Large Accelerated Filer ¨ Accelerated Filer x Non-accelerated Filer ¨

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

x U.S. GAAP

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

¨ Other

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

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

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Special Note Regarding Forward-Looking Statements

This annual report contains forward-looking statements that are based on our current expectations, assumptions, estimates and projections about us and our industry. All statements other than statements of historical fact in this annual report are forward-looking statements. These forward-looking statements can be identified by words or phrases such as "may," "will," "expect," "anticipate," "estimate," "plan," "believe," "is/are likely to" or other similar expressions. The forward-looking statements included in this annual report relate to, among others:

- our goals and strategies;
- our future business development, financial condition and results of operations;
- our projected revenues, earnings, profits and other estimated financial information;
- expected changes in our margins and certain costs or expenditures;
- our plans to expand and diversify the sources of our revenues;
- expected changes in the respective shares of our revenues from particular sources;
- our plans for staffing, research and development and regional focus;
- the projected economic lifespans of our current games, and our plans to launch games and to develop new games in-house or license additional games from third parties, including the timing of any such launches, development or licenses;
- our plans for strategic partnerships with other businesses;
- our acquisition strategy, and our ability to successfully integrate past or future acquisitions with our existing operations;
- competition in the PRC online game and mobile game industries;

- the outcome of ongoing, or any future, litigation or arbitration;
- the outcome of our annual evaluation as to our status as a passive foreign investment company;
- changes in PRC governmental preferential tax treatment and financial incentives we currently qualify for and expect to qualify for; and
- PRC governmental policies relating to online games, the Internet, Internet content providers and the provision of advertising over the Internet.

These forward-looking statements involve various risks and uncertainties. Although we believe that our expectations expressed in these forward-looking statements are reasonable, we cannot assure you that our expectations will turn out to be correct. Our actual results could be materially different from and worse than our expectations. Important risks and factors that could cause our actual results to be materially different from our expectations are generally set forth in the "Risk Factors" section of Item 3 and elsewhere in this annual report. The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

Certain Conventions

Except where the context otherwise requires and for purposes of this annual report only:

- "China" or "PRC" refers to the People's Republic of China, and for the purpose of this annual report, excludes Hong Kong, Macau and Taiwan;
- "Daily active users," or "DAUs," refers to the number of users who play our mobile games during a day;
- "Hao Ding" refers to Hao Ding International Limited and its affiliated entities, including Shanghai Buyout Fund L.P.;
- "MMO games" refers to massively multi-player online games, including MMORPGs and advanced casual games;
- "MMORPG" refers to massively multi-player online role-playing game;
- "Monthly active users" or "MAUs" refers to the number of users who play our MMO games during a calendar month;
- "Monthly paying users" or "MPUs" refers to the number of users who spend virtual currency at least once for our MMO games during a calendar month and includes users who spend virtual currency in our MMO games during beta testing;
- "Ningxia Zhongyin" refers to Ningxia Zhongyincashmere International Group Co., Ltd. and its affiliated entities;
- "Orient Finance" refers to Orient Finance Holdings (Hong Kong) Limited and its affiliated entities, including Orient Hongtai (Hong Kong) Limited and Orient Hongzhi (Hong Kong) Limited;
- "our HK subsidiaries" refers to Shanda Games Holdings (HK) Limited, or Shanda Games (HK), Shanda Games Technology (HK) Limited and Goldcool Holdings (HK) Limited;
- "our PRC subsidiaries" refers to Shengqu Information Technology (Shanghai) Co., Ltd., or Shengqu, Shengji Information Technology (Shanghai) Co., Ltd., or Shengji, Lansha Information Technology (Shanghai) Co., Ltd., or

Lansha, and Kuyin Software (Shanghai) Co., Ltd.;

- "our VIEs" refers to our variable interest entities, including primarily Shanghai Hongli Digital Technology Co., Ltd., or Shanghai Hongli; Shanghai Shulong Technology Development Co., Ltd., or Shanghai Shulong, and its subsidiaries, including its wholly owned subsidiaries Shanghai Shulong Computer Technology Co., Ltd., or Shulong Computer, Nanjing Shulong Computer Technology Co., Ltd., or Nanjing Shulong, Chengdu Aurora Technology Development Co., Ltd., or Chengdu Aurora, Chengdu Simo Technology Co., Ltd., or Chengdu Simo, Chengdu Youji Technology Co., Ltd., or Chengdu Youji, and Tianjin Youji Technology Co., Ltd., or Tianjin Youji; Shanghai Shengzhan Networking Technology Co., Ltd., or Shengzhan, and its wholly owned subsidiaries, Nanjing Shanda Networking Development Co., Ltd., or Nanjing Shanda, and Jiangsu Shanda Networking Technology Co., Ltd., or Jiangsu Shanda; and Tianjin Shengjing Trade Co., Ltd., or Shengjing;

- "Pre-IPO Reorganization" refers to Shanda Interactive's reorganization effective July 1, 2008, pursuant to which Shanda Interactive transferred substantially all of its assets and liabilities related to its online game business to us, as more fully described in Item 7.B. "Related Party Transactions—Transactions and Agreements with Shanda Interactive";

- "Shanda Computer" refers to Shanda Computer (Shanghai) Co. Ltd, a wholly owned subsidiary of Shanda Online;

- "Shanda Interactive" refers to Shanda Interactive Entertainment Limited, a Cayman Islands company which was our indirect controlling shareholder prior to November 25, 2014, and, unless the context requires otherwise, its subsidiaries and VIEs;

- "Shanda Group" refers to Shanda Interactive and its subsidiaries and VIEs, and (i) with respect to information on or prior to November 25, 2014 and unless the context requires otherwise, includes our company, our subsidiaries and our VIEs, and (ii) with respect to information on or after November 25, 2014, does not include our company, our subsidiaries or VIEs;

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- “Shanda Networking” refers to Shanghai Shanda Networking Co., Ltd., a PRC company wholly owned by Mr. Tianqiao Chen and Mr. Danian Chen;

- “Shanda Online” refers to Shanda Online Entertainment Limited, a Cayman Islands company majority-owned by Shanda Interactive, and, unless the context requires otherwise, its subsidiaries and VIEs;

- “Shengfutong” refers to Shanghai Shengfutong Electronic Business Co., Ltd., which is an entity controlled by Shanda Interactive;

- “VIE” refers to variable interest entity;

- “we,” “us,” “our company” and “our” refer to Shanda Games Limited, and, unless the context requires otherwise, (i) its directly wholly owned subsidiaries Shanda Games Holdings (HK) Limited, or Shanda Games (HK), a Hong Kong company, Shanda Games International (Pte) Ltd., or Shanda Games International, a Singapore company, and Shanda Games Korean Investment Limited, a British Virgin Islands company; (ii) its directly majority-owned subsidiary Goldcool Holdings Limited, or Goldcool, a British Virgin Islands company; (iii) its indirectly wholly owned subsidiary Shanda Games Technology (HK) Limited, a Hong Kong company; (iv) its indirectly majority-owned subsidiaries Eyedentity Games, Inc., or Eyedentity, a Korean company, Actoz Soft Co., Ltd., or Actoz, a Korean company publicly listed on the Korea Exchange, Actoz Soft Europe GmbH, or Actoz Europe, a German company, and Goldcool Holdings (HK) Limited, a Hong Kong company; (v) our PRC subsidiaries; and (vi) in the context of describing our operations, also include our VIEs; and

- “Yilida” refers to Ningxia Yilida Capital Investment Limited Partnership and its affiliated entities.

Amounts in United States dollars, or US$, are presented for the convenience of the reader and are translated from the corresponding amounts in Renminbi, or RMB, at the rate of US$1.00 to RMB6.2046, the exchange rate as set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2014. No representation is made that the RMB amounts could have been, or could be, converted into U.S. dollars at such rate, or at all.

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Part I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not Applicable.

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

Item 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The following selected consolidated statement of operations data for the three years ended December 31, 2014 and the consolidated balance sheet data as of December 31, 2013 and 2014 have been derived from our audited consolidated financial statements included in this annual report on Form 20-F.

On August 31, 2013, we completed the acquisition of Shengzhan and Shengjing, which operate platform services and prepaid card distribution services. See Item 7.B. "Related Party Transactions—Acquisition of Platform and Prepaid Card Distribution Businesses." As Shengzhan and Shengjing were under the common control of Shanda Interactive at the time of the acquisition, this transaction was accounted for as a reorganization of entities under common control in accordance with U.S. GAAP. Retrospective consolidation of the businesses is required by U.S. GAAP for all historical periods since the inception of common control, which dated to 2008 when our online game business was formed as a distinct business apart from Shanda Interactive prior to our initial public offering in September 2009. Accordingly, we have retrospectively restated our historical consolidated financial information as if Shengzhan and Shengjing had been part of us since 2008 with respect to periods and dates prior to January 1, 2013 in connection with our annual report on Form 20-F for the year ended December 31, 2013. Due to consistent accounting policies and methods between us, Shengzhan and Shengjing, there were no adjustments necessary to conform accounting methods. See Note 1 to our consolidated financial statement included elsewhere in this annual report. Our selected consolidated statement of operations data for the years ended December 31, 2010 and 2011 and our consolidated balance sheet data as of December 31, 2010, 2011 and 2012 have been derived from our audited consolidated financial statements which are not included in this annual report on Form 20-F and, with respect to the year ended December 31, 2010 and the balance sheet data as of December 31, 2010 and 2011, give effect to unaudited information associated with the retroactive consolidation of Shengzhan and Shengjing in 2013.

Prior to January 1, 2013, we reported our net revenues in two categories, (i) online game revenues derived in China, which included revenues from both MMO games and mobile games generated in China, and (ii) other revenues. From the first quarter of 2013, we adjusted the presentation of our net revenues to three categories, including MMO game revenues, mobile game revenues and other revenues, as a result of significant growth in mobile game revenues. We no longer distinguish net revenues generated inside and outside China. Beginning with our annual report on Form 20-F for the year ended December 31, 2013, amounts for prior periods were reclassified to conform to the current presentation. See Item 5.A. "Operating Results—Revenues."

You should read the selected consolidated financial data in conjunction with the consolidated financial statements and the related notes included under "Item 18. Financial Statements" and "Item 5. Operating and Financial Review and Prospects" included elsewhere in this annual report on Form 20-F. Our consolidated financial statements are prepared and presented in accordance with U.S. GAAP. Our historical results do not necessarily indicate our results expected for any future periods.

	For the Year Ended December 31,					
	2010	2011	2012	2013	2014	
	RMB	RMB	RMB	RMB	RMB	**US$(1)**
	(in millions, except earnings per share/ADS data)					
Consolidated Statements of Operation and Comprehensive Income Data:						
Net revenues:						
MMO game revenues	4,412.1	5,183.9	4,561.4	3,806.4	3,276.4	528.1
Mobile game revenues	—	—	10.2	482.2	396.4	63.9
Other revenues	118.8	125.9	147.0	56.1	44.5	7.2
Total net revenues	4,530.9	5,309.8	4,718.6	4,344.7	3.717.3	599.1
Cost of revenues:						
Third parties	(1,224.4)	(1,355.7)	(1,123.6)	(1,103.2)	(919.2)	(148.1)
Related parties	(10.6)	(11.8)	(32.2)	(32.5)	(20.9)	(3.4)
Total cost of revenues	(1,235.0)	(1,367.5)	(1,155.8)	(1,135.7)	(940.1)	(151.5)
Gross profit	3,295.9	3,942.3	3,562.8	3,209.0	2,777.2	447.6
Operating expenses:						
Product development	(517.1)	(755.4)	(712.3)	(714.1)	(657.6)	(106.0)
Sales and marketing						
Third parties	(321.8)	(270.0)	(262.2)	(401.6)	(593.3)	(95.6)
Related parties	—	(46.4)	(55.4)	(45.8)	(21.7)	(3.5)
Total sales and marketing	(321.8)	(316.4)	(317.6)	(447.4)	(615.0)	(99.1)
General and administrative	(431.6)	(519.5)	(412.9)	(348.7)	(320.6)	(51.7)
Impairment of goodwill	—	—	—	(30.8)	—	—
Settlement of gain contingency with former shareholder	—	—	—	59.9	—	—
Total operating expenses	(1,270.5)	(1,591.3)	(1,442.8)	(1,481.1)	(1,593.2)	(256.8)
Income from operations	2,025.4	2,351.0	2,120.0	1,727.9	1,184.0	190.8
Interest income						
Third parties	74.9	109.3	146.1	73.9	57.7	9.3
Related parties	2.0	32.5	83.7	48.6	1.7	0.3
Interest expense						
Third parties	(1.1)	(10.8)	(96.9)	(16.1)	(40.8)	(6.6)
Related parties	(11.1)	(12.2)	(26.8)	(28.8)	(2.0)	(0.3)
Investment income	0.2	0.5	0.1	16.3	(0.8)	(0.1)
Other income, net	246.2	209.7	128.9	136.0	75.8	12.2
Income before income tax expenses and equity in losses of affiliated companies	2,336.5	2,680.0	2,355.1	1,957.8	1,275.6	205.6
Income tax expenses	(436.7)	(609.3)	(545.5)	(322.3)	(248.6)	(40.1)
Equity in losses of and impairments of investments in affiliated companies	(5.4)	(10.0)	(21.0)	(7.5)	(30.4)	(4.9)
Net income	1,894.4	2,060.7	1,788.6	1,628.0	996.6	160.6
Less: Net income attributable to non-controlling interests	(15.8)	(21.1)	(23.2)	(40.1)	43.9	7.1
Net income attributable to Shanda Games Limited	1,878.6	2,039.6	1,765.4	1,587.9	1,040.5	167.7
Earnings Per Share Data:						

Earnings per share, basic	3.29	3.60	3.18	2.96	1.94	0.31
Earnings per share, diluted	3.29	3.60	3.18	2.95	1.92	0.31
Earnings per ADS, basic(2)	6.58	7.20	6.36	5.92	3.88	0.62
Earnings per ADS, diluted(2)	6.58	7.20	6.36	5.90	3.84	0.62

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	As of December 31,					
	2010	2011	2012	2013	2014	
	RMB	RMB	RMB	RMB	RMB	US$
	(in millions)					
Consolidated Balance Sheets Data:						
Total current assets	3,916.7	6,037.5	7,182.3	3,059.4	2,337.6	376.8
Total assets	7,404.2	8,322.9	8,816.5	5,127.4	3,647.5	587.9
Total current liabilities	2,695.2	4,222.8	4,162.5	3,733.4	1,057.5	170.4
Total long term liabilities	378.3	376.7	166.2	474.8	691.4	111.5
Total liabilities	3,073.5	4,599.5	4,328.7	4,208.2	1,748.9	281.9
Redeemable non-controlling interest	—	13.9	13.9	13.9	—	—
Total Shanda Games Limited shareholders' equity	4,091.8	3,452.3	4,420.5	595.0	1,613.9	260.1
Non-controlling interests	238.9	257.2	53.4	310.3	284.7	45.9
Total equity	4,330.7	3,709.5	4,473.9	905.3	1,898.6	306.0
Total liabilities and equity	7,404.2	8,322.9	8,816.5	5,127.4	3,647.5	587.9

(1) Translations of RMB into U.S. dollars were made at a rate of RMB6.2046 to US$1.00, the exchange rate as set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2014.

(2) Each American Depositary Share, or ADS, represents two Class A ordinary shares.

Exchange Rate Information

Solely for the convenience of the reader, unless otherwise noted, all translations from RMB to U.S. dollars and from U.S. dollars to RMB in this annual report were made at a rate of RMB6.2046 to US$1.00, the exchange rate as set forth in the H.10 statistical release of the U.S. Federal Reserve Board on December 31, 2014. We make no representation that any RMB or U.S. dollar amounts could have been, or could be, converted into U.S. dollars or RMB, as the case may be, at any particular rate, or at all. The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of RMB into foreign exchange and through restrictions on foreign trade.

The following table sets forth information concerning the exchange rates in Renminbi and U.S. dollars for the periods indicated.

Renminbi per U.S. Dollar Noon Buying Rate			
Average[1]	High	Low	Period End

2010	6.7603	6.8330	6.6000	6.6000
2011	6.4475	6.6364	6.2939	6.2939
2012	6.2990	6.3879	6.2221	6.2301
2013	6.1412	6.2438	6.0537	6.0537
2014	6.1704	6.2591	6.0402	6.2046
October 2014	6.1251	6.1385	6.1107	6.1124
November 2014	6.1429	6.1429	6.1117	6.1429
December 2014	6.1886	6.2256	6.1490	6.2046
2015				
January 2015	6.2181	6.2535	6.1870	6.2495
February 2015	6.2518	6.2695	6.2399	6.2695
March 2015	6.2386	6.2741	6.1955	6.1990
April (through April 10, 2015)	6.1989	6.2082	6.1930	6.2082

Source: H.10 statistical release of the U.S. Federal Reserve Board

(1) Annual averages were calculated using the average of the exchange rates on the last day of each month during the relevant period. Monthly averages were calculated using the average of the daily rates during the relevant month.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Risks Relating to Our Business and Our Industry

If we are unable to successfully develop and source new games, our business prospects, financial condition and results of operations would be materially and adversely affected.

To remain competitive, we must continue to develop and source new games that appeal to game players. We develop and source new MMO games and mobile games through our multi-channel strategy, including in-house development, licensing, investments, acquisitions, joint development and joint operation. However, we cannot assure you that we will be successful in executing such strategy. If we fail to do so, our business, financial condition, results of operations and business prospects would be materially and adversely affected. The following summarizes risks relating to our multi-channel strategy.

· *In-house development of new games and introduction of expansion packs for our existing games*

We must continue to successfully develop new games in-house to expand our game portfolio and introduce updates and expansion packs, which are more substantial enhancements than updates, for our existing games to extend the commercial lifespans of our existing games.

Our ability to develop successful new games in-house will largely depend on our ability to (i) anticipate and effectively respond to changing interests and preferences of the game players and technological advances in a timely manner, (ii) attract, retain and motivate talented game development personnel and (iii) execute effectively our game development plans. In-house development requires a substantial initial investment prior to the launch of a game, as well as a significant commitment of future resources to produce updates and expansion packs.

Our ability to introduce successful updates and expansion packs for our existing games will also depend on our ability to collect and analyze user behavior data and feedback from our online community in a timely manner and to effectively incorporate features into our updates and expansion packs to improve the variety and attractiveness of our virtual items. We cannot assure you that we will be able to collect and analyze game player behavior data on a timely basis or that such data will accurately reflect game player behavior.

- *Maintaining good relationships with our licensors, extending licenses for our existing licensed games and licensing new games*

We license many of our MMO games and mobile games, including some of our most popular games, from third parties. For example, a third party co-owns with Actoz the intellectual property rights relating to Legend of Mir II, or Mir II, and we pay, through Actoz, part of the ongoing licensing fees to this third party. In 2013 and 2014, we derived approximately 60.8% and 57.4% of our net revenues, respectively, from games that were licensed from third parties, including Mir II. We must maintain good relationships with our licensors to ensure the continued smooth operation of our licensed games. Additionally, we depend upon our licensors to provide technical support necessary for the operation of the licensed games, as well as updates and expansion packs that help to sustain interest in a game. Moreover, certain marketing activities often require the consent of our licensors. Finally, our licenses may be terminated upon the occurrence of certain events, such as a material breach by us. Only some of our license agreements allow us to automatically extend the term of the license without renegotiating with the licensors. We may want to extend a license upon its expiration but may not be able to do so on terms acceptable to us or at all. Our licensors may also demand new royalty terms that are unacceptable to us. Our ability to continue to license our games and to maintain good relationships with our licensors also affect our ability to license new games developed by the same licensors.

· *Investments in and acquisitions of other businesses that we believe may benefit our business*

We intend to continue to invest in or acquire other businesses that complement our business or games that we believe may benefit us in terms of game player base or game portfolio. For example, in 2010, we acquired Eyedentity, a Korea-based online game developer, and Goldcool, a Shanghai-based online game developer and operator. Our ability to grow through investments and acquisitions will depend on the availability of suitable candidates at an acceptable cost and our ability to consummate such transactions on commercially reasonable terms, as well as our ability to obtain any required governmental approvals. The identification and completion of these transactions may also require us to expend significant management and other resources. Moreover, the benefits of an investment or acquisition may take considerable time to materialize, and we cannot assure you that any particular transaction will achieve the intended benefits. For example, in October 2013, we sold a majority of our equity stake in eFusion, a German game operator acquired by us in July 2012, back to its minority shareholder due to its unsatisfactory performance. Future acquisitions could also expose us to potential risks, including those associated with the integration of new operations, technologies and personnel, unforeseen or hidden liabilities, the inability to generate sufficient revenues to offset the costs and expenses of the acquisitions and potential loss of, or harm to, our relationships with employees, customers, licensors and other suppliers as a result of integration of new businesses.

· *Sourcing of new games through joint development and joint operation*

We jointly develop certain games with international game developers. For example, we have jointly developed an online version of Championship Manager Online with Square Enix Co. Ltd., or Square Enix. We also jointly operate certain games with third-party developers in China. For example, in August 2012, we launched the 3D fantasy MMORPG, Age of Wushu, which is jointly operated by Suzhou Snail Electronics Co. Ltd. and us. We must maintain good relationships with our joint developers and joint operators to ensure the continued smooth development or operation of our joint development and joint operation games. Our ability to jointly develop and jointly operate successful games also depends on the availability of joint development and joint operation partner candidates.

We depend substantially on three MMORPGs, which accounted for approximately 55.0% and 53.3% of our net revenues in 2013 and 2014, respectively, and have finite commercial lifespans.

Three of our MMORPGs, Mir II, Dragon Nest, and The World of Legend, or Woool, including their sequels, contributed approximately 30.9%, 11.6% and 10.8% of our net revenues, respectively, in 2014. Even though we expect the percentage of our net revenues generated from these games to decrease as net revenues from our other games and our other sources of revenue increase, we expect to continue to derive a substantial portion of our net revenues from these games in the near term. Thus, our business prospects, financial condition and results of operations would be materially and adversely affected by any factor that contributes to a decline in revenues from Mir II, Dragon Nest or Woool, including:

- any reduction in purchases of virtual items by players of these games;
- a decrease in the popularity of any of these games in China due to increased competition or other factors;
- failure to improve, update or enhance these games in a timely manner; or
- any lasting or prolonged server interruption due to network failures or other factors or any other adverse developments specific to these games.

As with other games, Mir II, Dragon Nest and Woool have finite commercial lifespans. Mir II, Dragon Nest and Woool were launched in 2001, 2010 and 2003, respectively. While we believe we will be able to extend the commercial lifespans of these games by enhancing, expanding and upgrading these games to include new features that appeal to existing players and attract new players, revenues from these games may decline as a result of the games approaching the end of their commercial lifespans. In the second quarter of 2012, we scaled back monetization activities for Mir II and Woool and sought to lengthen their lifespans by promoting activities that enhance interaction among users, and our net revenues decreased by approximately 18% compared to the previous quarter. We experienced a decrease in net revenues from these games in the amount of RMB416.4 million from 2012 to 2013 and a further decrease in the amount of RMB297.5 million (US$47.9 million) from 2013 to 2014, as we continued to scale back monetization activities. If we are not able to extend the commercial lifespans of Mir II, Dragon Nest and Woool, our business prospects, financial condition and results of operations may be materially and adversely affected.

Our new games may not be commercially successful, and we may fail to launch new games according to our timetable, or at all.

In order to remain competitive, we must introduce new games that are attractive to our game players and can generate additional revenues and diversify our revenue sources. In addition, due to the substantially shorter lifecycles of mobile games than MMO games, we need to increase the development of mobile games in the pipeline and launch new mobile games at a higher frequency. We cannot assure you that the new games we launch will be commercially successful, and you should not use the success of our existing MMO games or mobile games as an indication of the future commercial success of any of the games in our pipeline. A number of factors could result in delays in launching or prevent us from launching our new games, including technical difficulties, insufficient game development personnel, a lack of marketing or other resources, insufficient interest in our new games among players during the beta testing, and adverse developments in our relationship with the licensors of our new licensed games. For example, we experienced a decrease of RMB164.6 million in net revenues generated from Dragon Nest in China in 2012 as several key expansion packs for the game were delayed in China. In addition, there are many factors that could adversely affect the popularity of our new games, including our abilities to anticipate and adapt to future technology trends, new business models and changed game player preferences and requirements, to plan and organize marketing and promotional activities, and to differentiate our new games from our existing games and other games offered by other companies. We pay licensing fees for games that we license from third-party developers, and failure to introduce new games or maintain their popularity may result in significant write-down or write-off of licensing fees of the relevant games. For example, despite being well received by game players in the United States, RIFT, a 3D MMORPG we licensed from a third party, did not gain momentum among Chinese players after its commercial launch. Due to its lack of popularity, we decided to shut down its operation in September 2013 and, as a result, accelerated amortization of the remaining licensing fee of RMB32.8 million for this game. In August 2014, we launched Final Fantasy XIV, a major game title that we planned to grow into a major revenue source based on our preliminary internal testing. However, the performance of this game failed to meet our original expectations. If we fail to launch new games according to our timetable or at all or if our new games are not commercially successful, our business prospects and results of operations would be materially and adversely affected and we may not be able to recover our game sourcing or development costs, which can be significant.

The consummation of the proposed going-private transaction is uncertain, and the announcement and pendency of the transaction could adversely affect our business, results of operations and financial condition.

We entered into an agreement and plan of merger on April 3, 2015 with respect to a going-private transaction. For more details, see Item 4.A “Information on the Company—History and Development of the Company—Proposed Going-Private Transaction.” The process of consummating the proposed going-private transaction or any other significant strategic transaction involving our company could cause disruptions in our business and divert our management’s attention and other resources from day-to-day operations, which could have an adverse effect on our business, results of operations and financial condition. Additionally, current and prospective employees and members of management could become uncertain about their future roles with us in the event the going-private transaction is completed. This uncertainty could adversely affect our ability to retain and hire employees and members of management. In addition, the announcement and pendency of the proposed going-private transaction could have an adverse effect on our relationships with customers and third-party game developers.

If the going-private transaction is not completed, you will not receive the proposed transaction consideration and the price of our ADSs could decline. Additionally, the ongoing business of our company could be adversely affected and, without realizing the benefits of having completed the going-private transaction, our company will be subject to a number of risks, including, but not limited to, the following:

- our company could be required to pay a termination fee of $57,250,000 if the merger agreement is terminated under certain circumstances;
- our company could be required to pay certain costs relating to the going-private transaction, even if the going-private transaction is not completed, such as legal, financial advisor and printing fees; and
- under the merger agreement, our company is subject to certain restrictions on the conduct of its business prior to completing the going-private transaction, which could affect its ability to execute certain of its business strategies.

The merger agreement also contains provisions that make it more difficult for us to sell our company to a party other than the consortium. These provisions include the general prohibition on taking certain actions that might lead to or otherwise facilitate a proposal by a third party for an alternative transaction and the requirement that we pay a termination fee of $57,250,000 million in specified circumstances, including if the merger agreement is terminated as a result of our entering into an agreement for an alternative transaction. These provisions might discourage a third party that might otherwise have an interest in acquiring all or a significant part of the shares or assets of our company from considering or proposing that acquisition, even if that party were prepared to pay consideration with a higher per ADS value than the current proposed transaction consideration.

Furthermore, we could be subject to potential lawsuits in connection with the proposed going-private transaction. See Item 8.A. “Consolidated Statements and Other Financial Information—Legal Proceedings.” All of the foregoing could materially adversely affect our business, results of operations and financial condition.

Our new games may attract game players away from our existing games, which may have a material adverse effect on our business, financial condition and results of operations.

Our new games may attract game players away from our existing games and shrink our existing games' player base, which could in turn make those existing games less attractive to other game players, resulting in decreased revenues from our existing games. Players of our existing games may also spend less money to purchase virtual items in our new games than they would have spent if they had continued playing our existing games. In addition, our game players may migrate from our existing games with a higher profit margin to new games with a lower profit margin. The occurrence of any of the foregoing could have a material and adverse effect on our business, financial condition and results of operations.

Changes or adjustments we make to our existing or new games may not be well received by our game players.

As we develop new games or introduce updates and expansion packs to our existing games, we closely monitor our game players' tastes and preferences and may introduce or change certain game features or game play styles to make our games more attractive. We cannot assure you that these changes or adjustments will be well received by our game players, who may decide not to play our new games or cease playing our existing games. For example, in the fourth quarter of 2009, we introduced an expansion pack for Mir II which was not well received and led to some game players' reducing the amount of virtual items they purchase in the game. Primarily as a result of the introduction of that expansion pack, our net revenues in the first quarter of 2010 decreased by approximately 14% compared with the net revenues in the previous quarter. As a result, any changes or adjustments we make to existing or new games may adversely impact our revenues and business prospects.

There are risks that the revenue models we adopt for our games may not be suitable.

We currently operate most of our MMO games and all of our mobile games using the item-based revenue model, and have generated, and expect to continue to generate, a substantial majority of our revenues using this revenue model. Although we have adopted the item-based revenue model for substantially all of our games, it may not be the best revenue model. The item-based revenue model requires us to develop or license games that not only attract game players to spend more time playing, but also encourage them to purchase virtual items. The sale of virtual items requires us to track closely game players' tastes and preferences, especially as to in-game consumption patterns. If we fail to develop or offer virtual items which game players purchase, we may not be able to effectively convert our active users into paying users. In addition, the item based revenue model may cause additional concerns from PRC regulators who have been implementing regulations that are designed to reduce the amount of time that Chinese youth spend on games and to limit the total amount of virtual currency issued by game operators and the amount purchased by an individual game player. A revenue model that does not charge for playing time may be viewed by the PRC regulators as inconsistent with this goal. Furthermore, we may change the revenue model for some of our games if we believe the existing revenue models are not optimal. A change in revenue model could result in various adverse consequences, including disruptions of our game operations, criticism from game players who have invested time and money in a game and would be adversely affected by such a change, decreases in the number of our game players or decreases in the revenues we generate from our games. We may also experiment with new revenue models for our new games, which may not gain acceptance among game players. We cannot assure you that the revenue model that we have adopted for any of our games will continue to be suitable for that game, or that we will not in the future need to switch our revenue model or introduce new revenue model for that game, or that any new revenue model we introduce will be well received by game players.

Our business could suffer if we do not successfully execute our growth strategies.

To execute our growth strategies, we anticipate that we will need to manage and supervise our current game portfolio, as well as develop and source additional games. We also will need to continue to expand, train, manage and motivate our workforce, manage our relationships with our game licensors, joint developers, joint operators, game players and third-party service providers, develop web-based games and mobile games and launch new technologies that provide ease of access to our games through micro clients. In addition, we need to implement various new or upgraded operational and financial systems, procedures and controls and to improve our accounting and other internal management systems, all of which will require substantial management efforts and financial resources and may divert our management's attention from running our business or otherwise harm our operations. We cannot assure you that we will be able to efficiently or effectively implement our growth strategies, and any failure to do so may limit our future growth and hamper our business strategy.

There are risks associated with our pursuit of growth through acquisitions and strategic investments.

In recent years we have pursued, and in the future we may continue to pursue, growth through acquisitions and strategic investments. In general, these acquired or invested companies either own intellectual property rights relating to games or operate a network for the distribution of our games. For example, in 2010, we acquired Goldcool, which owns the intellectual property rights to numerous MMORPGs, including Hades Realm I and II, Zodiac Tales, and Dukes and Lords, and Eyedentity, which owns the intellectual property rights to Dragon Nest. Our acquisition of these companies entails a number of other risks that could materially and adversely affect our business and results of operations, including an inability to realize the synergies or achieve the level of performance contemplated at the time of executing these transactions, difficulties integrating the acquired company's personnel, operations, technologies or products into our existing business, the need for financial resources above our planned investment levels, unknown and unforeseen assumed liabilities, the diversion of management resources from other strategic and operational issues, the inability to retain the key employees of the acquired companies, and the potential write-offs of acquired assets and goodwill, as well as potential expenses related to the amortization of intangible assets. See also "—We may need to record impairment charges to earnings if our acquisition goodwill, investments in affiliated companies or acquired intangible assets are determined to be impaired, which would adversely affect our results of operations." If we are unable to generate significant amounts of revenue from the acquired companies, we may suffer financial losses as a result of the acquired company's on-going operating expenses, expenses related to the amortization of intangible assets from the acquisition, and additional share-based compensation expenses related to the acquisition. In March 2012, we sold Mochi Media, Inc., or Mochi Media, a company with its focus on mini casual games, to Shanda Online, a company under the common control of Shanda Interactive at the time of the transaction, due to our decision to focus on more intensive and advanced online games in early 2012. As a result of the sale, we recognized a charge of RMB244.0 million to our additional paid-in capital in 2012. In October 2013, we sold a majority of our equity stake in eFusion, a German game operator acquired by us in July 2012, back to its minority shareholder due to its unsatisfactory performance. As a result, we recognized an investment loss of RMB3.2 million in 2013. Furthermore, in August 2013, we completed the acquisition of Shengzhan and Shengjing, which operate platform services and prepaid card distribution services. See Item 7.B. "Related Party Transactions—Acquisition of Platform and Prepaid Card Distribution Businesses." We face risks of integration of such new businesses and may not be able to realize the contemplated synergies for a unified platform. Our failure to address the risks associated with our acquisition may have a material adverse effect on our financial condition and results of operations.

Our operating margin and profitability may be affected by the change in the mix of revenues from our MMO games and mobile games.

In general, we believe our mobile games have lower operating margins compared with our MMO games. In 2013, we experienced rapid growth in revenues from our mobile games, which contributed to RMB482.2 million, or 11.1%, of our net revenues, as compared with RMB10.2 million, or 0.2%, of our net revenues in 2012. Our operating margin decreased from 44.9% to 39.8% from 2012 to 2013, partially due to such increase of the proportion of our mobile game revenues. In 2014, even though the revenue contribution from our mobile games decreased slightly to 10.7% of our total revenues, we incurred higher research and development expenses as we continued to invest in the development of mobile games. As a result, our operating margin further decreased from 39.8% to 31.9% from 2013 to 2014. We plan to continue to strengthen our mobile game business in the future by rolling out more titles and building our own mobile distribution platform. Therefore, our operating margin and profitability may be negatively affected as a result of further changes in the mix of revenues from MMO games and mobile games or the increased expenses relating to our mobile games.

We face risks associated with the licensing of our games internationally, and if we are unable to effectively manage these risks, our ability to expand our business internationally could be impaired.

As of March 31, 2015, we had licensed nine MMO games and six mobile games to game operators in a number of countries and regions throughout the world. We plan to further license our existing and new games in more countries and regions.

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Licensing our games for operations in overseas markets exposes us to a number of risks, including:

- identifying and maintaining good relationships with game operators who are knowledgeable about, and can effectively distribute and operate our games in, international markets;
- negotiating licensing agreements with game operators on terms that are commercially acceptable to us and enforcing the provisions of those agreements;
- developing games, updates and expansion packs catering to overseas markets and renewing our license agreements with game operators upon expiration;
- maintaining the reputation of our company and our games, given that our games are operated by game operators in the international markets with different standards;
- protecting our intellectual property rights overseas and managing the related costs;
- receiving and auditing the royalties we are entitled to receive;
- complying with the different commercial and legal requirements of the international markets in which our games are offered, such as game import regulatory procedures, taxes and other restrictions and expenses; and
- managing our foreign currency risks.

If we are unable to manage these risks effectively, our ability to license our games overseas may be impaired, which may materially and adversely affect our business, financial conditions and results of operations.

We or our licensors, joint developers, joint operators or investees may be subject to intellectual property infringement claims, which may force us to incur substantial legal expenses and, if determined adversely against us or our licensors, joint developers, joint operators or investees, may materially disrupt our business.

We cannot be certain that our in-house developed, licensed, jointly developed or jointly operated games or other content posted on our website do not and will not infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties. As of March 31, 2015, 15 of the games we operated were developed in-house, 40 were licensed from third parties, seven were acquired from third parties, one was jointly developed with a third party and one was jointly operated with third-parties. We have historically been sued for alleged copyright infringement and unfair competition by third parties, and we or any of our licensors, joint developers, joint operators or game developers and operators in which we have invested may in the future be perceived or alleged to infringe upon patents, copyrights, trademarks or other intellectual property rights held by third parties and become subject to legal proceedings and claims from time to time relating to the intellectual property rights of others.

If we, our licensors, joint developers, joint operators or game developers and operators in which we have invested are found to have violated the intellectual property rights of others, we may be subject to monetary damages and be enjoined from using such intellectual property, or we may incur new or additional licensing costs if we wish to continue using the infringing content, be forced to develop or license alternatives or be forced to stop operating a game, any of which may materially and adversely affect our business and results of operations. In addition, we may incur substantial expenses and require significant attention of management in defending against these third-party infringement claims regardless of their merit.

Some of our employees were previously employed at other companies, including some of our current and potential competitors. To the extent these employees or any employees we may hire in the future are involved in research that is similar to the research that they performed at their former employers, our competitors may file lawsuits or initiate proceedings against us alleging that these employees violated the intellectual property rights, such as trade secret rights, of their former employers. If any such claim arises in the future, litigation or other dispute resolution proceedings may be necessary to retain our ability to offer our current and future games, which could be costly and divert financial and management resources.

Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

We regard our copyrights, trademarks, service marks, trade secrets and other intellectual property as critical to our success. Unauthorized use of the intellectual property used in our business, whether owned by us or licensed to us, may adversely affect our business and reputation.

We rely on copyright, trademark, trade secret and other intellectual property law, as well as non-competition, confidentiality and license agreements with our employees, licensors, business partners and others to protect our intellectual property rights. Our employees are generally required to sign agreements acknowledging that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property, and assigning to us any ownership rights that they may claim in those works. Despite our precautions, third parties may obtain and use intellectual property that we own or license without our consent. Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may materially and adversely affect our business.

For instance, pirate game servers illegally operate unauthorized copies of our MMO games and enable players to play those games without purchasing prepaid cards for them. Despite our efforts to shut down pirate game servers, we believe that a significant number of pirate game servers continue to operate unauthorized copies of our MMO games. In addition, although we sell our mobile games through cloud-based vendor platforms, mobile device owners may modify their devices to bypass such vendor platforms and install pirate copies of our mobile games offline. If pirate game servers continue to operate any of our MMO games, or if pirate copies of our games proliferate, our business, financial condition and results of operations may be materially and adversely affected.

The validity, enforceability and scope of protection of intellectual property in Internet-related industries are uncertain and still evolving. In particular, the laws and enforcement procedures in China are uncertain and do not protect intellectual property rights in this area to the same extent as do the laws and enforcement procedures in the United States and other developed countries. Policing unauthorized use of intellectual properties is difficult and expensive. Any steps we have taken to prevent the misappropriation of our intellectual properties may be inadequate. Moreover, litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations.

Our business may be materially harmed if our MMO games are not featured prominently in a sufficient number of Internet cafés in China.

We believe a substantial number of game players access our games through Internet cafés in China. Due to limited hardware capacity, Internet cafés generally feature a limited number of games on their computers. We thus compete with a growing number of online game operators to have our MMO games featured on these computers. This competition has intensified in China due to a nationwide suspension of approvals for the establishment of new Internet cafés in 2007. See "—Risks Relating to Regulation of Our Business and to Our Structure—Intensified government regulation of Internet cafés could restrict our ability to maintain or increase our revenues and expand our game player base." If we fail to feature our games prominently and sufficiently in Internet cafés in China or fail to do so in a cost-effective manner, our business, financial condition and results of operations may be materially and adversely affected.

We use third-party mobile app platforms to distribute our mobile games, and our mobile game operation may be materially and adversely affected if there are any changes to their services, terms and conditions or pricing.

We distribute a substantial portion of our mobile games through Apple's App Store and Google's Google Play, and are subject to their standard service terms and conditions with regard to the promotion, distribution, operation and payment methods for our mobile games. For the Android platform, we also use other third-party mobile app platforms to distribute our mobile games in China. If any of these mobile app platforms (i) fails to provide high levels of service to enable players to access our games, (ii) experiences issues with in-app purchasing functionality, (iii) discontinues its relationship with us due to any reason, such as our failure to comply with any laws or regulations in any jurisdiction where our games are offered, (iv) limits our access to its channels, (v) modifies its terms of services or other policies, or (vi) changes its fee structure or revenue sharing strategy, our mobile game business could be adversely affected.

We face the risks of uncertainties in the growth of the online and mobile game industries and market acceptance of our games.

The growth of the online and mobile game industries and the level of demand and market acceptance of our games are subject to a high degree of uncertainty. Our results of operations will depend on factors beyond our control, including:

- whether the online and mobile game industries, particularly in China and the rest of the Asia-Pacific region, continue to grow and the rate of any such growth;
- changes in consumer demographics, tastes or preferences;
- the popularity and price of new games and virtual items that we and our competitors launch and distribute;
- our ability to timely upgrade and improve our existing games to extend their commercial lifespans and to maintain or expand their market share in the online and mobile game industries;
- the availability and popularity of other forms of entertainment, which are already popular in China and other countries or regions in which we market our games, including social networking games such as those offered on Tencent WeChat, Tencent Qzone, Renren, Qihoo and Weibo platforms, mobile games such as those offered on Apple’s iOS or Google’s Android platform, and console system games such as those made by Microsoft, Nintendo and Sony; and
- general economic conditions, particularly economic conditions that impact the level of discretionary consumer spending.

There is no assurance that online games, such as MMORPGs, will continue to be popular in China or elsewhere. For example, mobile games are growing at a much faster rate than MMORPGs in China and in certain overseas markets. Because we currently rely on MMORPGs as the primary source of our revenues, a decline in the popularity of online games in general, or the MMORPGs that we operate, would adversely affect our business prospects and results of operations.

We may not be able to adapt to the rapidly evolving online game industry in China and the mobile game industry globally.

The online and mobile game industries are evolving rapidly. In particular, as mobile devices become popular, the importance of mobile games has significantly increased for game developers and operators like us. We need to adapt to new industry trends, including changes in game players' preferences, new revenue models, new game content distribution models, new technologies, new platforms and new governmental regulations. For example, virtual reality games may be developed on mobile devices like Samsung Gear VR. We evaluate these changes as they emerge and strive to adapt our business and operations in order to maintain and strengthen our leadership in the industry. If we are unable to do so successfully or fall behind in adopting new technologies or standards, our existing games may lose popularity, and the games in our pipeline may not be well received by our game player base, which may have a material adverse effect on our business, financial condition and results of operations.

We face significant competition which could reduce our market share and materially and adversely affect our business, financial condition and results of operations.

The online and mobile game industries in China are highly competitive. In recent years, numerous competitors have entered the online game industry in China. We expect more companies to enter the market and we expect a wider range of games, including social networking games and mobile games, to be introduced to China. Competition from other game operators, both based in China as well as overseas, is likely to increase in the future. Other game operators or developers, such as China-based Boyaa Interactive, Changyou.com Limited, China Mobile Games and Entertainment Group Limited, Forgame Holdings Limited, Giant Interactive, IGG Inc., iDreamSky Technology Limited, Kingsoft, KongZhong, NetEase, Inc., NetDragon Websoft, Inc., Perfect World Co., Ltd., or Perfect World, Tencent Holdings Limited and The9 Limited, as well as international game developers and operators, such as Activision Blizzard, Inc., CJ Entertainment & Media, Com2us Corporation, DeNA Co., Ltd., Electronic Arts, Inc., Gameloft SE, GungHo Online Entertainment, Inc., Glu Mobile, Inc., Gree, Inc., King Digital Entertainment plc., NCSoft Corporation, Nexon Corporation, NHN Corp., SEGA Networks, Square Enix Co., Ltd., Wemade Entertainment Co., Ltd. and Zynga, Inc., are our current or potential future competitors. As the online and mobile game industries in China are constantly evolving, our current or future competitors may compete more successfully as the industry matures. In particular, any of these competitors may offer products and services that provide significant performance, price, creativity or other advantages over those offered by us. These products and services may weaken our brand name and achieve greater market acceptance than ours. In addition, even if we are successful in launching new games, competitors may launch similar games which compete for potential game players. Furthermore, any of our current or future competitors may be acquired by, receive investments from or enter into other strategic or commercial relationships with larger, more established and better financed companies and therefore, obtain significantly greater financial, marketing and game licensing and development resources than us. In addition, increased competition in the online and mobile game industries in China and globally could make it difficult for us to retain existing players and attract new players. Moreover, we may face increasing competition from console systems. New forms of games, such as virtual reality games on Oculus Rift, may quickly become popular and compete with online and mobile games. We also compete with other forms of entertainment, such as television and movies. If we are unable to compete effectively, our business, financial condition and results of operations would be materially and adversely affected.

We may face intensive competition from game console systems in the near future.

Previously, PRC regulations prohibited the sale of game console systems in China. As a result, despite significant success achieved by console systems in markets other than China, we experienced less competition from them. In September 2013, such prohibition was released upon the establishment of China (Shanghai) Pilot Free Trade Zone, or Shanghai FTZ. Since then, foreign-invested companies have been allowed to manufacture and sell game console systems within Shanghai FTZ and may also sell game console systems to the domestic market subject to the approval by MOC. In December 2014, the State Council promulgated the Notice on Promoting the Replicable Experience Gained in China (Shanghai) Pilot Free Trade Zone, or the 2014 Notice. The 2014 Notice provides that foreign and domestic-invested enterprises are now allowed to engage in the production and sales of game console systems throughout the PRC. Under such new policy, various competitors began the process to introduce game console systems into the Chinese markets. If they are successful, we may face intensive competition from these console systems.

We depend on our key personnel, and our business and growth prospects may be severely disrupted if we lose their services or are unable to attract new key employees.

Our future success is heavily dependent upon the continued service of our key executive officers and other key employees. In particular, we rely on the expertise, experience and leadership ability of Mr. Yingfeng Zhang, our chairman, director and acting chief executive officer, Mr. Tunghai Chien, our president, Ms. Jin Zhang, our chief administrative officer, Mr. Richard Wei, our chief financial officer and Mr. Jisheng Zhu, our chief operating officer. We also rely on a number of key technology staff for the development and operation of our MMO games and mobile games. In addition, as we expect to focus increasingly on the development of our own games, we will need to continue attracting and retaining skilled and experienced game development personnel to maintain our competitiveness.

If one or more of our key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all and may incur additional expenses to recruit and train new personnel, our business could be severely disrupted, and our financial condition and results of operations could be materially and adversely affected. We do not maintain key-man life insurance for any of our key personnel. In addition, if any of our executive officers or key employees joins a competitor or forms a competing company, we may lose know-how, trade secrets, suppliers and key professionals and staff. All of our employees, including each of our executive officers and key employees, have entered into an employment agreement with us, which contains customary non-compete provisions. Although non-compete provisions are generally enforceable under PRC laws, PRC legal practice regarding the enforceability of such provisions is not as well-developed as those in countries such as the United States, especially with respect to liquidated damages for breach of non-compete obligations by employees. Thus, we cannot assure you that a PRC court would enforce our rights under the non-compete provisions. Furthermore, since the demand and competition for talent is intense in our industry, particularly for game development personnel and related technical personnel, we may need to offer higher compensation and other benefits in order to attract and retain key personnel in the future, which could increase our compensation expenses. We cannot assure you that we will be able to attract or retain the key personnel that we will need to implement our strategies and achieve our business objectives.

Our business, financial condition and results of operations could be materially and adversely affected by a severe and prolonged global economic downturn and a corresponding slowdown of China's economy.

The global financial markets experienced significant disruptions in 2008 and the United States, Europe and other economies went into recession. The recovery from the lows of 2008 and 2009 was uneven and is facing new challenges, including the escalation of the European sovereign debt crisis since 2011 and the slowdown of the growth of China's economy since 2012. In 2014, China's gross domestic product expanded by 7.4%, which was its slowest rate in the past 20 years and below the PRC government's growth target. It is unclear whether China's economy will resume its high growth rate. There is considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world's leading economies, including China's. There have also been concerns over unrest in the Middle East and Africa, which have resulted in volatility in oil and other markets, and over the possibility of a conflict involving Ukraine. There have also been concerns about the tensions in the relationship between China and Japan and about North Korea's nuclear program. Economic conditions in China are sensitive to global economic conditions. Any prolonged slowdown in the global or China's economy may have a negative impact on our business, results of operations and financial condition, and continued turbulence in the international markets may adversely affect our ability to access the capital markets to meet liquidity needs.

If we fail to anticipate or successfully implement new technologies, our games may become obsolete or uncompetitive, and our business prospects and results of operations could be materially and adversely affected.

The online and mobile game industries are subject to rapid technological change. We need to anticipate the emergence of new technologies and assess their market acceptance. In addition, government agencies or industry organizations may adopt new standards that apply to game development. We also need to invest significant financial resources in product development to keep pace with technological advances. However, development activities are inherently uncertain, and our significant expenditures on technologies may not generate corresponding benefits. If we fall behind in adopting new technologies or standards, our existing games may decline in popularity, our new games may not be well received by our game players, and we may incur significant cost overruns in product development, any of which would materially and adversely affect our business prospects and results of operations.

Errors or defects in our games and the proliferation of cheating programs could materially and adversely affect our business prospects and results of operations.

Our games may contain errors or other defects. In addition, parties unrelated to us have developed, and may continue to develop, Internet cheating programs that enable game players to obtain unfair advantages over other game players who do not use such programs. Furthermore, certain cheating programs could cause the loss of a character's superior features acquired by a player. The occurrence of errors or defects in our MMO games or our failure to discover and disable cheating programs affecting the fairness of our game environment could disrupt our operations, damage our reputation and discourage our game players from playing our games. As a result, such errors, defects and cheating programs could materially and adversely affect our business, financial condition and results of operations.

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

Any failure to maintain the satisfactory performance, reliability, security and availability of the network infrastructure relating to our games, including as a result of natural disasters such as earthquakes and floods, may cause significant harm to our reputation and our ability to retain existing and attract new game players. For example, we maintain a distributed server network architecture with third-party service providers hosting servers in more than one hundred cities throughout China. We do not maintain full backup for our server network hardware.

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Major risks involved in such network infrastructure include:

- any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures which may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware;

- any disruption or failure in the national backbone network, which would prevent our players outside Shanghai from logging on to any of our games, or playing games for which the servers are all located in Shanghai; and

- any disruption, system failure, blockage or security breach of third-party cloud computing platforms, where the data and services relating to some of our mobile games are hosted, or third-party cloud-based vender platforms, through which we sell some of our mobile games.

In the past, the server network relating to our games has experienced unexpected outages for several hours and occasional slower performance in a number of locations in China as a result of failures by third-party service providers. Our network systems are also vulnerable to damage from fire, flood, power loss, telecommunications failures, computer virus, hackings and similar events. Any network interruption or inadequacy that causes interruptions in the availability of our games or deterioration in the quality of access to our games could reduce our game players' satisfaction. In addition, any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could have a material adverse effect on our business, financial condition and results of operations. In recent years, the risks that we face from cyber-attacks have increased significantly. Some of these attacks may originate from well organized, highly skilled organizations. Any such attack or system or network disruption could result in a loss of our intellectual property, the release of commercially sensitive information, and the personal data of our game players or employees, and in turn could result in damage to our reputation. We do not maintain insurance policies covering losses relating to our systems and we do not have business interruption insurance, and any of the above could materially and adversely affect our business, financial condition and results of operations.

The successful operation of our business and implementation of our growth strategies, including our ability to accommodate additional game players in the future, depend upon the performance and reliability of the Internet infrastructure and fixed line and wireless telecommunications networks in China.

We rely on the Internet infrastructure and fixed line and wireless telecommunication networks in China to provide data communication capacity or to host our servers. Although there are private sector Internet and wireless telecommunication operators in China, almost all access to the Internet or wireless telecommunication is maintained through a limited number of state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or MIIT. MIIT or these telecommunication operators may unilaterally change their policies or change the enforcement of their current policies. Theses telecommunication operators may also impose higher service or network fees on us or our third-party service providers. We typically enter into contracts directly or through agencies with the local branches of the principal telecommunication operators. Such contracts are typically for a term of one year and are renewable subject to early termination. If we are unable to renew these contracts when they expire or locate alternative telecommunication service providers in a timely manner or on commercially reasonable terms or at all in the event of any infrastructure disruption or failure or other problems with the Internet infrastructure or the telecommunication networks in China, the quality and stability of our websites and our platform may be affected, which could have a material adverse effect on our business, financial condition and results of operations.

We may need to record impairment charges to earnings if our acquisition goodwill, investments in affiliated companies or acquired intangible assets are determined to be impaired, which would adversely affect our results of operations.

We acquire or invest in companies whose businesses supplement our business and license games from affiliated entities and third parties. We record acquisition goodwill, investments in affiliated companies and acquired intangible assets on our balance sheet in connection with such acquisitions, investments and licensing arrangements, respectively. If the carrying value of our acquisition goodwill, investments in affiliated companies or acquired intangible assets are determined to be impaired, we would be required to write down the carrying value or to record charges to earnings in our financial statements during the period in which our acquisition goodwill, investments in affiliated companies or acquired intangible assets are determined to be impaired, which would adversely affect our results of operations. In connection with this risk, impairment charges recorded in earnings for intangible assets, prepaid upfront license fees in connection with licensing arrangements, investments in affiliated companies and goodwill were RMB22.5 million, RMB30.8 million and RMB26.7 million (US$4.3 million) for 2012, 2013 and 2014, respectively.

We have limited business insurance coverage in China.

China's insurance industry is still at an early stage of development. In particular, PRC insurance companies do not offer many business insurance products available in other countries. As a result, we do not have any business liability or disruption insurance coverage for our operations in China. Any business disruption, litigation or natural disaster might cause us to incur substantial costs and result in the diversion of resources.

While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002.

We are subject to the reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, or the SEC, as required under Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management on the effectiveness of such companies' internal control over financial reporting in their annual reports. In addition, an independent registered public accounting firm for a public company must issue an attestation report on the effectiveness of such company's internal control over financial reporting. Our management conducted an evaluation of the effectiveness of our internal control over financial reporting and concluded that our internal control over financial reporting was effective as of December 31, 2014. In addition, PricewaterhouseCoopers Zhong Tian LLP, our independent registered public accounting firm, reported that our internal control over financial reporting was effective as of December 31, 2014. If we fail to maintain the effectiveness of our internal control over financial reporting, we may not be able to conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal control over financial reporting is necessary for us to produce reliable financial reports. As a result, any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could negatively impact the trading price of our ADSs. Furthermore, we may need to incur additional costs and use additional management and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act and other requirements going forward.

You may not be able to rely on our quarterly operating results as an indication of our future performance because our quarterly operating results may be subject to significant fluctuations.

We may experience significant fluctuations in our quarterly operating results due to a variety of factors, many of which are beyond our control, including but not limited to:

- our ability to retain existing game players, attract new game players at a steady rate and maintain user satisfaction;
- the announcement or introduction of new games or updates or expansion packs to existing games by us or our competitors;
- measures taken by us to lengthen the commercial lifespans of our existing games;

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- the range, number and pricing of virtual items available for sale;
- technical difficulties, system downtime or Internet failures;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure;
- the adoption of new, or changes to existing, governmental regulations;
- seasonality effect during national or school holidays in the first quarter and the third quarter, when generally more game players play our games;
- a shortfall in our revenues relative to our forecasts and a decline in our operating results; and
- economic conditions in general and specific to the online and mobile game industries and to China.

For example, in the fourth quarter of 2009, we introduced an expansion pack for Mir II which was not well received by the game's users and led to some of the game's users reducing the amount of virtual items they purchase in the game. Primarily as a result of the introduction of that expansion pack, our net revenues in the first quarter of 2010 decreased by approximately 14% compared with the previous quarter. In the second quarter of 2012, we scaled back monetization activities for Mir II and Woool and sought to lengthen their lifespans by promoting activities that enhance interaction among users, and our net revenues decreased by approximately 18% compared to the previous quarter. In addition, our quarterly results may not always be available due to our limited resources. As a result, you should not rely on our quarterly operating results or operational metrics such as monthly active users, monthly paying users and average monthly revenue per paying user, in this annual report as indicators of our likely future performance. Our operating results may be below our expectations or the expectations of public market analysts and investors in one or more future quarters. If that occurs, the price of our ADSs could decline and you could lose part or all of your investment.

Shanda Interactive ceased to be our shareholder in November 2014. We will not be able to continue to receive the same level of support from Shanda Interactive, which could have a material adverse effect on our business, financial condition and results of operations.

Shanda Interactive ceased to be our shareholder and became an independent third party in November 2014, and we will not be able to continue to receive the same level of support from Shanda Interactive.

Our online game business has benefited significantly from Shanda Interactive's brand name and strong market position in China. Previously, we operated our business with trademarks licensed from entities controlled by Shanda Interactive, including our corporate name "Shanda Games." See Item 7.B "Related Party Transactions—Transactions and Agreements with Shanda Interactive." In October 2014, before Shanda Interactive ceased to be our controlling shareholder, we and entities controlled by Shanda Interactive amended the relevant license agreements, pursuant to which such licenses will terminate on December 31, 2016. We cannot assure you that we will be able to renew these trademark license agreements upon expiration on terms acceptable to us or at all. We may also have to establish a new corporate identity and change our brand and corporate name in light of such uncertainty prior to the expiration. Any rebranding efforts may lead to confusion and substantial marketing expenses and may not be successful, which may have a material adverse effect on our business, financial condition and results of operations.

Previously, we have engaged various entities controlled by Shanda Interactive to provide certain services that are critical to our business, including online payment, rental of office spaces and others. For example, we rely on the online payment platform of Shengfutong for the backend interfaces to the online payment processing services. Secured transmission of confidential information, such as game players' credit card numbers and expiration dates, personal information and billing addresses over public networks, is essential to maintaining consumer confidence in such payment channels and to allowing us to collect payments on a timely basis. For additional details on our agreements and the fees that we pay to these entities, see Item 7.B. "Related Party Transactions—Transactions and Agreements with Shanda Interactive." Since we do not control these entities and we are no longer affiliated with Shanda Interactive, and because we depend on them for the provision of services that are critical to the operation of our online game business in China, we face substantial risks with respect to our arrangements with such entities in the future. Any failure of or significant quality deterioration in the services offered by entities controlled by Shanda Interactive could materially and adversely affect our business. For example, any deterioration of services provided by Shengfutong could result in delay or failure in collecting payments, expose us to litigation and potential liability relating to online payments, and harm our reputation and our ability to retain existing players, to attract new players and to encourage the consumption of virtual items in our MMO games by game players. In addition, if any of these entities breach their obligations under the respective agreements, terminate these agreements, or refuse to renew these agreements on terms acceptable to us or at all, we may not be able to find a suitable alternative service provider or be able to establish our own alternative platform in a timely manner. Similarly, if we breach the terms of the agreements, these entities could terminate these agreements and halt services that are critical to our business. Termination of these agreements could have a material adverse effect on our business, financial condition and results of operations.

The non-compete and non-solicitation agreement with Shanda Interactive contains exceptions and may not be effective in preventing Shanda Interactive from engaging in certain transactions that directly or indirectly may compete with (or be perceived to be in competition with) our online game business.

In connection with the Pre-IPO Reorganization, we entered into a non-compete and non-solicitation agreement (which was amended and restated on September 10, 2009 and July 1, 2013), or the non-compete agreement with Shanda Interactive, pursuant to which Shanda Interactive has agreed, for a period of five years commencing July 1, 2013, not to engage, and to cause each other member of the Shanda Group (other than Shanda Games) not to engage, directly or indirectly, in the online game and mobile business anywhere in the world. This agreement is subject to important exceptions, namely, (1) certain of Shanda Interactive's subsidiaries may continue to engage in third party billing, payment and related services, (2) Shanda Interactive may hold or acquire equity interests in a company that does not have more than 25.0% of its gross revenues (based on the latest annual audited financial statements of the investee company) attributable to the online game and mobile game business; (3) Shanda Interactive may make minority, passive or venture capital investments by its private equity and venture capital funds; and (4) Shanda Interactive may operate virtual communities with certain online game features provided that such features do not constitute the core business model of such community. In addition, the non-compete agreement permits Shanda Interactive to acquire or invest in any third party engaging in the online game and mobile game business if, after using its reasonable best efforts to make such investment opportunity available to us as required under the agreement, we do not pursue such opportunity; provided that Shanda Interactive's equity interest in such third party shall not exceed 50%. Because of the exceptions described above, we cannot assure you that the non-compete agreement will be effective in preventing Shanda Interactive from engaging in certain conduct or transactions that directly or indirectly may compete with (or be perceived to be in competition with) our online game business, especially after Shanda Interactive ceased to be our shareholder. Even if there is no actual direct or indirect competition to our online game business, the perception by investors or securities analysts of possible competition from Shanda Interactive could adversely affect our business prospects and the price of our ADSs. Nor can we assure you that Shanda Interactive will not breach the non-compete agreement. Although non-compete agreements are generally enforceable under PRC laws, the PRC legal practice regarding the enforceability of such agreements is not as well-developed as those in countries such as the United States, especially with respect to liquidated damages for breach of non-compete obligations by employees. Thus, we cannot assure you that a PRC court would enforce our rights under the non-compete agreement. Even if such agreement is enforced, we may not receive adequate remedies from courts in China or elsewhere. In addition, Shanda Interactive may not agree to extend or renew such non-compete agreement upon its expiration on June 30, 2018 and may decide to compete with us at that time, which will have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to Regulation of Our Business and to Our Structure

If the PRC government finds that the agreements that establish the structure for operating our business do not comply with its restrictions on foreign investment in the online game industry, we could be subject to severe penalties or be forced to relinquish our interests in those operations.

Various regulations in China currently restrict or prevent foreign and foreign-invested entities from engaging in telecommunication services in China, including operating online games. Since we are a Cayman Islands exempted company and therefore are a foreign or foreign-invested enterprise under PRC law, neither we nor our PRC subsidiaries are eligible to hold a license to operate online games in China. In order to comply with the foreign ownership restrictions, we operate our online game business in China through our VIEs, all of which are wholly owned by either PRC citizens or PRC companies. Our PRC subsidiaries have entered into a series of contractual arrangements with our VIEs and their respective shareholders. As a result of these contractual arrangements, we are considered the primary beneficiary of our VIEs and consolidate the results of operations of our VIEs in our financial statements. In the opinion of our PRC counsel, Zhong Lun Law Firm, our current ownership structure and the contractual arrangements between our PRC subsidiaries, on the one hand, and our VIEs and their respective shareholders on the other hand, are in compliance with current PRC laws and regulations. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, PRC government agencies may ultimately take a view that is inconsistent with the opinion of our PRC counsel.

On July 13, 2006, MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Services, or the MIIT 2006 Circular, in order to prevent foreign investors from indirectly operating telecommunication services in China through domestic value-added telecommunication carriers, including through the lease, transfer or purchase of telecommunications business operation license in any form. The MIIT 2006 Circular provides that any domain name or trademark used by a value-added telecommunication carrier shall be legally owned by such carrier or its shareholders. The MIIT 2006 Circular also provides that the operation site and facilities of a value-added telecommunication carrier shall be installed within the business scope as prescribed by operating licenses obtained by the carrier and shall correspond to the value-added telecommunication services that the carrier has been approved to provide. Due to a lack of interpretative materials from the authorities, it is uncertain whether MIIT would consider our corporate structure and the contractual arrangements between our PRC subsidiaries and our VIEs as a kind of foreign investment in telecommunication services. Therefore, it is unclear what impact the MIIT 2006 Circular might have on us or the other Chinese Internet companies that have adopted the same or similar corporate structures and contractual arrangements as ours. On January 13, 2015, MIIT issued the Announcement on Lifting Restrictions on Foreign Equity Ratio in Online Data Processing and Transaction Processing Business (For-profit E-commerce) in China (Shanghai) Pilot Free Trade Zone, or the MIIT 2015 Circular. The MIIT 2015 Circular provides that in Shanghai FTZ, foreign investors in those companies engaging in the business of providing online data processing and transactions processing services (E-commerce) would be permitted to hold up to 100% of equity interests in such companies. However, restrictions on foreign investments in companies engaging in value-added telecommunications services other than online data processing and transaction processing business are not affected.

In September 2009, the General Administration of Press and Publications, or GAPP, one of the predecessor authorities of the State General Administration of Press, Publication, Radio, Film and Television, or the SAPPRFT, and several other government agencies jointly issued a circular, or the GAPP 2009 Circular, which restates the general principle espoused in various regulations that foreign investment is not permitted in online game operating businesses in China. The GAPP 2009 Circular prohibits foreign investors from participating in online game operating businesses via wholly owned, equity joint venture or cooperative joint venture investments in China, and from controlling and participating in such businesses directly or indirectly through contractual or technical support arrangements. In the event of a violation of these provisions, GAPP shall, in conjunction with the relevant government agencies of the PRC, investigate and handle the same in accordance with the law. In serious cases, the relevant licenses and registrations shall be terminated. However, as a detailed interpretation of the GAPP 2009 Circular has not been issued, it is not yet clear how and to what extent this circular will be implemented. Furthermore, as certain other government agencies such as the Ministry of Commerce, or MOFCOM, the Ministry of Culture, or the MOC, and MIIT did not join GAPP in issuing the GAPP 2009 Circular, the views of these authorities are uncertain in clarifying the scope of implementation and enforcement of the GAPP Circular 2009.

On January 19, 2015, MOFCOM published on its website for public comment on a draft Foreign Investment Law of the PRC, or the draft FIL. The draft FIL is believed to strengthen the regulation of PRC companies, such as our VIEs, which have contractual arrangements with foreign investors or foreign invested companies. Under the draft FIL, a company controlled by foreign investors through contractual arrangements is considered to be a foreign invested enterprise and as a result is explicitly subject to restrictions on foreign investment. If the current version of the draft FIL becomes effective, our VIEs could fall within the scope of foreign invested companies and be subject to restrictions on foreign investment in the telecommunication service industry including online games, and the related contractual arrangements between our VIEs and us could be challenged. Under the draft FIL, it is unclear how "control" would be determined for such purpose, and the draft FIL is silent as to the enforcement actions that might be taken against existing companies, such as our VIEs, that operate in restricted industries. See "—Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of the draft Foreign Investment Law and how it may impact the viability of our current corporate structure, corporate governance and business operations."

We cannot assure you that the PRC government would view our operating arrangements to be in compliance with PRC licensing, registration or other regulatory requirements, including without limitation the requirements described in the MIIT 2006 Circular and the GAPP 2009 Circular, with existing policies or with requirements or policies that may be adopted in the future such as the draft FIL. For example, as some of the domain names and trademarks that we use in our operations are not owned by our VIEs or their respective shareholders, we may be in violation of the provisions of the MIIT 2006 Circular or the GAPP 2009 Circular because we operate our online game business through such VIEs. If any of our businesses are determined not to be in compliance with the MIIT 2006 Circular or the GAPP 2009 Circular, the PRC government could take a number of regulatory or enforcement actions that would be harmful to our business, including but not limited to levying fines, revoking our business and operating licenses, requiring us to discontinue or restrict our operations, blocking our website, requiring us to restructure our business or imposing additional conditions or requirements with which we may not be able to comply. New regulations may also be adopted in the future with additional restrictions on our business. We may also encounter difficulties in obtaining performance under or enforcement of these VIE contracts. Any of these actions could cause our business, financial condition and results of operations to suffer and the market price of our ADSs to decline.

Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of the draft FIL and how it may impact the viability of our current corporate structure, corporate governance and business operations.

In January 2015, MOFCOM published the draft FIL aiming to, upon its enactment, replace the existing laws regulating foreign investment in the PRC, namely, the Sino-foreign Equity Joint Venture Enterprise Law, the Sino-foreign Cooperative Joint Venture Enterprise Law and the Wholly Foreign-invested Enterprise Law. The draft FIL is believed to embody a PRC regulatory trend to rationalize its foreign investment regulatory regime in line with prevailing international practice and the legislative efforts to unify the corporate legal requirements for both foreign and domestic investments. MOFCOM is currently soliciting comments on the draft FIL and substantial uncertainties exist with respect to its enactment timetable, interpretation and implementation. The draft FIL, if enacted as proposed, may materially impact the viability of our current corporate structure, corporate governance and business operations in many aspects.

Among other things, the draft FIL expands the definition of foreign investment and introduces the principle of "actual control" in determining whether a company is considered a foreign-invested enterprise, or an FIE. The draft FIL specifically provides that entities established in the PRC but "controlled" by foreign investors will be treated as FIEs, whereas an entity set up in a foreign jurisdiction would nonetheless be, upon market entry clearance by MOFCOM, treated as a PRC domestic investor provided that the entity is "controlled" by PRC entities and/or citizens. "Control" is broadly defined in the draft FIL to cover the following categories: (i) holding, directly or indirectly, not less than 50% of shares, equities, share of voting rights or other similar rights of the subject entity; (ii) holding, directly or indirectly, less than 50% of the voting rights of the subject entity but having the power to secure at least 50% of the seats on the board or other equivalent decision making bodies, or having the voting power to materially influence the board, the shareholders' meetings, or other equivalent decision making bodies; or (iii) having the power to exert decisive influence, via contractual or trust arrangements, over the subject entity's operations, financial matters or other key aspects of business operations. Once an entity is determined to be an FIE, it will be subject to the foreign investment restrictions or prohibitions set forth in a catalogue of "special administrative measures" to be separately issued by the

State Council, which will classify industries into the “catalogue of prohibitions” and the “catalogue of restrictions.” Foreign investors are not allowed to invest in any sector set forth in the catalogue of prohibitions.

The "variable interest entity" structure, or the VIE structure, has been adopted by many PRC-based companies, including us, to obtain necessary licenses and permits in the industries that are currently subject to foreign investment restrictions in China. Under the draft FIL, variable interest entities that are controlled through contractual arrangements could also be deemed FIEs if they are ultimately "controlled" by foreign investors. If MOFCOM takes this position, our VIEs may be deemed FIEs and we may be deemed to operate FIEs in industries listed in the "catalogue of restrictions" based on the current catalogue relating to foreign investment, and our current corporate structure may be challenged. The draft FIL has not taken a position on what actions shall be taken with respect to the existing companies with a VIE structure and MOFCOM is soliciting comments from the public on this point. Moreover, it is uncertain whether the industry in which our variable interest entities operate will be subject to the foreign investment restrictions or prohibitions set forth in the "catalogue of special administrative measures" to be issued. We cannot assure you that the Foreign Investment Law and the final "catalogue of special administrative measures," if enacted, will not mandate further actions to be completed by companies with an existing VIE structure like us or that we will be able to comply with such requirements within reasonable time, on commercially acceptable terms, or at all.

The draft FIL, if enacted as proposed, may also materially impact our corporate governance practices and increase our compliance costs. For instance, the draft FIL imposes stringent ad hoc and periodic information reporting requirements on foreign investors and the applicable FIEs. Aside from an investment information report required at each investment, and investment amendment reports, which shall be submitted upon changes to investments, it is mandatory for entities established by foreign investors to submit an annual report, and large foreign investors meeting certain criteria are required to report on a quarterly basis. Any company found to be non-compliant with these reporting obligations may potentially be subject to fines and/or administrative or criminal liabilities, and the persons directly responsible may be subject to criminal liabilities. If we are subject to such requirements, our compliance costs may substantially increase, and our business, financial condition and results of operations may be materially and adversely affected.

The contractual arrangements with our VIEs and their respective shareholders may not be as effective in providing operational control as direct ownership.

Due to restrictions on foreign ownership of Internet-based businesses in China, we rely on contractual arrangements with our VIEs and their respective shareholders to operate our business. See Item 7.B. "Related Party Transactions—Contractual Arrangements with Our VIEs and Their Shareholders." These contractual arrangements are intended to provide us with effective control over our VIEs and allow us to obtain economic benefits from them, but they may not be as effective as direct ownership in providing us with such control.

Because we rely on these contractual arrangements to effect control and management of our VIEs, we are exposed to the risk that our VIEs and their respective shareholders may breach, or fail to perform their respective obligations under, these contractual arrangements. Direct ownership would allow us to directly or indirectly exercise our rights as a shareholder to effect changes in the boards of directors of our VIEs, which in turn could effect changes, subject to any applicable fiduciary obligations, at the management level. However, under the current contractual arrangements, if our VIEs or their shareholders fail to perform their obligations, we may have to incur substantial costs to enforce such arrangements, and rely on legal remedies under PRC law, which may not be sufficient or effective. As all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in China, they would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. The legal framework and system in China, particularly those relating to arbitration proceedings, is not as developed as other jurisdictions such as the United States. As a result, significant uncertainties relating to the enforcement of legal rights through arbitration, litigation and other legal proceedings remain in China, which could limit our ability to enforce these contractual arrangements and exert effective control over our VIEs. Furthermore, these contracts may not be enforceable in China if PRC government agencies or courts take a view that such contracts contravene PRC laws and regulations or are otherwise not enforceable for public policy reasons. If we are unable to enforce these contractual arrangements, or if we suffer significant delay or other obstacles in the process of enforcing these contractual arrangements, our business and operations could be severely disrupted, which could materially and adversely affect our results of operations and damage our reputation, and we may not be able to consolidate the financial results of our VIEs into our consolidated financial statements in accordance with U.S. GAAP.

The shareholders of our VIEs have potential conflicts of interest with us, which may adversely affect our business.

Under the contractual arrangements with our VIEs and their respective shareholders, (a) we may replace any such individual or entity as a shareholder of any of our VIEs, and (b) each of these shareholders has executed a power of attorney to appoint the relevant PRC subsidiary as the attorney-in-fact to act on such shareholder’s behalf on all matters pertaining to our VIEs and to exercise all of the rights as a shareholder of our VIEs. However, most of the nominee shareholders of our VIEs are not a director or major shareholder of our company. As a result, most of the shareholders of our VIEs may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to the interest of our company, if they believe such action furthers their own interest, or if they otherwise act in bad faith. If any of the foregoing were to occur, we may have to incur substantial costs and expend significant resources to enforce these contractual arrangements, including initiating legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt our business operations and adversely affect our ability to control our VIEs.

The arrangements with our VIEs may be reviewed by the PRC tax authorities for transfer pricing adjustments.

We could face material adverse tax consequences if the PRC tax authorities determine that the contractual arrangements between our PRC subsidiaries and our VIEs were not entered into based on arm’s length negotiations. Although we based our contractual arrangements on those of similar businesses, if the PRC tax authorities determine that these contracts were not entered into on an arm’s length basis, they may adjust our income and expenses resulting from such arrangements for PRC tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could adversely affect us by increasing our VIEs’ tax liabilities without reducing our PRC subsidiaries’ tax liabilities, which could further result in late payment fees and other penalties to our VIEs for under-paid taxes. As a result, any transfer pricing adjustment could have a material adverse effect on our financial condition and results of operations.

Our holding company structure may restrict our ability to receive dividends from, or transfer funds to, our PRC subsidiaries and our VIEs, which could restrict our ability to act in response to changing market conditions and reallocate funds among our Chinese entities in a timely manner.

We are a Cayman Islands holding company and conduct substantially all of our operations through our PRC subsidiaries and our VIEs. We may rely on dividends and other distributions on equity by our PRC subsidiaries for our cash requirements, including the funds to pay dividends on the Class A ordinary shares underlying our ADSs and to service any debt we may incur or financing we may need for our operations. If any of our PRC subsidiaries incurs its own debt in the future, the instruments governing the debt may restrict such PRC subsidiary’s ability to pay dividends or make other distributions to our HK subsidiaries and to us. Furthermore, under PRC laws and regulations, each PRC subsidiary is only permitted to pay dividends out of its retained earnings, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, each PRC subsidiary is also required to set aside at least 10% of its after-tax profit based on PRC accounting standards each year for its general reserves until the cumulative amount of such reserves reaches 50% of its registered capital. These reserves are not distributable as cash dividends, loans or advances. Each PRC subsidiary may also allocate a portion of its after-tax profits, as determined by its board of directors, to its staff welfare and bonus funds, which may not be distributed to us. As a result of these and other restrictions under PRC laws and regulations, each PRC subsidiary is restricted from transferring a portion of its assets to us as dividends, loans or advances, which restricted portion amounted to approximately RMB1,847.3 million (US$297.7 million), or 114.5% of our total consolidated net assets, as of December 31, 2014. Any limitation on the ability of our PRC subsidiaries to transfer funds to us as dividends, loans or advances could materially and adversely limit our ability to grow, make investments or acquisitions that could benefit our businesses, pay debt or dividends, and otherwise fund and conduct our business.

In addition, any funds we transfer to our PRC subsidiaries, either as a shareholder loan or as an increase in registered capital, is generally subject to registration with, and approval of, the relevant PRC government agencies, including the State Administration of Foreign Exchange, or SAFE. Our PRC subsidiaries and VIEs are generally prohibited by PRC law from directly lending money to each other. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our PRC subsidiaries. These limitations on the free flow of funds between us and our PRC subsidiaries could restrict our ability to act in response to changing market conditions and reallocate funds among our PRC subsidiaries on a timely basis.

The existing contractual arrangements with our VIEs and their shareholders may be subject to national security review by MOFCOM, and the failure to receive the national security review could have a material adverse effect on our business, operating results and reputation and trading price of our ADSs.

In August 2011, the MOFCOM promulgated the Rules of the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the MOFCOM Security Review Rules, to implement the Notice of the General Office of the State Council on Establishing Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or Circular 6, which was promulgated in February 2011 and became effective in March 2011. Under the MOFCOM Security Review Rules, a national security review is required for certain mergers and acquisitions by foreign investors that raise concerns regarding national defense and security. Foreign investors are prohibited from circumventing the national security review requirements by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. On January 19, 2015, the MOFCOM published the draft FIL which sets forth more specific rules regarding the procedures of national security review. The application and interpretation of the MOFCOM Security Review Rules remain unclear.

We have concluded that there is no need to submit our existing contractual arrangements with our VIEs and their shareholders to the MOFCOM for national security review because, among other reasons, (i) we gained de facto control over our VIEs prior to the effectiveness of Circular 6 and the MOFCOM Security Review Rules; and (ii) there are currently no explicit provisions or official interpretations indicating that our current businesses fall within the scope of the national security review rules. However, there are substantial uncertainties regarding the interpretation and application of the MOFCOM Security Review Rules, and any new laws, rules, regulations or detailed implementation measures in any form relating to such rules.

Therefore, we cannot assure that the relevant PRC regulatory authorities, such as the MOFCOM, would not ultimately reach a different conclusion based on the existing regulations or any requirements or policies that may be adopted in the future. If the MOFCOM or other PRC regulatory authority determines that we need to submit the existing contractual arrangements with our VIEs and their shareholders for national security review, we may face sanctions by the MOFCOM or other PRC regulatory authorities. These sanctions may include revoking the business or operating licenses of our PRC subsidiaries or our VIEs, discontinuing or restricting our operations in China, confiscating our income or the income of our PRC subsidiaries or our VIEs, requiring us to undergo a costly and disruptive restructuring and taking other regulatory or enforcement actions, such as levying fines, that could be harmful to our business.

Our operations may be adversely affected by the implementation of anti-fatigue-related regulations.

The PRC government may decide to adopt more stringent policies to monitor the online game industry as a result of adverse public reaction to perceived addiction to online games, particularly by minors. In April 2007, eight PRC government agencies, including GAPP, the Ministry of Education and MIIT, jointly issued a notice requiring all Chinese online game operators to adopt an anti-fatigue system in an effort to curb addiction to online games by minors. Under the anti-fatigue system, three hours or less of continuous play is defined to be healthy, three to five hours is defined to be fatiguing, and five hours or more is defined to be unhealthy. Game operators are required to reduce the value of game benefits for minor game players by half when those game players reach the fatigue level, and to zero when they reach the unhealthy level. In addition, online game players in China are now required to register their identity card numbers before they can play an online game, which helps game operators identify which game players are minors. These restrictions could limit our ability to increase our business among minors. Furthermore, if these restrictions were expanded to apply to adult game players in the future, our business could be materially and adversely affected.

In July 2011, eight PRC government agencies, including GAPP, the Ministry of Education and MIIT, promulgated the Circular on Implementing the Verification of Real-name Registration for the Anti-Fatigue System of Online Games, or the Real-name Registration Circular, to strengthen the implementation of the anti-fatigue system and the real-name registration system. The Real-name Registration Circular indicates that the National Citizen Identity Information Center of the Ministry of Public Security shall verify identity information of game players submitted by online game operators. In addition, this circular imposes more stringent penalties on online game operators failing to implement the anti-fatigue and real-name registration systems properly and effectively, including suspension or termination of online game services. On July 25, 2014, the General Office of SAPPRFT promulgated the Notice on Deepening Work of Anti-Fatigue and Real-name Registration for Online Games, or the SAPPRFT Circular 72. According to this circular, an application to publish an online game shall be rejected if the relevant online game operator has not established an anti-fatigue system and a real-name registration system.

Intensified government regulation of Internet cafés could restrict our ability to maintain or increase our revenues and expand our game player base.

In China, Internet cafés are one of the primary places where our games are played. The PRC government has tightened its regulation and supervision of Internet cafés since 2001 and closed a large number of unlicensed Internet cafés. The PRC government has also imposed higher capital and facility requirements for the establishment of Internet cafés. Furthermore, the PRC government's policy, which encourages the development of a limited number of national and regional Internet café chains and discourages the establishment of independent Internet cafés, may slow down the growth of Internet cafés. In February 2007, several government agencies jointly issued a circular suspending the issuance of new Internet café licenses. Since this ban was imposed in 2007, to our knowledge, local governments have not issued new Internet café licenses and it is unclear when local governments will start issuing new licenses again. It was reported that in November 2013, MOC, the Ministry of Public Security, the MIIT and the SAIC jointly issued an internal notice and revoked this ban. However, this has not been confirmed by any public or official announcement and it is uncertain when and how this internal notice will be implemented. In March 2010, MOC issued a circular to increase the penalties for Internet cafés that admit minors. According to this circular, among other things, the governments may revoke an Internet café's Internet culture operation license if that Internet café allows three or more minors to enter and use the Internet at one time. On April 17, 2013, the MOC promulgated the Notice on Carrying out Pilot Work of Internet Cafés Access, or the Internet Cafés Pilot Notice. According to this notice, the MOC seems to loosen the previous restrictions on Internet cafés in certain pilot cities and areas. On November 16, 2014, the MOC, the MIIT, the SAIC and the Ministry of Public Security jointly issued the Notice on Strengthening the Supervision of Law Enforcement, Improve the Management of Policies, and Promote Healthy and Orderly Development of the Internet Access Service Industry, which purports to loosen the existing restrictions on issuing new Internet café licenses. However, the impact of the implementation of these two latest notices remain to be seen and we cannot assure you that the government agencies will continue to lift the restrictions nationwide. Government agencies may cease to implement any favorable policy or impose stricter requirements in future, such as the customers' age limit and hours of operation, among others, as a result of the occurrence and perception of, and the media attention on, gang fights, arson and other incidents in or related to Internet cafés. Since a substantial portion of our users play our games in Internet cafés, any reduction in the number, or slowdown in the growth, of Internet cafés in China, or any new regulatory restrictions on their operations, could limit our ability to maintain or increase our revenues and expand our game player base, thereby adversely affecting our business and results of operations, as well as growth prospects.

The PRC government may prevent us from distributing, and we may be subject to liability for, content deemed to be inappropriate.

China has enacted laws and regulations governing Internet access and the distribution of news, information or other content, as well as products and services, through the Internet. In September 2000, the State Counsel promulgated the Administrative Measures on Internet Information Services, or the Internet Measures, which prohibit information that violates PRC law from being distributed through the Internet. MIIT, GAPP and MOC have promulgated regulations that prohibit games from being distributed through the Internet if the games contain content that is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of China, or compromise state security or secrets. In addition, certain PRC social organizations have discussed the possibility of implementing a rating system for online games. The effect that such a system could have on our business is unclear. If any games we offer were deemed to violate any such content restrictions, we would not be able to obtain the necessary government approval, may not be able to continue such offerings and/or could be subject to penalties, including confiscation of income, fines, suspension of business and revocation of our license for operating online games, which would materially and adversely affect our business, financial condition and results of operations.

We may also be subject to potential liability for unlawful actions of our users or for content we distribute that is deemed inappropriate. We may be required to delete content that violates PRC law and report content that we suspect may violate PRC law. It may be difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our games or offering other services in China.

We may be required to reapply for approvals for MMO games licensed from overseas licensors.

MOC issued a Circular Concerning the Examination and Declaration of Imported Online Game Products in April 2009. "Imported online games" refers to online games that are licensed from licensors outside of China. According to this circular, in the event of a change of the operator of an imported online game, the game's existing import approval will be automatically revoked and the new operator must apply to MOC for a new approval for the same game. Although this circular has been issued for a period of time, it remains unclear how and to what extent this circular will be implemented or enforced. In September 2009, GAPP, together with two other government agencies, issued the GAPP 2009 Circular, which contains a similar provision to the MOC circular mentioned above. The GAPP 2009 Circular also requires that, in the event of a change of the operator of an imported online game, the new operator must apply to GAPP for a new approval for the same game, and the operation of the online game should be suspended until GAPP approves the change in operator.

We have obtained MOC approvals for all of our imported MMO games. However, we currently operate substantially all of our imported MMO games under import approvals granted by GAPP to Shanda Networking. Under the above referenced circulars, we are required to reapply to GAPP for approvals for our imported MMO games. We are committed to complying with the requirements of these circulars. However, we cannot assure you that we will succeed in obtaining all the approvals as required by these circulars in time or at all. If we fail to comply with the requirements of these circulars or fail to obtain all the approvals for our imported MMO games, we may be subject to fines, revocation of the relevant operating licenses, the discontinuation or restrictions on our operations or other sanctions. As a result, our business, financial condition and results of operations could be materially and adversely affected.

Currently there is no law or regulation specifically governing virtual asset property rights and therefore, it is not clear what liabilities, if any, online game operators may have for virtual assets.

In the course of playing online games, some virtual assets, such as special equipment, player experience grades and other features of our users' game characters, are acquired and accumulated. Such virtual assets can be important to online game players and have monetary value and in some cases are sold among players for actual money. In practice, virtual assets can be lost for various reasons, often through unauthorized use of the game account of one user by other users and occasionally through data loss caused by a delay of network service, a network crash or hacking activities. Currently, there is no PRC law or regulation specifically governing virtual asset property rights. As a result, there is uncertainty as to who is the legal owner of virtual assets, whether and how the ownership of virtual assets is protected by law, and whether an operator of online games such as us would have any liability to game players or other interested parties (whether in contract, tort or otherwise) for loss of such virtual assets. In case of a loss of virtual assets, we may be sued by our game players and held liable for damages, which may negatively affect our reputation and business, financial condition and results of operation.

Restrictions on virtual currency may adversely affect our revenues and results of operations.

Our MMO game revenues are collected primarily through the sale of our prepaid cards or online sale of game points. The Notice on the Reinforcement of the Administration of Internet Cafés and Online Games, or the Internet Cafés Notice, issued by MOC in February 2007, directs the People's Bank of China, or PBOC, to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. The Internet Cafés Notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, and virtual currency should only be used to purchase virtual items.

In June 2009, MOC and MOFCOM jointly issued the Notice on Strengthening the Administration of Online Game Virtual Currency, or the Virtual Currency Notice. In the Virtual Currency Notice, the PRC government for the first time defined "Virtual Currency" as a type of virtual exchange instrument issued by online game operators, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the online game operators in electronic record format and represented by specific numeric units. In addition, the Virtual Currency Notice categorizes companies involved with virtual currency as either issuers or trading platforms and prohibits companies from operating as both an issuer and as a trading platform. The Virtual Currency Notice also requires online game operators to report the total amount of their issued virtual currencies on a quarterly basis and game operators are prohibited from issuing disproportionate amounts of virtual currencies in order to generate revenues.

We issue online game virtual currency to game players for them to purchase various virtual items or time units to be used in our MMO games. Shanghai Shulong, Shulong Computer, Chengdu Simo, Chengdu Aurora, Shanghai Hongli, Chengdu Youji, Tianjin Youji and Shengzhan have obtained approval from MOC to issue online game virtual currency, as required under the Virtual Currency Notice. Although we believe we do not offer online game virtual currency transaction services, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours. For example, certain virtual items we issue (such as coupons) are transferable and exchangeable in the games. If the PRC regulatory authorities deem such transfer or exchange to be a virtual currency transaction, aside from being engaged in the issuance of virtual currency, we may also be deemed to be providing transaction platform services that enable the trading of such virtual currency. In that event, we may be required to cease either our virtual currency issuance activities or such deemed "transaction service" activities and may be subject to certain penalties, including but not limited to mandatory corrective measures and fines. The occurrence of any of the foregoing could have a material adverse effect on our business and results of operations.

In addition, the Virtual Currency Notice prohibits online game operators from creating game features that involve the direct payment of cash or virtual currency by players to increase their chance to win virtual items or virtual currency based on random selection through a lucky draw, wager or lottery. The notice also prohibits game operators from issuing virtual currency to game players through means other than purchases with legal currency. It is unclear whether these restrictions would apply to certain aspects of our MMO games. For example, certain of our games contain features known as "treasure boxes." Players may use "yuanbao," a type of virtual item they obtain in the games, to acquire keys to open treasure boxes that, if opened, award the player with rewards, such as game points or virtual items. As no cash or virtual currency is directly paid by the players in opening treasure boxes, we believe this feature is distinct from those prohibited by the Virtual Currency Notice. However, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours and deem such feature as prohibited by the Virtual Currency Notice, thereby subjecting us to penalties, including mandatory corrective measures and fines. In addition, since we believe many of our game players find treasure boxes to be an enjoyable feature of our games, if we are required to eliminate this from our games, our games could be less attractive to players. The occurrence of any of the foregoing could materially and adversely affect our business and results of operations.

The Virtual Currency Notice also requires online game operators to keep transaction data records for no less than 180 days and prohibits them from providing virtual currency trading services to minors. In order to comply with the requirements of the Virtual Currency Notice, we may need to change our virtual currency distribution channels, and to retain transaction records for a longer period than we otherwise would. These restrictions may result in higher costs for our online game operation and lower sales of our prepaid cards or game points, which may have an adverse effect on our games revenue.

Our business may be adversely affected by public opinion and governmental policies in China as well as in other jurisdictions where we license our games to third parties.

Due to a relatively high degree of game player loyalty and easy access to personal computers and Internet cafés, many teenagers in China frequently play online games. This may result in these teenagers spending less time on or refraining from other activities, including education, vocational training, and sports, which could result in adverse public reaction and stricter government regulation. For example, the PRC government has promulgated anti-fatigue-related regulations to limit the amount of time minors can play online games. See "—Our operations may be adversely affected by the implementation of anti-fatigue-related regulations." The PRC government has also begun to tighten its regulations on Internet cafés, currently one of the primary places where online games are played, including limiting the issuance of Internet café operating licenses and imposing higher capital and facility requirements for the establishment of Internet cafés. See "—Intensified government regulation of Internet cafés could restrict our ability to maintain or increase our revenues and expand our game player base."

Adverse public opinion could discourage game players from playing our games, and could result in government regulations that impose additional limitations on the operations of online games as well as the game players' access to online games. For example, in January 2011, MIIT and seven other central government agencies jointly issued a circular under which online game operators are required to adopt various measures to maintain a system to communicate with the parents or other guardians of minors playing online games and are required to monitor the activities of the minors and suspend their accounts if so requested by their parents or guardians. We believe stricter government regulations, such as regulations imposing stricter age and hour limits on Internet cafés, limiting the issuance of virtual currency by online game operators or the amount of virtual currency that can be purchased by an individual game player, or extending anti-fatigue-related regulations to adults, could be implemented in the future. Such adverse public opinion and tightened government regulations could materially and adversely affect our business prospects and our ability to maintain or increase revenues.

In addition, the PRC State Administration of Taxation previously announced that it will tax game players on the income and profits derived from the trading of virtual currencies at the rate of 20%. However, it is currently unclear how the tax will be collected or if there will be any effect on our game players or our business.

Our plan to continue to license our games in international markets may also be adversely affected by public opinion or government policies in markets in which we license our games. For example, South Korea requires online game operators, such as Actoz, to obtain ratings classifications for online games and implement procedures to restrict minors from accessing online games without consents of their parents or guardians. More recently, the Ministry of Gender Equality and Family and the Ministry of Culture, Sports and Tourism in South Korea have enacted and enforced the Shutdown Law since November 2011. It prohibits users under the age of 16 from playing online games during the "shutdown period" from midnight to 6:00 a.m. every day, and requires online game operators to block access by such users to online games and automatically log off such users during the shutdown period.

The laws and regulations governing the online game industry and related businesses in China are developing and subject to future changes. If we or any of our VIEs fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The Internet industry, including the operation of online games, in China is highly regulated by the PRC government. Various regulatory authorities of the central PRC government, such as the State Council, MIIT, the State Administration for Industry and Commerce, or SAIC, MOC, SAPPRFT, the State Council Information Office, the State Internet Information Office and the Ministry of Public Security, are empowered to promulgate and implement regulations governing various aspects of the Internet and the online game industry.

Our VIEs are required to obtain applicable permits or approvals from different regulatory authorities in order to provide their services. For example, an Internet content provider, or ICP, must obtain a value-added telecommunications business operation license, or ICP license, from MIIT or its local office in order to engage in any commercial ICP operations within China. An online game operator must also obtain an Internet culture operation license from MOC and an Internet publishing license from the SAPPRFT in order to operate and distribute games through the Internet. Shanghai Shulong currently holds a regional ICP license, an inter-regional ICP license, an Internet culture operation license, and an Internet publishing license. Each of Chengdu Aurora, Chengdu Simo and Shanghai Hongli currently holds a regional ICP license, an Internet culture operation license and an Internet publishing license. Each of Tianjin Youji, Chengdu Youji and Shulong Computer currently holds a regional ICP license and an Internet culture operation license. Nanjing Shulong currently holds a regional ICP license. Shengzhan currently holds an inter-regional ICP license, a regional ICP license and an Internet culture operation license. While we believe that we comply in all material respects with all applicable PRC laws and regulations currently in effect, we cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

If the SAPPRFT and other competent PRC regulatory authorities consider that we were operating without proper license or approval, they may, among other things, levy fines, confiscate our income, revoke our businesses and require us to discontinue our business or impose restrictions on the affected portion of our business. In addition, the PRC government may promulgate new laws and regulations that require additional licenses or imposes additional restrictions on the operation of any part of our business. Any of these actions may have a material and adverse effect on our results of operations.

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Stricter government supervision of the online game industry may adversely affect our business and operations.

Under the Regulations on the Administration of Publishing Electronic Publications, or the GAPP Notice, promulgated by GAPP in February 2008, all online game operators must obtain an Internet publishing license to provide online game services. In addition, approvals from the SAPPRFT are required when game operators release new versions or expansion packs, or make any changes to the originally approved online game. In July 2009, GAPP issued the Notice on Strengthening the Approval and Administration of Imported Online Games, which requires game operators to obtain the approval of GAPP to import online games from offshore copyright owners. In the event of any failure to meet the above mentioned requirements, an operator may face heavy penalties, such as being ordered to stop operating online games, or having its business license revoked. Our online game business may be adversely affected by these two GAPP notices. The launch of expansion packs and imported games might be delayed because of the extra approval required. Such delay in releasing expansion packs or imported games may result in higher costs for our online game operation and have an adverse effect on our game revenue.

In June 2010, MOC issued the Interim Measures for Online Games Administration, or the Online Game Measures, aiming to further strengthen MOC's supervision of the online game industry. The Online Game Measures provide that all domestic online games must be filed with MOC, while all imported online games are subject to a content review prior to their launch. If a substantial change (for example, any significant modification to a game's storyline, language, tasks, or trading system) is made to an existing imported or domestic online game, it will be subject to a new content review.

Our online game business may be adversely affected by the Online Game Measures. The Online Game Measures do not set forth any specific procedure for the required filing and content review process for online games and therefore may cause delay when we try to file or apply for content review with MOC. In addition, for our imported licensed games, the requirement for prior approval of any substantial change may cause delay in releasing expansion packs, which may result in higher costs of our online game operation and have an adverse effect on our revenues. Because there is ambiguity in the scope of the authority and the roles and responsibilities of the 22 government agencies with oversight of the online game industry, we may face stricter scrutiny on the day-to-day operations of our online game business. If any of our PRC subsidiaries and VIEs cannot comply with any of the stipulations of any PRC government agencies regarding the online game industry, we may be subject to various penalties and our online game business may be adversely affected.

Risks Relating to the Countries in Which We Operate

Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

Most of our business operations are conducted in China and most of our revenues are generated in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The Chinese economy differs from the economies of most developed countries in many respects, including the amount of government involvement, the level of development, the growth rate, the control of foreign exchange, and the allocation of resources.

While the Chinese economy has grown significantly in the past 30 years, the growth has been uneven geographically among various sectors of the economy, and during different periods. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. While some of these measures benefit the overall PRC economy, they may also have a negative effect on us if the measures reduce the consumable income of our game players.

The PRC legal system embodies uncertainties which could limit the legal protections available to us.

The PRC legal system is relatively new, and differs from the legal system of many developed countries in material ways, including the degree of certainty with respect to how government agencies will interpret and enforce existing laws and regulations. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing general economic and business matters. The overall effect of legislation since 1979 has been a significant enhancement of the protections afforded to various forms of foreign-invested enterprises in China. Each of our PRC subsidiaries is a wholly foreign owned enterprise, or WFOE, which is an enterprise incorporated in China and wholly owned by foreign investors. Our PRC subsidiaries are subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to WFOEs in particular. However, these laws, regulations and legal requirements are constantly changing and their interpretation and enforcement involve uncertainties, which could limit the legal protections available to us. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. Furthermore, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention.

Regulations relating to offshore investment activities by PRC residents may subject us to fines or sanctions imposed by the PRC government, including restrictions on our PRC subsidiaries' abilities to pay dividends or make distributions to us and our ability to increase investment in our PRC subsidiaries.

In July 2014, SAFE promulgated the Circular on Issues Concerning Foreign Exchange Administration over the Overseas Investment and Financing and Roundtrip Investment by Domestic Residents through Special Purpose Vehicles, or Circular 37, which replaced the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment Through Offshore Special Purpose Vehicles, or Circular 75. Circular 37 states that if PRC residents use assets or equity interests either in their onshore entities or offshore entities to establish or indirectly control offshore companies for purpose of investment or financing, they must register with local SAFE branches. They must also file amendments to their registrations if their offshore companies experience material events, such as changes in share capital, share transfers, mergers and acquisitions and spin-off transactions. Under Circular 37, their failure to comply with the registration procedures set forth in such regulation may result in fines or sanctions imposed by the PRC government, including restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on the capital inflow from the offshore entity to the PRC entity.

We are committed to complying with and to ensuring that our shareholders who are subject to the regulations comply with the relevant rules. However, we cannot assure you that all of our shareholders who are PRC residents will comply with our request to make any applicable registrations or comply with other requirements required by Circular 37 or other related rules. Any future failure by any of our shareholders who is a PRC resident, or controlled by a PRC resident, to comply with relevant requirements under these regulations could subject us to fines or sanctions imposed by the PRC government, including restrictions on our PRC subsidiaries' abilities to pay dividends or make distributions to us and our ability to increase our investment in our PRC subsidiaries.

Restrictions on currency exchange may limit our ability to utilize our capital effectively.

Since a significant amount of our future revenues will be denominated in Renminbi, the existing and any future restrictions on currency exchange may limit our ability to utilize capital generated in Renminbi to fund our business activities outside of China, if any, or expenditures denominated in foreign currencies. The Renminbi is currently freely convertible under the "current account," which includes dividends, trade and service-related foreign exchange transactions, but not under the "capital account," which includes foreign direct investment and loans. Currently, our PRC subsidiaries may purchase foreign exchange for settlement of "current account transactions," including payment of dividends to our HK subsidiaries and payment of license fees to international game licensors, and our VIEs may purchase foreign exchange for payment of license fees to international game licensors without the approval of SAFE. Our PRC subsidiaries may also retain foreign exchange in its current account, generally subject to a ceiling approved by SAFE, to satisfy foreign exchange liabilities or to pay dividends. However, we cannot assure you that the relevant PRC government agencies will not limit or eliminate our PRC subsidiaries' abilities to purchase and retain foreign currencies in the future.

Foreign exchange transactions under the capital account are subject to limitations and require registration with or approval by the relevant PRC government agencies. In particular, if we finance our PRC subsidiaries by foreign currency loans, those loans cannot exceed certain statutory limits and must be registered with SAFE, and if we finance our PRC subsidiaries by capital contributions, those capital contributions must be approved by MOFCOM. In addition, because of the regulatory issues related to foreign currency loans to, and foreign investment in, domestic PRC enterprises, we may not be able to finance our VIEs' operations by loans or capital contributions. We cannot assure you that we can make these governmental registrations or obtain relevant approvals on a timely basis, if at all. These limitations could affect the ability of these entities to obtain foreign exchange through debt or equity financing, and could adversely affect our business and financial conditions.

Fluctuations in exchange rates may have a material adverse effect on your investment.

The value of the Renminbi against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. The conversion of Renminbi into foreign currencies, including U.S. dollars, was historically based on exchange rates set by the PBOC. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi solely to the U.S. dollar. Under this revised policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. From July 21, 2005 to December 31, 2014, the value of the Renminbi appreciated by approximately 33.4% against the U.S. dollar.

There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in greater fluctuation of Renminbi against the U.S. dollar. In particular, the PBOC has recently indicated that it will further relax the restrictions on the fluctuation of exchange rates between Renminbi and foreign currencies to allow a wider band of fluctuation in the near future. Significant revaluation of the Renminbi may have a material adverse effect on your investment, as a substantial majority of our revenues and costs are denominated in Renminbi. Any significant revaluation of the Renminbi may materially inflate our revenues and earnings as expressed in U.S. dollars without reflecting an underlying change in our results of operations.

The discontinuation, reduction, delay or retroactive revocation of any of the preferential tax treatments or the government financial incentives currently available to us in China could materially and adversely affect our business, financial condition and results of operations.

Under the enterprise income tax law, or the EIT Law, both foreign-invested enterprises and domestic enterprises are subject to a unified 25% income tax rate. Preferential tax treatments are granted to enterprises that conduct business in certain encouraged sectors and to enterprises that qualify as "high and new technology enterprises," "national key software enterprises" or "software development enterprises." See Item 5.A. "Operating Results—Taxation—PRC Enterprise Income Tax." Some of our PRC subsidiaries and VIEs are currently qualified for such preferential tax treatments. However, we cannot assure you that these PRC subsidiaries and VIEs will be able to continue to qualify for preferential tax treatments at the same level or at all. For example, Shanghai Shulong, which was previously recognized as a high and new technology enterprise, was unable to renew its favorable tax status in 2011. Qualification for preferential tax treatments may also be reassessed by the tax authority retroactively. In 2012, the relevant tax authority determined that Shengji did not qualify as a software development enterprise for 2011. As a result, Shengji incurred additional tax charges of RMB21.9 million in 2012, based on the 25% statutory tax rate instead of a preferential rate of 12.5%, on the taxable income of 2011. If any of our PRC subsidiaries and VIEs that have qualified for preferential tax treatments fail to continue to qualify for such treatments, our income tax expenses would increase, which would have a material adverse effect on our net income and results of operations.

In 2012, 2013 and 2014 we received financial incentives from the government in the aggregate amount of RMB183.9 million, RMB159.4 million and RMB114.5 million (US$18.5 million), respectively, which were calculated with reference to taxable revenues and taxable income. To be eligible for the government financial incentives, we are required to continue to meet a number of financial and non-financial criteria and, even if we meet these criteria, the grant of any incentive is still subject to the discretion of the municipal government. Moreover, the central government or municipal government could determine at any time to eliminate or reduce these government financial incentives. Since the government has discretion in the timing of payment and the amount of the financial incentive, we cannot assure you that we will be able to continue to enjoy these government financial incentives or receive such incentives promptly. The discontinuation, reduction or delay of these government financial incentives could have a material adverse effect on our business, financial condition and results of operations.

There are significant uncertainties under the EIT Law relating to our PRC enterprise income tax liabilities.

Under the EIT Law, the profits of a foreign invested enterprise arising in 2008 and onwards which are distributed to its immediate holding company outside China will be subject to a withholding tax rate of 10%. Pursuant to a special arrangement between Hong Kong and the PRC, such rate is lowered to 5% if a Hong Kong resident enterprise owns over 25% of the equity interest of the PRC company. However, according to a tax circular issued by the State Administration of Taxation in February 2009, if the main purpose of an offshore arrangement is to obtain a preferential tax treatment, the PRC tax authorities have the discretion to adjust the preferential tax rate enjoyed by the relevant offshore entity. In addition, under the EIT Law and the Notice of the State Administration of Taxation on Issues Relating to the Determination of Foreign-registered Chinese-controlled Holding Enterprises as PRC Resident Enterprises under De Facto Management Organization Standard issued by the State Administration of Taxation in April 2009, enterprises established under the laws of jurisdictions outside China with their “de facto management bodies” located within China may be considered to be PRC tax resident enterprises for tax purposes.

Although we are a Cayman Islands company and our HK subsidiaries own 100% of the equity interests of all of our PRC subsidiaries, the PRC tax authorities may regard the main purpose of our HK subsidiaries as obtaining a lower withholding tax rate of 5%. As a result, the PRC tax authorities could impose a higher withholding tax rate on dividends received by our HK subsidiaries from our PRC subsidiaries. In addition, a substantial majority of the members of our management team, as well as the management team of our HK subsidiaries, are located in China. Under current PRC laws and regulations, it is uncertain whether we and/or our HK subsidiaries would be deemed to be PRC tax resident enterprises under the EIT Law. If we or our HK subsidiaries are deemed to be a PRC tax resident enterprise, our global income would be subject to PRC enterprise income tax at the rate of 25%, which would have a material adverse effect on our financial condition and results of operations.

We face risks related to health epidemics and other outbreaks of contagious diseases, including avian flu, H1N1 flu, Ebola and SARS, and natural disasters.

Our business could be adversely affected by avian flu, H1N1 flu, Ebola, SARS, or other epidemics or outbreaks. There have been reports of outbreaks of an avian flu caused by the H7N9 virus, including confirmed human cases, in China. An outbreak of contagious diseases could result in a widespread health crisis that could adversely affect the economies and financial markets of China and other countries in which we operate. Additionally, any recurrence of SARS, a highly contagious form of atypical pneumonia, similar to the occurrence in 2003 that affected China, Hong Kong, Taiwan, Singapore, Vietnam and certain other countries and regions, would also have similar adverse effects. In 2014, the outbreak of Ebola fever in West Africa received considerable worldwide media attention. Experts warn that China is at serious risk of Ebola because of the large numbers of travelers from Africa as well as poor hospital standards.

Our business could also be adversely affected by natural disasters, such as the earthquakes in Sichuan Province, China on May 12, 2008 and in Qinghai Province, China on April 14, 2010. In connection with each of the earthquakes, we observed a three-day period of national mourning for the victims, during which period we suspended our online games, in accordance with a public notice issued by the PRC government. These natural disasters, outbreaks of contagious diseases, and other adverse public health developments in China could severely disrupt our business operations and adversely affect our financial condition and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future natural disasters or outbreaks of avian flu, H1N1 flu, SARS or any other epidemic.

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

On December 25, 2006, the PBOC issued the Administration Measures on Individual Foreign Exchange Control, and its Implementation Rules were issued by SAFE on January 5, 2007. Under these regulations, all foreign exchange matters involved in an employee stock holding plan, stock option plan or similar plan in which a PRC citizen participates, requires approval from SAFE or its authorized branch. On March 28, 2007, SAFE issued the Application Procedure for Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plans or Stock Option Plans of Overseas Listed Companies, or Notice 78. Under Notice 78, PRC individuals who participate in an employee stock option holding plan or a stock option plan of an overseas listed company are required, through a PRC domestic agent or PRC subsidiary of the overseas listed company, to register with SAFE and complete certain other procedures. On February 15, 2012, SAFE promulgated the Circular on Issues Concerning the Administration of Foreign Exchange for Domestic Individuals' Participation in Stock Incentive Plans Adopted by Overseas Listed Companies, or Circular 7. Circular 7 superseded Notice 78 in its entirety and immediately became effective upon circulation. In general, Circular 7 is more practical than Notice 78 and further expands the scope of stock incentive plans to include employee stock ownership plans, stock options, stock appreciation rights, restricted shares, performance shares, phantom stocks and others. Companies that received SAFE approval for their equity plans under Circular 78 have to follow the ongoing compliance requirements under Circular 7. Consequently, from April 2012, such companies are required to file quarterly reports with their local SAFE office by the third business day of each month following the end of the applicable quarter rather than the tenth business day of the month as previously required. Furthermore, if any changes have been made to the underlying equity plans, including their termination, those companies must now amend their applications using the new form as required by Circular 7.

We and our Chinese employees who have been granted restricted shares or stock options pursuant to our share incentive plan are currently subject to Circular 7. However, in practice, there are uncertainties with regard to the interpretation and implementation of Circular 7. Although we have registered our employee stock holding plans and stock option plans with SAFE in accordance with the requirements of Notice 78, we are required to follow the new ongoing compliance requirements under the newly promulgated Circular 7 and we cannot provide any assurance that we or our Chinese employees will continue to be able to satisfy the registration requirements of Circular 7. In particular, if we and/or our Chinese employees fail to comply with the provisions of Circular 7 in the future, we and/or our Chinese employees may be subject to fines and legal sanctions imposed by SAFE or other PRC government agencies, as a result of which our business operations and employee option plans could be materially and adversely affected.

Registered public accounting firms in China, including our independent registered public accounting firm, are not inspected by the U.S. Public Company Accounting Oversight Board, which deprives us and our investors of the benefits of such inspection.

Auditors of companies whose securities are registered with the U.S. Securities and Exchange Commission and traded publicly in the United States, including our independent registered public accounting firm, must be registered with the U.S. Public Company Accounting Oversight Board, or the PCAOB, and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess their compliance with the laws of the United States and professional standards applicable to auditors. Our independent registered public accounting firm is located in, and organized under the laws of, the PRC, which is a jurisdiction where the PCAOB, notwithstanding the requirements of U.S. law, is currently unable to conduct inspections without the approval of the Chinese authorities. In May 2013, the PCAOB announced that it had entered into a Memorandum of Understanding on Enforcement Cooperation with the China Securities Regulatory Commission, or the CSRC, and the PRC Ministry of Finance, which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations undertaken by the PCAOB, or the CSRC or the PRC Ministry of Finance, in the United States and the PRC, respectively. The PCAOB continues to discuss with the CSRC and the PRC Ministry of Finance to permit joint inspections in the PRC of audit firms that are registered with PCAOB and audit Chinese companies that trade on U.S. exchanges.

This lack of PCAOB inspections in China prevents the PCAOB from fully evaluating audits and quality control procedures of our independent registered public accounting firm. As a result, we and investors in our ADSs are deprived of the benefits of such PCAOB inspections. The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our independent registered public accounting firm’s audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections, which could cause investors and potential investors in our ADSs to lose confidence in our audits and reported financial information and the quality of our financial statements.

Escalations in tensions between South Korea and North Korea could have an adverse effect on our operations in South Korea.

Relations between South Korea and North Korea have been tense throughout the two Koreas' modern history. The level of tension between the two Koreas has fluctuated and may increase abruptly as a result of current and future events. In particular, since the death of the North Korean ruler, Kim Jong-il, in December 2011, there has been increased uncertainty with respect to the future of North Korea's political leadership and concern regarding its implications for political and economic stability in the region.

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In recent years, there have been heightened security concerns stemming from North Korea's nuclear weapons and long-range missile programs and increased uncertainty regarding North Korea's actions and possible responses from the international community. In January 2003, North Korea renounced its obligations under the Nuclear Non-Proliferation Treaty. Since the renouncement, South Korea, the United States, North Korea, China, Japan and Russia have held numerous rounds of six party multi-lateral talks in an effort to resolve issues relating to North Korea's nuclear weapons program.

In March 2010, a South Korean warship was destroyed by an underwater explosion, killing many of the crewmen on board. The Korean government formally accused North Korea of causing the sinking, while North Korea has denied responsibility for the sinking and has threatened retaliation for any attempt to punish it for the act. In November 2010, North Korean forces reportedly fired more than one hundred artillery shells targeting Yeonpyeong Island located near the Northern Limit Line, killing two South Korean soldiers and two civilians as well as causing substantial property damage. South Korea responded by firing approximately 80 artillery shells and putting the military on its highest alert level. The South Korean government condemned North Korea for the act and vowed stern retaliation should there be further provocation. In April 2012, North Korea failed in its attempt to launch a satellite using a long-range rocket.

North Korea's economy also faces severe challenges. For example, in November 2009, the North Korean government redenominated its currency at a ratio of 100 to 1 as part of a currency reform undertaken in an attempt to control inflation and reduce income gaps. In tandem with the currency redenomination, the North Korean government banned the use or possession of foreign currency by its residents and closed down privately run markets, which led to severe inflation and food shortages. Such developments may further aggravate social and political tensions within North Korea.

There can be no assurance that the level of tension on the Korean peninsula will not escalate in the future. Since a significant portion of our in house game development is conducted by Eyedentity and Actoz, two of our subsidiaries in South Korea, and a significant portion of our mobile game revenues were generated in South Korea, any further increase in tension for any reason could have a material adverse effect on our operations in South Korea and, in turn, on our business, financial condition and results of operations.

Risks Relating to Our ADSs

The price of our ADSs has been volatile historically and may continue to be volatile, which may make it difficult for holders to resell the ADSs when desired or at attractive prices.

The trading price of our ADSs has been and may continue to be subject to wide fluctuations. Since we completed our initial public offering on September 30, 2009, the market price of our ADSs on the NASDAQ Global Select Market has ranged from US$2.71 to US$13.00 per ADS and the last reported closing price on April 16, 2015 was US$6.86.

Our ADS price may fluctuate in response to a number of events and factors, including among other factors:

- announcements of technological or competitive developments;
- regulatory developments in our target markets affecting us, our game players or our competitors;
- announcements regarding intellectual property rights litigation;
- actual or anticipated fluctuations in our quarterly operating results;
- market perception of our corporate decisions, including declaration of special dividends and related-party transactions with Shanda Interactive;
- changes in financial estimates by securities research analysts;
- changes in the economic performance or market valuations of our online games;

- addition or departure of our executive officers and key research personnel; and

- sales or perceived sales of additional ordinary shares or ADSs.

For example, we introduced an expansion pack in Mir II which was not well received and led to some of the game's players reducing the amount of virtual items they purchase in the game. Primarily as a result of the introduction of that expansion pack, on March 1, 2010, we announced that we expected our net revenues in the first quarter of 2010 to decrease by 10-15% compared with the net revenues in the previous quarter. On that day, the market price of our ADSs decreased by approximately 18%, and on the following night, further decreased by approximately 6%. On July 29, 2013, we acquired Shengzhan and Shengjing, two affiliates providing user and payment platform services, from Shanda Interactive for an aggregate consideration of US$812.7 million. On the date of announcement, the market price of our ADSs decreased by approximately 20%. In addition, the financial markets in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the price of our ADSs, regardless of our operating performance.

We may need additional capital and may sell additional ADSs or other equity securities or incur indebtedness, which could result in additional dilution to our shareholders or increase our debt service obligations.

We may require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

We may be required to withhold PRC income tax on the dividends we pay you (if any), and any gain you realize on the transfer of our ordinary shares and/or ADSs may also be subject to PRC withholding tax.

Non-resident enterprise investors

Pursuant to the EIT Law, we may be treated as a PRC resident enterprise for PRC tax purposes. See "—There are significant uncertainties under the EIT Law relating to our PRC enterprise income tax liabilities." If we are so treated by the PRC tax authorities, we may be obligated to withhold PRC income tax on payments of dividends on our ordinary shares and/or ADSs to investors that are non-resident enterprises of the PRC because the dividends payable on our ordinary shares and/or ADSs may be regarded as being derived from sources within China. The withholding tax rate on China-sourced dividends paid to non-resident enterprises would generally be 10%, subject to the provisions of any applicable bilateral tax treaty between the PRC and the jurisdiction where the non-resident enterprise is incorporated. The U.S.-China tax treaty does not reduce the 10% tax rate. If we are treated as a PRC resident enterprise, any gain realized by any investors that are non-resident enterprises from the transfer of our ordinary shares and/or ADSs could be regarded as being derived from sources within China and be subject to a 10% PRC tax.

Non-resident individual investors

Moreover, if we are treated as a PRC resident enterprise, under the PRC Individual Income Tax Law, or IITL, non-resident individual investors would be required to pay PRC individual income tax on dividends payable to such investors and any capital gains realized from the transfer of our ordinary shares and/or ADSs if such gains are deemed income derived from sources within China. For this purpose, a non-resident individual is an individual who has no domicile in China and has stayed within China for less than one year during the relevant taxable year. Pursuant to the IITL and its implementation rules, for purposes of the PRC capital gains tax, the taxable income will be based on the total income obtained from the transfer of our ordinary shares and/or ADSs minus all the costs and expenses that are permitted under PRC tax laws to be deducted from the income. Therefore, if we are considered a PRC resident enterprise and dividends we pay with respect to our ordinary shares and/or ADSs or the gains realized from the transfer of our ordinary shares and/or ADSs are considered income derived from sources within China by relevant PRC tax authorities, such income or gains earned by non-resident individuals may also be subject to PRC tax, which in the case of dividends will be withheld by us at source. The applicable tax rate would generally be 20%, except for individuals qualifying for a lower tax rate under a tax treaty. Under the U.S.-China tax treaty, a 10% tax rate will apply to dividend payments provided certain conditions are met. The foregoing PRC withholding tax would reduce your investment return on our ordinary shares and/or ADSs and may also materially and adversely affect the price of our ordinary shares and/or ADSs. See Item 10.E. “Taxation—PRC Taxation—PRC taxation of our overseas shareholders.”

Your right as a holder of ADSs to participate in any future rights offerings may be limited, which may cause dilution to your holdings and you may not receive cash dividends if it is impractical to make them available to you.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to our ADS holders in the United States unless we register the rights and the securities to which the rights relate under the Securities Act or an exemption from the registration requirements is available. In addition, the deposit agreement provides that the depositary bank will not make rights available to you unless the distribution to ADS holders of both the rights and any related securities are either registered under the Securities Act or exempted from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, ADS holders may be unable to participate in our rights offerings and may experience dilution in their holdings. In addition, if the depositary is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

In addition, the depositary of our ADSs has agreed to pay to ADS holders the cash dividends or other distributions it or the custodian receives on our ordinary shares or other deposited securities after deducting its fees and expenses. ADS holders will receive these distributions in proportion to the number of ordinary shares their ADSs represent. However, the depositary may, at its discretion, decide that it is inequitable or impractical to make a distribution available to any holders of ADSs. As a result, the depositary may decide not to make the distribution and ADS holders will not receive such distribution.

You may be subject to limitations on transfer of your ADSs.

Your ADSs represented by the ADRs are transferable on the books of the depositary. However, the depositary may close its transfer books at any time or from time to time when it deems it necessary in connection with the performance of its duties. In addition, the depositary may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary deem it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

As we are a Cayman Islands company, you may face difficulties in protecting your interests, and our ability to protect our rights through the U.S. federal courts may also be limited.

Our corporate affairs are governed by our amended and restated memorandum and articles of association, the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) and common law of the Cayman Islands. The rights of our shareholders to take action against our directors, actions by minority shareholders and the fiduciary responsibilities of our directors under Cayman Islands law, are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as that from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities law when compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action in the federal courts of the United States.

In addition, most of our directors and officers are nationals and residents of countries other than the United States. Substantially all of our assets and a substantial portion of the assets of these persons are located outside the United States.

The Cayman Islands courts are also unlikely:

- to recognize or enforce against us judgments of courts of the United States based on certain civil liability provisions of U.S. securities laws; and

- to impose liabilities against us, in original actions brought in the Cayman Islands, based on certain civil liability provisions of U.S. securities laws that are penal in nature.

There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits. As a result of all of the above, our public shareholders may have more difficulties in protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a public company incorporated in a jurisdiction in the United States.

In addition, Cayman Islands companies may not have standing to sue before the federal courts of the United States. As a result, our ability to protect our interests if we are harmed in a manner that would otherwise enable us to sue in a United States federal court may be limited.

You may have difficulties in enforcing judgments obtained against us.

We are a Cayman Islands company, substantially all of our assets are located outside of the United States, and substantially all of our current operations are conducted in China. In addition, most of our directors and officers are nationals and residents of countries other than the United States, and a substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors. In addition, there is uncertainty as to whether the courts of the Cayman Islands or the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state due to the lack of reciprocal treaty in the Cayman Islands or the PRC providing statutory recognition of judgments obtained in the United States. Furthermore, it is uncertain whether such Cayman Islands or PRC courts would be competent to hear original actions brought in the Cayman Islands or the PRC against us or such persons who reside outside the United States predicated upon the securities laws of the United States or any state.

As a foreign private issuer with ADSs listed on the NASDAQ Global Select Market, we follow home country corporate governance practices instead of certain NASDAQ requirements.

As a foreign private issuer whose ADSs are listed on the NASDAQ Global Select Market, we are permitted to follow home country corporate governance practices instead of certain NASDAQ requirements. As a company incorporated in the Cayman Islands with ADSs listed on the NASDAQ Global Select Market, we are relying on the "foreign private issuer" exemption under the NASDAQ Listing Rules and are not obliged to comply with certain NASDAQ corporate governance requirements, including the requirements:

- that the majority of our board of directors consist of independent directors;
- that our audit committee has at least three members;
- that we have a corporate governance and nominating committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities;
- that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities; and

· an annual performance evaluation of the nominating and governance committee and the compensation committee.

We are not required to and will not voluntarily meet these requirements. As a result of our reliance on the "foreign private issuer" exemption, you will not have the same protection afforded to shareholders of companies that are subject to all of NASDAQ's corporate governance requirements.

It was not clear whether we were a passive foreign investment company, or PFIC, for taxable years 2012 and 2013. Although we believe we were not a PFIC for taxable year 2014, we may be a PFIC for subsequent taxable years, which could result in adverse U.S. federal income tax consequences to U.S. holders of our ADSs or Class A ordinary shares.

We will be a PFIC for U.S. tax purposes for a taxable year if either (a) 75% or more of our gross income for such taxable year is passive income or (b) 50% or more of the average quarterly value, generally determined by fair market value, of our assets during such taxable year consists of assets that either produce passive income or are held for the production of passive income. For such purposes, if we directly or indirectly own 25% or more of the shares of another corporation, we generally will be treated as if we (a) held directly a proportionate share of the other corporation's assets and (b) received directly a proportionate share of the other corporation's income. If we were a PFIC for any taxable year during which you held Class A ordinary shares or ADSs, we would generally continue to be treated as a PFIC with respect to those Class A ordinary shares or ADSs for all succeeding years during which you hold them. **Although we believe we were not a PFIC for taxable year 2014, it is not clear whether we were a PFIC for taxable years 2012 and 2013.** The determination of our PFIC status is subject to uncertainty in any taxable year because it is not clear how the contractual arrangements between our PRC subsidiaries and our VIEs will be treated for purposes of the PFIC rules, and because of the uncertain characterization of certain of our assets and income for purposes of the PFIC rules. Our PFIC status for any taxable year will not be determinable until after the end of the taxable year and will depend on the composition of our income and assets and the market value of our assets for such taxable year, which may be, in part, based on the market price of our Class A ordinary shares or ADSs (which may be especially volatile). For these reasons, and because of the uncertainties regarding the treatment of our contractual arrangements with our consolidated affiliated entities, there can be no assurance that we will not be a PFIC for any taxable year. Such characterization could result in adverse U.S. federal income tax consequences to a U.S. investor. In general, if we are a PFIC, "excess distributions" to a U.S. investor and any gain realized by a U.S. investor on the sale or other disposition of our Class A ordinary shares or ADSs will be allocated ratably over the U.S. investor's holding period for the Class A ordinary shares or ADSs; the amount allocated to the taxable year of receipt of the distribution or disposition and any year prior to our becoming a PFIC will be taxed as ordinary income; and the amount allocated to each other taxable year will be subject to tax at the highest rate in effect for the applicable class of taxpayer for that year. Additionally, an interest charge will be imposed with respect to the resulting tax attributable to each such other taxable year and the U.S. investor will be subject to U.S. tax reporting requirements. Alternatively, if we are a PFIC and if our ADSs are "regularly traded" on a "qualified exchange," a U.S. investor could make a mark-to-market election that would result in tax treatment different from the general tax treatment for PFICs described above.

Given the complexity of the issues regarding our classification as a PFIC, U.S. investors are urged to consult their own tax advisors for guidance as to the U.S. federal, state and local and other tax consequences of our status as a PFIC in light of their particular circumstances, as well as the availability of and procedures for making a mark-to-market or other available election. For further discussion of the adverse U.S. federal income tax consequences of our classification as a PFIC, see Item 10.E. "Taxation—U. S. Federal Income Tax Considerations" below.

Our dual-class ordinary share structure with different voting rights could discourage others from pursuing any change of control transactions that holders of our Class A ordinary shares and ADSs may view as beneficial.

Our amended and restated memorandum and articles of association provide for a dual-class ordinary share structure. Our ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares are entitled to one vote per share, and the holders of Class B ordinary share are entitled to 10 votes per share. Class B ordinary shares are convertible into one Class A ordinary share at any time by the holders thereof, while Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances. As of December 31, 2014, 97,518,374 Class B ordinary shares were outstanding. See Item 4.A "Information on the Company—History and Development of the Company—Proposed Going-Private Transaction" and Item 7.A "Major Shareholders." Due to the disparate voting rights attached to these two classes, the holder of our Class B ordinary shares has significant voting rights over matters requiring shareholder approval, including the election and removal of directors and certain corporate transactions, such as mergers, consolidations and other business combinations. This concentrated control could discourage others from pursuing any potential merger, takeover or other change of control transactions that holders of Class A ordinary shares and ADSs may view as beneficial.

Our amended and restated articles of association contain anti-takeover provisions that could adversely affect the rights of holders of our ordinary shares and ADSs.

Our amended and restated articles of association include certain provisions that could limit the ability of others to acquire control of our company. Such provisions could deprive our shareholders of the opportunity to sell their shares at a premium over the prevailing market price by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transactions.

The following provisions in our amended and restated memorandum and articles of association may have the effect of delaying or preventing a change of control of our company:

- our amended and restated memorandum and articles of association provides for a dual-class ordinary share structure with disparate voting rights attached to the two classes of ordinary shares;
- our board of directors has the authority, without approval by the shareholders, to issue any unissued shares and determine the terms and conditions of such shares, including preferred, deferred or other special rights or restrictions with respect to dividend, voting and return of capital;
- the chairman, a majority of our board of directors or shareholder(s) who hold(s) more than 25% of the voting rights of our company having requisitioned for an extraordinary shareholders' meeting at least 21 days previously, have the right to convene an extraordinary shareholders' meeting, and the agenda of such meeting will be set by a majority of the directors or the shareholder(s) who hold more than 25% of the voting rights of our company who request such meeting; and
- the amended and restated articles of association may be amended only by a resolution passed at a shareholders' meeting by a majority of not less than two-thirds of the vote cast.

The voting rights of holders of ADSs are limited by the terms of the deposit agreement.

Except as described in this annual report and in the deposit agreement, holders of our ADSs will not be able to exercise voting rights attaching to the shares evidenced by our ADSs on an individual basis. Holders of our ADSs will appoint the depositary or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. You may not receive voting materials in time to instruct the depositary to vote, and it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, will not have the opportunity to exercise a right to vote.

Under the deposit agreement for the ADSs, the depositary will give us a discretionary proxy to vote our Class A ordinary shares underlying your ADSs at a shareholders' meeting if you do not vote, unless:

- we have instructed the depositary that we do not wish a discretionary proxy to be given;
- we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting; or
- a matter to be voted on at the meeting would have a material adverse impact on shareholders.

The effect of this discretionary proxy is that you cannot prevent our Class A ordinary shares underlying your ADSs from being voted, absent the situations described above, and it may be more difficult for holders of ADSs to influence the management of our company.

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If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, we could be unable to timely file future financial statements in compliance with the requirements of the Securities Exchange Act of 1934.

In December 2012, the SEC instituted administrative proceedings against the "Big Four" PRC-based accounting firms, including our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder for failing to provide to the SEC such firms' audit work papers with respect to certain PRC-based companies that are publicly traded in the United States.

On January 22, 2014, the administrative law judge presiding over the matter rendered an initial decision that each of the firms had violated the SEC's rules of practice for failing to produce audit workpapers to the SEC. The initial decision censured each of the firms and barred them from practicing before the SEC for a period of six months. The Big Four PRC-based accounting firms appealed the judge's initial decision to the SEC. As a result, the decision will not take effect unless and until it is endorsed by the SEC.

On February 6, 2015, the four PRC-based accounting firms each agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC and audit U.S.-listed companies. The settlement required the firms to follow detailed procedures and to seek approval from the CSRC to provide the SEC with access to such firms' audit documents in response to future document requests by the SEC made through the CSRC. If the Big Four PRC-based accounting firms, including our independent registered public accounting firm, fail to comply with the document production procedures that are in the settlement agreement or if there is a failure of the process between the SEC and CSRC, the SEC retains authority to impose a variety of additional remedial measures on the accounting firms, such as imposing penalties on such firms and restarting the proceedings against such firms, depending on the nature of the failure.

If the accounting firms are subject to additional remedial measures, our ability to file our financial statements in compliance with SEC requirements could be impacted. A determination that we have not timely filed financial statements in compliance with SEC requirements could ultimately lead to the delisting of our ADSs from NASDAQ or the termination of the registration of our ADSs under the Securities Exchange Act of 1934, or both, which would substantially reduce or effectively terminate the trading of our ADSs in the United States.

Item 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Our online game business was founded by Shanda Interactive in 2001. In November 2001, Shanda Interactive launched its first MMORPG, Mir II, which it had licensed from Actoz. In October 2003, Shanda Interactive launched Woool, its first in-house developed online game. As a part of the Pre-IPO Reorganization by Shanda Interactive in 2008, our company, Shanda Games Limited, was incorporated in the Cayman Islands on June 12, 2008 as an exempted company with limited liability and as a direct wholly owned subsidiary of Shanda Interactive to be the holding company for the online game business. Subsequently, we completed our initial public offering of our ADSs on the Nasdaq Global Select Market on September 30, 2009. There were an aggregate of 537,832,318 ordinary shares outstanding as of December 31, 2014.

Our principal executive offices are located at No. 1 Office Building, 690 Bibo Road, Pudong New Area, Shanghai 201203, China. Our telephone number is (86-21) 5050- 4740. Our registered address in the Cayman Islands is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman, KY1-1111, Cayman Islands. Our agent for service of process in the United States is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011.

Investments, Acquisitions and Disposals

In March 2012, we sold Mochi Media, a platform for distributing and monetizing browser-based mini casual games, for an appraised value of US$60 million to Shanda Online, a company then under the common control of Shanda Interactive, in a stock-for-stock transaction. Prior to this disposal, Mochi Media was our direct wholly owned subsidiary incorporated in Delaware.

In July 2012, we acquired a 70% stake in eFusion, a German game operator, for a consideration of €2.3 million. In March 2013, we started to operate Dragon Nest in the European region through eFusion.

In October 2012, we sold a 20.5% equity interest in Eyedentity to Actoz.

In June 2013, through a rights offering, Actoz issued 1,900,000 common shares at a price of KRW40,150 per share and raised KRW76,285 million (US$69.0 million) in proceeds. We fully participated in this offering and subscribed for 991,237 common shares of Actoz.

In August 2013, we acquired Shengzhan and Shengjing, two companies providing platform services and prepaid card distribution services, from Shanda Interactive.

In September 2013, we established a wholly owned German subsidiary, Shanda Games International Europe GmbH, or Shanda Europe, to operate Dragon Nest in Europe. In October 2013, we sold a majority of our 70% stake, or 42% of the total equity interests, in eFusion back to the minority shareholders for consideration of €0.4 million, or approximately RMB2.9 million.

In August 2014, Shanda Games International, the direct shareholder of Shanda Europe, transferred a 60% stake in Shanda Europe to Actoz for consideration of US$0.7 million, and Shanda Europe was later renamed as Actoz Soft Europe GmbH.

Proposed Going-Private Transaction

On January 27, 2014, our board of directors received a preliminary non-binding proposal letter from Shanda Interactive, our then controlling shareholder, and an affiliate of Primavera Capital Limited, or Primavera, which together with Shanda Interactive comprised the consortium at the time, to acquire all of our outstanding Class A and Class B ordinary shares in a going-private transaction for US$6.90 per ADS, or US$3.45 per ordinary share, in cash.

A special committee of our board of directors, consisting solely of independent directors, was formed and proceeded to consider the proposed going-private transaction and to negotiate with the consortium as it existed from time to time, while considering other strategic options available to us, with the aid of Bank of America Merrill Lynch as its financial adviser and Sullivan & Cromwell LLP as its U.S. legal counsel. On April 3, 2015, we entered into an agreement and plan of merger with special purpose vehicles wholly owned by affiliates of the consortium, which as of the date of the merger agreement was comprised of Yilida, Ningxia Zhongyin, Orient Finance and Hao Ding. Pursuant to the merger agreement, the consortium will acquire the shares of our company not already owned by members of the consortium for a purchase price of US$3.55 per ordinary share and US$7.10 per ADS cash.

The transaction is subject to customary closing conditions, including approval by our shareholders. Pursuant to the support agreement that they entered into in connection with the going-private transaction, the members of the consortium have agreed to vote all of the shares they beneficially own, which represent approximately 90.9% of the total number of votes represented by our issued and outstanding shares, in favor of the authorization and approval of the merger agreement and the going-private transaction.

If completed, the going-private transaction will result in us becoming a privately-held company and our ADSs will no longer be listed on the NASDAQ. See Item 3.D. “Risk Factors—Risks Relating to Our Business and Our Industry—The consummation of the proposed going-private transaction is uncertain, and the announcement and pendency of the transaction could adversely affect our business, results of operations and financial condition.”

B. BUSINESS OVERVIEW

We are one of China's leading online game companies in terms of the size and diversity of our game portfolio, our game revenues and our game player base. Through our extensive experience in the online game industry in China and in certain overseas markets, we have created a scalable approach to develop, source and operate online games, as well as license our games to third parties. We use multiple channels to assemble a large and diversified game portfolio of various genres. We operate a nationwide, secure network to host hundreds of thousands of users playing simultaneously, and monitor and adjust the game environment to optimize our game players' experience.

We develop and source a broad array of game content through multiple channels, including in-house development, licensing, investment, acquisition, joint development and joint operation. Through these channels, we have built a large, diversified game portfolio and a robust game pipeline. As of March 31, 2015, we operated 35 MMO games and 29 mobile games in China and certain overseas markets. In 2014, we derived 88.1% of our net revenues from MMO games and 10.7% of our net revenues from mobile games. As of March 31, 2015, our in-house development capabilities consisted of approximately 1,350 game development personnel, and we operate nine MMO games and six mobile games that we developed in-house. We license games from international and domestic developers. In 2014, we derived approximately 57.4% of our net revenues from games that were licensed from third parties, including Mir II and its sequels, from which we derived approximately 30.9% of our net revenues in 2014. As of March 31, 2015, 40 of our 64 games were licensed from third-party developers on an exclusive basis, one game was jointly developed with a third-party developer, and one game was jointly operated with third-party developers.

Our game player base is one of the largest in China. For the three-month period ended December 31, 2014, we had 17.1 million average monthly active users and 2.9 million average monthly paying users for our MMO games, and 715,500 average daily active users for our mobile games. We seek to strengthen our game players' loyalty by, among other things, closely monitoring our players' preferences and introducing updates, expansion packs and other game improvements in a timely manner. We believe the size of our game player base is a key factor in attracting and retaining both game players and additional game content.

We are a leader in the development and innovation of China's online game industry. In 2003, we launched Woool, which is our in-house developed game and one of China's first domestically developed MMORPGs. We were among the first in China to adopt the item-based revenue model for advanced casual games and were the first to adopt this revenue model for MMORPGs on a large scale. This revenue model has since become the prevailing revenue model in China. We successfully launched Million Arthur, a mobile card game, in South Korea through Actoz in December 2012 and introduced it to China in July 2013.

We are expanding our business into selected overseas markets. We established Shanda Games International, our wholly owned Singapore subsidiary, to help establish our overseas business. In August 2011, we began operating a localized version of Dragon Nest in Singapore. In December 2012, we launched Million Arthur in South Korea through Actoz. In March 2013, we started to operate Dragon Nest in Europe. In addition, we also license certain of our MMO games and mobile games, in which we own the related game intellectual property rights, to overseas third parties. As of March 31, 2015, we licensed nine MMO games and six mobile games to third parties in international markets, including Hong Kong, Macau, Taiwan, Malaysia, Indonesia, the Philippines, Singapore, Thailand, South Korea, Japan, the United States, Canada, Australia, Turkey and Russia, as well as countries in the Middle East and Europe.

Our net revenues were RMB3,717.3 million (US$599.1 million) in 2014, compared to RMB4,344.7 million in 2013. Our net income attributable to our company was RMB1,040.5 million (US$167.7 million) in 2014, compared to RMB1,587.9 million in 2013.

Our Games

Overview

We operate MMO games and mobile games in China and in certain overseas markets.

Most of our MMO games are MMORPGs, which are action-based and draw upon themes such as martial arts adventure, fantasy, strategy and historical events. Each of these MMORPGs creates an evolving virtual world within which game players can play and interact with each other simultaneously over the Internet. Because these MMORPGs require a significant amount of players' time and commitment to develop the skills and character attributes required to progress to the next level, they tend to develop game player loyalty.

Our MMO games also include advanced casual games, which are generally less time-consuming and require less focus and attention, but typically also have a story line, elaborate graphics, virtual items available for purchase, and frequent interactions among game players. Advanced casual games are an important component of our overall growth strategy as such games generally attract a broader range of demographic groups, as well as more home users, than the more intensive MMORPGs.

Some of our MMO games are web games. Web games are played through a web browser and typically do not require any stand-alone client-side software to be installed. We categorize them as MMORPGs rather than a separate category of online games.

We also operate mobile games for smartphones and tablets. We offer mobile games to both iOS and Android devices, and have adopted an item-based revenue model for all of these games.

As of March 31, 2015, we operated 35 MMO games and 29 mobile games. The following table sets forth certain information relating to the major games that we operated as of March 31, 2015.

Game	Genre	Game Type	Game Source	Launch Date/Region
Mir II(1)	Martial arts adventure	2D MMORPG	License	November 2001, China
BNB	Battle	2D advanced casual	License	August 2003, China
Woool(2)	Martial arts adventure	2D MMORPG	In-house	October 2003, China
The Age	Martial arts adventure	2D MMORPG	In-house	June 2004, China
Maple Story	Side-scrolling combat	2D advanced casual	License	August 2004, China
Latale	Side-scrolling combat	2D MMORPG	In-house	July 2006, South Korea April 2007, China
Fengyun Online	Martial arts adventure	3D MMORPG	Acquisition	July 2007, China November 2010, Singapore
A Thousand Years III	Martial arts adventure	2D MMORPG	In-house	November 2008, China
AION	Fantasy	3D MMORPG	License	April 2009, China
Luvinia Online	Fantasy	3D MMORPG	Acquisition	August 2009, China
Dragon Nest	Action	3D MMORPG	Acquisition	July 2010, China August 2011, Singapore November 2012, South Korea March 2013, Europe
Legend of Immortals	Martial arts adventure	2.5D(3) MMORPG	In-house	May 2011, China
Mir III(1)	Martial arts adventure	2D MMORPG	License	October 2011, China
Million Arthur	Card	2D mobile	License	December 2012, South Korea March 2013, Taiwan July 2013, China March 2014, Singapore

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Game	Genre	Game Type	Game Source	Launch Date/Region
Chain Chronicle	Card	2D mobile	2D mobile	March 2014, South Korea May 2014, China July 2014, Taiwan
LoveLive!	Card	2D mobile	License	May 2014, Taiwan June 2014, China
Iron Knights	RPG	3D mobile	License	June 2014, South Korea December 2014, China
Bloodline	Card	2D mobile	In-house	July 2014, China December 2014, South Korea
Final Fantasy XIV	Fantasy	3D MMRPG	License	August 2014, China

(1) We license Mir II from Actoz, which is our majority-owned subsidiary. While Actoz controls the licensing of Mir II in China, we continue to classify Mir II as a licensed game because Actoz shares a portion of the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

(2) Including the following sequels to Woool: Woool: Legend of Heroes, Woool: Raider of Gems and Woool: Unrivaled, as well as the web version and mobile version of Woool of Paladin.

(3) 2.5D refers to a game with 3D-rendered characters but a 2D game environment.

The following table sets forth, for the periods indicated, certain operating statistics for our MMO games and mobile games.

	For the Three Months Ended,			
	March 31, 2014	June 30, 2014	September 30, 2014	December 31, 2014
MMO games:				
Average monthly active users (in millions)(1)	17.7	17.5	17.1	17.1
Average monthly paying users (in millions)(2)	3.0	3.0	2.9	2.9
Average monthly revenue per paying user (in RMB)(3)	101.0	97.9	88.3	83.8
Mobile games:				
Average daily active users (in thousands)(4)	472.8	537.1	890.6	715.5
Average revenue per daily active user (in RMB)(5)	1.5	1.8	1.7	1.6

(1) Monthly active users, or MAUs, refers to the number of users who play our MMO games during a calendar month. Average monthly active users is the average of the MAUs for each calendar month during a given period.

(2) Monthly paying users, or MPUs, refers to the number of users who spend virtual currency at least once for our MMO games during a calendar month and includes users who spend virtual currency in our MMO games during beta testing. Average monthly paying users is the average of the MPUs for each calendar month during a given period.

(3) Average monthly revenues per paying user, or ARPU, refers to the total revenues from MMO games during a given quarter divided by the average MPUs, further divided by three.

(4) Daily active users, or DAUs, refers to the number of users who play our mobile games during a day. Average daily active users is the average of the DAU for each day during a given period.

(5) Average revenues per daily active user, or ARDAU, refers to the total mobile game revenues for a given period, divided by the number of days in that period, further divided by the average DAU during the period.

Access to Our Games

MMO games. All of the MMO games we operate in China are accessible through a website dedicated to each game. Each game's website provides detailed information and updates on that game and on the products and services that we offer in connection with that game. Game players typically access our games at Internet cafés or through the Internet by using personal computers. A game player can download the end-user software, if necessary, for a game from the website for free and set up a user account and password to access and play the game.

Mobile games. We offer our mobile games in different versions that are adapted for a range of mobile devices, including iPhone, iPad and Android devices. All of our mobile games are accessible from mobile devices, including tablets and mobile phones, through App Store, Google Play, our own mobile game distribution platform, and other third-party mobile app platforms for Android.

Our Game Development and Sourcing Model

The sources of our game content include the games that we develop in-house and games that we license from, acquire from, jointly develop or jointly operate with third parties.

In-House Development

Our in-house development team produces new games and related updates and expansion packs. As of March 31, 2015, we operated nine MMO games that we developed in-house, including Woool, the first large-scale MMORPG developed in China and one of our most popular games. In addition, we introduced approximately 148 updates and expansion packs for our existing MMO games in 2014. As of March 31, 2015, we operated six mobile games that we developed in-house.

We have strong in-house game development capabilities supported by our research and development center and our proprietary game development platform, which is designed with modularized functions and provides a stable, efficient and scalable platform for developing both server-end and client-end game software. We have used this platform to successfully develop in-house games, such as The Age, Woool and Age of Dawn. Furthermore, we have significantly strengthened our in-house game development capabilities by acquiring game developers such as Actoz and Eyedentity. Because Actoz is a majority-owned subsidiary, we classify all games developed by Actoz as in-house developed, except for Mir II, which we categorize as a licensed game because Actoz shares the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

Our game development process generally includes the following key steps:

- formulate a new game proposal based on a preliminary market study;
- conduct an in-depth feasibility study;
- establish a project team to produce a new game development plan;
- develop the game story and overall game design;

- design the game style, characters and environments;
- develop the server-end and user-end software;
- conduct intermediate management review after the fundamental game structure has been developed; and
- conduct final management review upon completing the development of the new game.

The development of MMO games, from management approval of a new game proposal to commencement of closed beta testing, generally takes two to three years, but could take longer depending on a variety of circumstances. The development of mobile games, in comparison, generally takes less than one year.

As of March 31, 2015, we had approximately 1,350 game development personnel. Most of our software programmers and testing engineers have university or graduate degrees.

Game Licensing

We license games from international and domestic developers. We monitor certain key markets such as South Korea, Japan, the United States and Europe to identify and source game content.

As of March 31, 2015, 17 of our 35 MMO and 23 of our 29 mobile games were licensed from third-party developers, including Mir II, which was our leading game in terms of revenues in 2014 and for which Actoz shares the ongoing licensing fees we pay to Actoz with a third party that co-owns the intellectual property rights relating to the game.

The cost of licensing MMO games and mobile games from game content owners generally consists of an upfront licensing fee, which we typically pay in installments, and ongoing licensing fees which are equal to a percentage of revenues we generate from operating the games. In some circumstances, the licensing fees include minimum guarantees. We generally obtain an exclusive license to operate our MMO games for a term of three to six years in China and our mobile games for a term of two years. Most game content owners agree to provide us with updates and expansion packs developed for the games licensed to us without additional charge. For many of our licensed mobile games, we are also responsible for the localization of the games. Most of our license agreements require the game content owners to provide us with technical support.

Investment and Acquisition

We have expanded our game portfolio through acquisitions and strategic investments. For example, in July 2007, we acquired Chengdu Aurora, which operates Fengyun Online, a martial arts adventure 3D MMORPG. In 2010, we acquired Goldcool, which operates numerous MMORPGs, including Hades Realm I and II, Zodiac Tales, and Dukes and Lords, and Eyedentity, which develops Dragon Nest. Our investments and acquisitions have in turn enhanced the influence of our game development and operation platforms and strengthened our brand recognition within the online and mobile game industries in China.

Joint Development

We jointly develop certain games with international game developers. For example, we have jointly developed an online version of Championship Manager Online with Square Enix. Under the joint development agreements, we have the exclusive right to operate the game in China, South Korea, Hong Kong, Taiwan and several countries in South East Asia, and to receive a portion of any revenues that Square Enix generates from operating the game. Square Enix owns the intellectual property rights related to Championship Manager Online.

Joint Operation

We jointly operate certain games with third-party developers in China. For example, from 2012 to 2014, we had an agreement with Suzhou Snail Electronics in connection with the operation of Age of Wushu, pursuant to which we collected operating service fees from Suzhou Snail Electronics and paid no upfront licensing fee to them. We did not own any of the related game intellectual property rights for Age of Wushu. In the future, we may enter into similar joint operation agreements with more third-party developers.

Our Game Performance Evaluation and Testing Systems

Game Performance Evaluation System

To better identify games with potential for commercial success, we have developed a game performance evaluation system to determine a game's potential attractiveness to game players and its expected performance before we source such games. The main characteristics of the system are as follows:

- *Stage 1.* We evaluate a game based upon a number of criteria, including game and artistic design, technology and infrastructure requirements and operational metrics, if any. Of the thousands of games evaluated over our years of operation, only a small number have been submitted to our steering committee, which is comprised of personnel from our game development and operations, quality management, finance, marketing and other departments, for further evaluation.

- *Stage 2.* The steering committee assesses these games and approves a select number, which are then passed on to the game management, business development and quality management divisions for testing and final evaluation.

- *Stage 3.* These divisions evaluate the games to identify those with the highest potential for commercial success and begin the process of licensing, investing or acquiring such games.

Pre-Launch Game Testing System

Before the launch of a new game, we generally conduct internal beta testing to detect and resolve technical problems and improve the quality and features of the game. Thereafter, we conduct closed beta testing to minimize technical problems, followed by open beta testing in which our registered users play the game to ensure consistency of performance and stability of operation systems. Open beta testing generally creates an initial game player base, builds awareness and generates publicity for the game. Based on information and feedback collected in pre-launch game testing, we make adjustments to the game. We conduct open beta testing for our MMO games and major mobile games. For smaller mobile games, we only conduct close beta testing before launching them on various mobile app platforms.

Our Game Operation Model

Game Management

Each of the games we operate is managed by a designated game management team. Our game management teams:

- conduct cost/benefit analyses and form operational plans;
- coordinate internal resources and interact with our other departments such as game design, artistic design, quality management, marketing, and technological services to ensure the smooth daily operation of the game;
- control the timing of update and expansion pack releases; and
- manage the game's virtual community on an ongoing basis by, for example, organizing in-game events.

A centralized game management center monitors the performance of each team. Operational expertise and best practices are shared among all of our game management teams and departments.

Network and Technology Infrastructure

We have developed an extensive technology infrastructure to support our online game operations, including a nationwide server network. As of March 31, 2015, the server network in China consisted of approximately 14,700 servers and 9,500 server annex equipment units with the capacity to accommodate up to 4.7 million concurrent online game players.

Due to the real-time interaction among hundreds of thousands of users, the stable operation of our MMO games requires a large number of servers and a significant amount of Internet connectivity bandwidth. Due to China's large geographical area and limited Internet connectivity bandwidth, we have located game servers in numerous regions throughout China. As a result, our users can play our MMO games using servers located in their region without exchanging data across long distances, thereby increasing the speed at which our MMO games operate and enhancing our users' experience.

The servers for each of our MMO games are organized into a number of independent operating networks. Each operating network consists of a set of login system servers and a number of game server groups. Each operating network for our MMO games operates one game environment and our game players interact in a single virtual environment. Accordingly, with the expansion of our game player base for these MMO games, we continue to increase the number of game server groups running separate game environments. We have introduced server virtualization technologies that allow a single hardware unit to host multiple "virtual" machines or game environments, to increase hardware efficiency.

Each operating network is linked to our centralized billing system, which processes access codes and passwords provided by users from their prepaid cards to add virtual currency into users' accounts, and to deduct virtual currency consumed by users from their accounts as they play our MMO games. Each operating network is also linked to our central data backup system, which backs up data from all login system servers and game servers on a daily basis. Most of our login servers for each operating network, as well as the servers for the central billing system and our central data backup system, are located in Shanghai.

We continuously monitor the operation of our server network. Our remote control system allows us to track our MMO game players on an ongoing basis, and to discover and fix problems in the operation of hardware and software in our server network on a timely basis.

For mobile games in China, the server network and technology infrastructure is similar to that for our MMO games. For mobile games overseas, we generally lease servers from providers who can meet our technical specifications.

As of March 31, 2015, we owned all of the servers in the server network for our online game operations in China. All of the servers in the server network for our online game operations in China are located on the premises of our hosting telecommunications operators. Our server lease arrangements reduce our initial expenditures on servers, provide flexibility in network deployment and include incentives for network operators to maximize our network performance. We plan to add additional servers in order to introduce new games into our portfolio, service additional game players in more locations, accommodate a larger game player base and replace old servers when necessary.

Anti-Cheating and Anti-Hacking

We are committed to quickly disabling cheating programs developed by unauthorized third parties for use in connection with our games. For MMO games, we have developed a MMO game protection kit, which disables cheating programs created by unauthorized third parties to help ensure the fairness of our game environments and enhance our game players' experience. Our game protection kit is used currently in most of the MMO games that we operate in China. With respect to cheating programs for MMO games that we license, the licensors generally develop the disablement software. For mobile games, we developed a mobile app protection kit to protect the games from cheating programs and apply the kit for our key mobile games. We are working on a more advanced version of the mobile app protection kit and plan to apply it to most of our mobile games. Upon the detection of a cheating program, our technology support team cooperates with our game development team to analyze the cheating program and develop and deploy software to disable it.

Marketing

We employ various traditional and online marketing programs and promotional activities, including in-game events and announcements, online and traditional advertising, and offline promotions.

In-game events and announcements. We frequently organize in-game events for our game players to strengthen our communities of game players and generate more interest in our MMO games and mobile games. Examples of in-game events include special challenges or features introduced to the game environments for a scheduled period. In addition, we use in-game events to introduce new game features. Furthermore, we post in-game announcements to promote new features and other improvements of the game and in-game events. We also use in-game announcements for cross-game promotions.

Online and traditional advertising. We regularly advertise on a wide range of Internet portals and online game websites in China. We target a broad base of Internet users through three key initiatives: (i) the launch of large-scale coordinated advertising campaigns on major Internet portals, (ii) an "affiliate marketing campaign" attracting hundreds of regional websites in China through an incentive scheme to jointly promote our new games and direct traffic to our games' websites or our own mobile game distribution platform and (iii) a "multi-segment" targeted advertising campaign promoting our games to different demographic groups of game players.

Social media marketing. We also market our games through various social networking sites in China.

Offline promotions. We market new MMO games through posters at Internet cafés where a large number of game players play our games. We also organize promotional events for our games at distribution points, school campuses and other locations frequented by game players. In addition, we partner with local distributors nationwide in organizing promotional activities for our games. Furthermore, we selectively sponsor media events to promote our games and have entered into arrangements with home personal computer manufacturers, consumer product manufacturers and telecommunications service providers in China to cross-market our games. We also advertise in national and regional newspapers and magazines as well as on billboards and city buses.

Our Revenue Models

Operation of Our Games

We currently use the item-based revenue model for most of our MMO games and all of our mobile games. Under the item-based model, players are able to play the basic features of each game for free. We generate revenues when players purchase virtual items that enhance their playing experience, such as weapons, clothing, accessories and pets. The item-based revenue model allows us to introduce new virtual items or change the features or properties of virtual items to enhance game player interaction and create a better game community. The item-based revenue model also allows us to generate additional revenues by offering new virtual items through updates and expansion packs that meet the changing demands of game players. We determine the price of each virtual item before it is introduced, generally based on an analysis of certain benchmarks, such as the extent of the advantage to the player's character that the virtual item brings, the demand for the virtual item and the price of similar virtual items offered in other games. We track the number and price of each virtual item sold as well as user behavior in response to the launch of a virtual item. We adjust the pricing of certain virtual items based on their consumption pattern and other factors.

We use a time-based revenue model for some of our MMO games. Under the time-based model, players pay for game-playing time. The pricing is typically determined near the end of the open beta testing period based on several factors, including the game's development and operation costs, the pricing of competing games with comparable features in the market, the playing and payment patterns of game players, the technological and other features of the game and the targeted market.

We choose the revenue model for a particular game based on a number of factors, including the quality and features of the game, the preference and playing habits of game players and the revenue models adopted for similar games. For licensed games, we also consider the revenue model adopted by the licensor or by other licensees.

Licensing of Our Games to Third Parties

We license to third parties certain of our online games in which we own the relevant intellectual property rights. Under these license agreements, we typically license the right to exclusively operate, promote, distribute and service our online games in specified territories. In return, the licensee pays us an upfront licensing fee, which is typically paid in installments, and a royalty fee, which is equal to a percentage of revenues generated by the licensee from operating the game in the specific country or region. Generally, the licensees are responsible for the sales and marketing of the licensed games, including setting the price of virtual items, as well as maintaining the network infrastructure and customer service, and we provide the localized versions of our games and the technical support for the operation of our games. We generally provide our licensees with updates to the licensed games. We also usually assist the licensee in preventing, detecting and resolving cheating and hacking activities. As of March 31, 2015, we licensed 15 games to third parties in international markets, including Hong Kong, Macau, Taiwan, Malaysia, Indonesia, the Philippines, Singapore, Thailand, South Korea, Japan, the United States, Canada, Australia, Turkey and Russia, as well as countries in the Middle East and Europe.

Billing, Payment and Distribution

MMO Games

Players of our MMO games can purchase virtual currency directly online, or purchase electronic or physical prepaid cards to access our MMO games. Each prepaid card contains a unique access code and password that enables the user to purchase virtual currency. Such virtual currency can be used to purchase virtual items or time units in our MMO games. Fees incurred for purchases of these virtual items are deducted from the user’s account.

Players of our MMO games can purchase virtual currency or prepaid cards primarily through the following channels:

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- *Direct online sales.* Game players can purchase virtual currency directly online and payment can be made using certain commercial bank cards and other online payment service providers.

- *Indirect e-sales.* Distributors order prepaid cards through a central e-sales computer system and resell the cards to game players through Internet cafés or other retail points of sale.

- *Indirect offline distribution.* Game players can purchase physical prepaid cards from retail points of sale, which primarily consist of newsstands, convenience stores, software stores and book stores.

Mobile Games

We distribute our mobile games primarily through Apple's App Store and Google's Google Play, and are subject to their standard service terms and conditions with regard to the promotion, distribution, operation and payment methods for our mobile games. In 2013, as part of our efforts to further strengthen our mobile strategy, we launched our own mobile game distribution platform for Android, through which we distribute our mobile games for Android and collect payments from players. For the Android platform, we also use other third-party mobile app platforms to distribute our mobile games in China. Players may make payments and purchase our virtual currency through App Store, Google Play, our own mobile game distribution platform or other mobile app platforms. For third-party mobile app platforms including Apple's App Store and Google's Google Play, payments are settled to us upon confirmation of total proceeds collected and after deductions of service fees and taxes, if applicable, typically on a monthly basis. We track various information, including player accounts and in-game purchases, to verify the transactions and proceeds.

Customer Service

When our game players make inquiries, a customer service representative is the initial point of contact, and if the inquiry involves game related technical problems, that representative liaises with a member of our game management team responsible for the relevant game. Our game management teams investigate and address irregularities in game operation reported by users, including eliminating cheating programs that are used by players to enable their game characters to acquire superior in-game capabilities. Typical requests handled by the customer service representatives include addressing problems in adding value to user accounts, retrieving forgotten passwords, and recovering lost user accounts. Typical requests handled by our game management teams include recovering virtual items or in-game characters, and other game-related questions. Customer service is provided through call centers, walk-in customer service centers and online customer service, including online forums and in-game customer service.

VIP game players (i.e., those who achieve designated spending targets in our games) also have access to more personalized customer service. When a VIP game player's in-game habits decrease significantly over a period of time, a customer service representative may contact them to persuade them to become a more active player.

Our game management teams monitor our game players' activities on a real-time basis and utilize a full array of user data to better manage and promote our games. Game players can use the bulletin board services to post questions to, and receive responses from, other users, which helps us to monitor our users' common interests and concerns and provides us with important feedback on our online games. Furthermore, game player comments are collected and weekly reports are generated summarizing important issues and problems raised by game players as well as how such issues have been addressed.

Competition

We compete primarily with other online game and mobile game developers and operators in China, including Boyaa Interactive, Changyou.com Limited, China Mobile Games and Entertainment Group Limited, Forgame Holdings Limited, Giant Interactive, IGG Inc., iDreamSky Technology Limited, Kingsoft, KongZhong, NetEase, Inc., NetDragon Websoft, Inc., Perfect World, Tencent Holdings Limited and The9 Limited. We also compete with other private companies in China devoted to game development or operation, many of which are backed by venture capital funds and international competitors. Competition may also come from international game developers and operators, such as Activision Blizzard, Inc., CJ Entertainment & Media, Com2us Corporation, DeNA Co., Ltd., Electronic Arts, Inc., Gameloft SE, GungHo Online Entertainment, Inc., Glu Mobile, Inc., Gree, Inc., King Digital Entertainment plc., NCSoft Corporation, Nexon Corporation, NHN Corp., SEGA Networks, Square Enix Co., Ltd., Wemade Entertainment Co., Ltd. and Zynga, Inc.

We compete primarily on the basis of the quality or features of our online games, our operational infrastructure and expertise, the strength of our product management approach, and the services we offer to enhance our game players' experience.

We believe that domestic game developers and operators, including us, are likely to have a competitive advantage over international game developers entering the China market, as these companies are likely to lack operational infrastructure in China and content localization experience for the China market. We cannot assure you, however, that this competitive advantage will continue to exist, particularly if international competitors establish joint ventures, form alliances with or acquire domestic game developers and operators. In addition, we also compete for users against other forms of online games such as social network games, various forms of offline video games, such as console games, arcade games and handheld games, as well as various other forms of traditional or online entertainment. For a discussion of risks relating to competition, see Item 3.D. "Risk Factors—Risks Relating to Our Business and Our Industry—We face significant competition which could reduce our market share and materially and adversely affect our business, financial condition and results of operations."

Intellectual Property and Proprietary Rights

Intellectual property is essential to our business. We rely on copyright, trademark, patent, trade secret and other intellectual property law, as well as noncompetition, confidentiality and license agreements with our employees, suppliers, business partners and others to protect our intellectual property rights. We generally require our employees to sign agreements acknowledging that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property, and assigning to us any ownership rights that they may claim in those works.

As of December 31, 2014, we owned 259 software copyrights, each of which has been registered with the State Copyright Bureau of the PRC.

As of December 31, 2014, we owned 357 trademarks, each in various categories, each of which has been registered with the China Trademark Office, and had 123 trademark applications, each in various categories, pending with the China Trademark Office. We have also filed applications to register certain trademarks in a number of other jurisdictions, including Hong Kong and Vietnam.

As of December 31, 2014, we owned 96 patents and had 25 patent applications pending with the State Intellectual Property Office of China.

As of December 31, 2014, we owned or licensed 284 registered domain names, including our official website and domain names registered in connection with each of the games we offer. All of our domain names are either held by, or licensed by our PRC subsidiaries or VIEs.

Government Regulations

Certain areas related to the Internet, such as telecommunications, Internet information services, international connections to computer information networks, information security and censorship, are covered extensively by a number of existing laws and regulations issued by various PRC government agencies, including:

- the Bureau of State Secrecy;
- the State Administration of Press, Publication Radio, Film and Television, or the SAPPRFT, which is the successor authority of the General Administration of Press and Publication, or GAPP, and the State Administration for Radio, Film and Television;
- the Ministry of Commerce, or MOFCOM;
- the Ministry of Culture, or MOC;

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- the Ministry of Industry and Information Technology, or MIIT (formerly the Ministry of Information Industry);
- the Ministry of Public Security;
- the State Administration of Foreign Exchange, or SAFE;
- the State Administration of Industry and Commerce, or SAIC;
- the State Copyright Bureau; and
- the State Council Information Office.

Foreign Ownership Restrictions

Foreign direct investment in telecommunications companies in China is regulated by the Regulations for the Administration of Foreign-Invested Telecommunications Enterprises, or the FITE Regulations, which was issued by the State Council on December 11, 2001 and subsequently amended on September 10, 2008. The FITE Regulations limit foreign ownership of companies that provide value-added telecommunications services, including Internet content provision, to 50%. In addition, foreign and foreign-invested enterprises are currently not able to apply for the required licenses for operating online games in China.

On July 13, 2006, MIIT issued the Circular on Strengthening the Administration of Foreign Investment in Value-added Telecommunication Services, or the MIIT 2006 Circular. The MIIT 2006 Circular provides that (i) foreign investors can only operate a telecommunications business in China by establishing a telecommunications enterprise with a valid ICP license; (ii) domestic ICP license holders are prohibited from leasing, transferring or selling an ICP license to foreign investors in any form, or providing any resource, sites or facilities to foreign investors to facilitate the illegal operation of telecommunications business in China; (iii) ICP license holders (including their shareholders) must directly own the domain names and registered trademarks they use in their daily operations; (iv) each ICP license holder must have the necessary facilities for its approved business operations and maintain such facilities in the regions covered by its license and (v) all value-added telecommunication service providers must improve the network and information security, draft relevant information safety administration regulations and set up networks and information safety emergency plans.

On January 13, 2015, MIIT issued the Announcement on Lifting Restrictions on Foreign Equity Ratio in Online Data Processing and Transaction Processing Business (For-profit E-commerce) in China (Shanghai) Pilot Free Trade Zone, or the MIIT 2015 Circular. The MIIT 2015 Circular provides that in Shanghai FTZ, foreign investors in those companies engaging in the business of providing online data processing and transactions processing services (E-commerce) would be permitted to hold up to 100% of equity interests in such companies. However, restrictions on foreign investments in companies engaging in value-added telecommunications services other than online data processing and transaction processing business are not affected.

In order to comply with such foreign ownership restrictions, we operate our online game business in China through our VIEs, which are controlled by our PRC subsidiaries through a series of contractual arrangements. We believe that our ownership structure, business and operation model comply, in all material respects, with current PRC laws and regulations.

On January 19, 2015, MOFCOM published on its website for public comment on a draft Foreign Investment Law of the PRC, or the draft FIL. The draft FIL is believed to strengthen the regulation of PRC companies, such as our VIEs, which have contractual arrangements with foreign investors or foreign invested companies. Under the draft FIL, a company controlled by foreign investors through contractual arrangements is considered to be a foreign invested enterprise and as a result is explicitly subject to restrictions on foreign investment. If the current version of the draft FIL becomes effective, our VIEs could fall within the scope of foreign invested companies and be subject to restrictions on foreign investment in the telecommunication service industry including online games, and the related contractual arrangements between our VIEs and us could be challenged. Under the draft FIL, it is unclear how "control" would be determined for such purpose, and the draft FIL is silent as to the enforcement actions that might be taken against existing companies, such as our VIEs, that operate in restricted industries. See also Item 3.D. "Risk Factors–Risks Relating to Regulation of Our Business and to Our Structure—If the PRC government finds that the agreements that establish the structure for operating our business do not comply with its restrictions on foreign investment in the online game industry, we could be subject to severe penalties or be forced to relinquish our interests in those operations" and Item 3.D. "Risk Factors–Risks Relating to Regulation of Our Business and to Our Structure—Substantial uncertainties exist with respect to the enactment timetable, interpretation and implementation of the draft FIL and how it may impact the viability of our current corporate structure, corporate governance and business operations."

Licenses

A number of aspects of our business require us to obtain licenses from a variety of PRC regulatory authorities.

ICP License. According to the Administrative Measures on Internet Information Services, commercial Internet information service operators must obtain a value-added telecommunications business operation license, or ICP license, or be sublicensed by qualified ICP license holders. Moreover, a value-added telecommunications service provider providing services in multiple provinces, autonomous regions and centrally administered municipalities may be required to obtain an inter-regional ICP license. Shanghai Shulong and Shengzhan have obtained an inter-regional ICP license which covers online game services. Chengdu Youji, Chengdu Aurora and Chengdu Simo have obtained a regional ICP license which only allows them to provide value-added telecommunications services within Sichuan Province. Shanghai Shulong, Shanghai Hongli, Shulong Computer and Shengzhan have obtained regional licenses which allow them to provide ICP services in Shanghai. Tianjin Youji and Nanjing Shulong have obtained regional licenses which allow them to provide ICP services in Tianjin and Jiangsu Province, respectively.

According to the Administrative Measures for Telecommunications Business Operating Licenses, a value-added telecommunications service provider that has obtained an inter-regional ICP license shall commence its business operations in the geographic areas as covered by its license within one year after acquiring the license. The ICP license will be valid for five years. A value-added telecommunications service provider may, subject to approval by the competent authority, authorize its subsidiaries or branches to conduct a value-added telecommunications service business in licensed regions and have greater than 51% of the equity ownership in the subsidiaries in order to do so. Moreover, a value-added telecommunications service provider shall not authorize two or more subsidiaries or branches to conduct the same value-added telecommunications service business in the same region.

Internet Culture Operation License. According to the Provisional Regulations for the Administration of Online Culture, a commercial operator of “online cultural products,” including online games, must obtain, in addition to the ICP license, an Internet culture operation license from MOC. In addition, the Interim Measures for Online Games Administration issued by MOC, which became effective on August 1, 2010, reiterate that online game operators shall obtain an Internet culture operation license for operating online games. Each of Shanghai Shulong, Chengdu Youji, Chengdu Aurora, Chengdu Simo, Shanghai Hongli, Shulong Computer, Tianjin Youji and Shengzhan currently hold an Internet culture operation license.

Internet Publishing License. The Interim Administration Measures on Internet Publication impose a license requirement for any company that engages in online publishing, defined as any act by an Internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the Internet. Under current PRC laws and regulations, the provision of online games is deemed an Internet publication activity. Therefore, an online game operator must obtain an Internet publishing license in order to directly make its online games publicly available in China. Each of Shanghai Shulong, Shanghai Hongli, Chengdu Aurora and Chengdu

Simo currently hold an Internet publishing license. All of our MMO games in commercial operation have been filed with the SAPPRFT as electronic publications.

Regulation of Internet Content

The PRC government has promulgated measures relating to Internet content through a number of government agencies. These measures specifically prohibit Internet activities, which include the operation of online games that result in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of China, or compromise state security or secrets. When an Internet content provider or an Internet publisher finds that information falling within the above scope is transmitted on its website, it shall terminate the transmission of such information or delete such information immediately and keep records and report to the relevant authorities. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

In addition, according to the Notice on the Work of Purification of Online Games jointly issued by several government agencies in June 2005, online games are required to be registered and filed as software products in accordance with the Administrative Measures on Software Products, as amended in March 2009, for the purpose of being operated in China. Furthermore, in accordance with the Notice on Enhancing the Content Review Work of Online Game Products (2004) promulgated by MOC, imported online games are subject to a content review by MOC prior to their operation in China. In addition, imported and domestic online games are required to be filed with MOC before the operation of each game. Our MMO games in commercial operation were all filed with MOC.

In August 2013, MOC promulgated the Administrative Rules on Self-Censorship by Internet Culture Operators, which became effective on December 1, 2013. According to these rules, each Internet cultural operator shall review the content of the Internet cultural products internally before publication. Such review must be done by at least two specialized persons with the required qualifications, and verified by the manager in charge.

Regulation of Information Security

Internet content in China is regulated and restricted from a state security standpoint. In December 2000, the Standing Committee of the National People's Congress, China's national legislative body, has adopted a Decision to Safeguard Internet Security. Pursuant to this decision, criminal punishment is available to punish any action to: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak state secrets; (iv) spread false commercial information; or (v) infringe intellectual property rights.

The Ministry of Public Security has promulgated measures that prohibit using the Internet in ways which, among other things, result in a leakage of state secrets or a spread of socially destabilizing content. The Ministry of Public Security has supervision and inspection rights in this regard, and we may be subject to the jurisdiction of the local security bureaus. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

Technology Import and Export

Our ability to license online games from abroad and import them into China is regulated in several ways. We are required to register with MOFCOM, any license agreement with a foreign licensor that involves an import of technologies, including online game software into China. Without that registration, we cannot remit licensing fees out of China to any foreign game licensor. Furthermore, the State Copyright Bureau requires us to register copyright license agreements relating to imported software before we publish or reproduce the imported game software in China. In addition, imported online game software is also required to pass a content examination by MOC. Any imported online game software which has not been examined and approved by MOC is not allowed to be put into operation in China. If we import into China and operate online games without obtaining game content approval, MOC may impose certain penalties on us, including the revocation of our Internet culture operation license that are required to operate online games in China. In 2009, MOC and GAPP issued separate circulars to further tighten the review procedure for importing online games into China. See also Item 3.D. "Risk Factors–Risks Relating to Regulation of Our Business and to Our Structure—We may be required to reapply for approvals for online games licensed from overseas licensors."

Intellectual Property Rights

China has enacted various laws and regulations relating to protection of intellectual property rights, including copyrights, software, trademarks, patents, domain names and other forms of intellectual property.

Software Copyright. Software copyrights are under the protection of various laws, regulations, and rules promulgated by the State Council and the State Copyright Bureau, including the Regulations on Computer Software Protection, or the Software Regulations, which was promulgated in December 2001 by the State Council and amended in January 2011 and January 2013, and the Measures on the Registration of Computer Software Copyright, promulgated in February 2002 by the State Copyright Bureau. In addition, on March 5, 2009, MIIT issued the Administrative Measures on Software Products, which became effective on April 10, 2009, to strengthen the regulation of software products and to encourage the development of the PRC software industry. Under these rules and regulations, software owners, licensees and transferees may register their rights in software with the State Copyright Bureau or its local branches and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process and registered software rights may be entitled to better protections. We have registered with the State Copyright Bureau all of our in-house developed online games that have been commercially launched.

Copyright. According to the PRC Copyright Law, which was adopted in September 1990 and amended in October 2001 and February 2010, and its implementing rules, publications and products disseminated over the Internet and software products are protected by the PRC laws and regulations. In addition, according to the Trial Measures of Voluntary Registration of Works, which became effective in January 1995, copyright owners are encouraged, although not required, to register their copyrights with the State Copyright Bureau or its local branches and receive written registration certificates.

Trademark. The PRC Trademark Law, which was adopted in August 1982 and amended in February 1993, October 2001 and August 2013, with its implementation rules adopted in August 2002 and amended in April 2014, protects registered trademarks. The Trademark Law was further amended in August 2013, which will become effective in May 2014. In connection with the amendment, the SAIC is also in the process of amending its implementation rules. The Trademark Office of SAIC handles trademark registrations and grants a protection term of ten years to registered trademarks.

Patent. The PRC Patent Law, which was promulgated in March 1984 and amended in September 1992, August 2000 and December 2008, with its implementing rules adopted in December 2002 and amended in January 2010, protects the patents. The State Intellectual Property Office is responsible for administering patents in China. Under the PRC Patent Law, patents are grouped into three categories: inventions, utility models and designs. Patents for inventions remain valid for twenty years, and patents for utility models and designs remain valid for ten years, in each case from the filing date of the patent application.

Domain Name. China Internet Network Information Center, or CNNIC, issued the Implementing Rules on Registration of Domain Names, which became effective in June 2009 and was amended in May 2012. The other two major laws and regulations regarding to the domain name are the Measures on Administration of Domain Names for the Chinese Internet, which was issued by the MIIT in November 2004 and became effective in December 2004, and the Measures on Domain Name Disputes Resolution, which was issued by CNNIC in June 2012. In July 2001, the PRC Supreme People's Court issued the Judicial Interpretation on Certain Issues Concerning the Application of Laws in the Trial of Cases Involving Civil Disputes over Computer Network Domain Names to clarify certain issues in civil disputes in registration and use of computer network domain names.

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Internet Café Regulation

Internet cafés are required to obtain a license from MOC and SAIC and are subject to requirements and regulations with respect to location, size, number of computers, age limit of customers and business hours. Although we do not own or operate any Internet cafés, many Internet cafés distribute virtual prepaid cards. The PRC government has intensified its regulation of Internet cafés, which are currently one of the primary venues for our users to play our games. In 2004, MOC, SAIC and several other government agencies jointly issued a notice to suspend issuance of new Internet café licenses. Though this nationwide suspension has been generally lifted in 2005, the local authorities have the authority of controlling the volume and recipients of new licenses at their discretion. In addition, local and higher-level government agencies may from time to time strictly enforce customer age limits and other requirements relating to Internet cafés, as a result of the occurrence of, and media attention on, gang fights, arsons or other incidents in or related to Internet cafés. As many of our game players access our games from Internet cafés, any reduction in the number, or any slowdown in the growth, of Internet cafés in China as a result of any intensified Internet café regulation will limit our ability to maintain or increase our revenues and expand our game player base, which will in turn materially and adversely affect our business and results of operations. A notice jointly issued by several central government agencies in February 2007 suspended nationwide the approval for the establishment of new Internet cafés in 2007 and enhanced the punishment for Internet cafés admitting minors. In September 2009, MOC promulgated the Measures for the Administration of Recognition of Internet cafés Chain Enterprises, according to which, the PRC government and its related authorities encourage the development of a limited number of national and regional Internet café chains and discourages the establishment of independent Internet cafés. In March 2010, MOC issued a circular to increase the punishment on Internet cafés which allow minors to enter and use the Internet in their cafes. On April 17, 2013, the MOC promulgated the Notice on Carrying out Pilot Work of Internet Cafés Access, or the Internet Cafés Pilot Notice. According to this notice, the MOC seems to loosen the previous restrictions on Internet cafés in certain pilot cities and areas. On November 16, 2014 the MOC, the MIIT, the SAIC and the Ministry of Public Security jointly issued the Notice on Strengthening the Supervision of Law Enforcement, Improve the Management of Policies, Promote Healthy and Orderly Development of the Internet Access Service Industry, which purports to loosen the existing restrictions on issuing new Internet café licenses. However, the impact of the implementation of these two latest notices remain to be seen. We cannot assure you that the government agencies will continue to lift the restrictions nationwide. Government agencies may cease to implement any favorable policy or impose stricter requirements in the future, such as the customers' age limit and hours of operation, among others, as a result of the occurrence and perception of, and the media attention on, gang fights, arson and other incidents in or related to Internet cafés. See also Item 3.D. "Risk Factors–Risks Relating to Regulation of Our Business and to Our Structure—Intensified government regulation of Internet cafés could restrict our ability to maintain or increase our revenues and expand our game player base."

Privacy Protection

In December 2011, MIIT issued the Several Provisions on Regulating Market Order of Internet Information Service, or the MIIT Provisions, which became effective in March 2012. The MIIT Provisions provide clear rules protecting Internet users against intrusion upon their computers or other terminal devices and regulating the collection and storage of users' personal information and data by Internet information service providers.

According to the MIIT Provisions, without users' consent or otherwise required or permitted by PRC laws and regulations, an Internet information service provider shall neither collect personal information of users nor disclose such information to a third party. The MIIT Provisions also require an Internet information service provider to keep their users' information properly protected and take remedial measures promptly in case of leakage of users' information. In addition, without users' authorization or other justifiable reasons, an Internet information service provider shall not change or delete users' personal information, force users to upload their personal information, or use the personal information collected for any other purpose other than for providing its service to users.

In December 2012, the Standing Committee of the National People's Congress issued the Decision on Strengthening Internet Information Protection, or the Congress' Decision. Under the Congress' Decision, an Internet service provider shall, in accordance with the principle of legality, legitimacy and necessity, explicitly state its purposes, methods and scopes when collecting and using personal electronic information. In addition, Internet service providers are required to keep strictly confidential any information so collected and shall not divulge, tamper with, damage, sell or illegally provide others with such information. Internet service providers shall further take technical and other necessary measures to ensure information security and prevent personal information from being leaked, damaged or lost. Remedial measures shall be taken immediately in case of the leakage, damage or loss of the information. Any violation of the Congress' Decision could be subject to warning, fine, confiscation of illegal income, license revocation, website shutdown, or permanent ban on engaging in Internet-related business in the future, and will also be documented in social credit records and publicly announced. If such violation constitutes a public security violation, crime or infringement of a civil right, applicable administrative penalty, criminal liability or civil liability would be imposed. In July 2013, the MIIT promulgated the Regulations on Protection of Personal Information of Telecommunications and Internet Users, or the MIIT Regulations, to implement the Congress's Decision and enhance and enforce the legal protection of information security and privacy on the Internet.

In October 2013, the Standing Committee of the National People's Congress amended the Consumer Rights Protection Law of the PRC, or the Consumer Rights Protection Law, which became effective in March 2014. Under the Consumer Rights Protection Law, business operators collecting and using personal information of consumers shall adhere to the principles of legitimacy, bona fide and necessity, state expressly the purpose, method and scope of collection and use of information, and obtain the consent of consumers for collecting and using personal information of consumers. Business operators collecting and using personal information of consumers shall publish their collection and use rules, and shall not violate the provisions of laws and regulations or any agreement with the consumers regarding collection and use of the information. Business operators and their staffs shall keep strict confidentiality of personal information of consumers collected by them, and shall not divulge, sell or provide such information to others illegally. Business operators shall adopt technical measures and other requisite measures, ensure information security, and prevent disclosure and loss of personal information of consumers. In the event of disclosure or loss or possible disclosure or loss of information, remedial measures shall be forthwith adopted. Business operators shall not send commercial information to consumers without their consent or request or when a consumer has explicitly rejected.

In August 2014, the Supreme People's Court of the PRC promulgated the Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law to Trial of Civil Dispute Cases over Infringement upon Personal Rights and Interests by Using Information Networks, which provides that if an ICP operator uses the network to disclose the genetic information, medical records, health examination data, criminal records, home address, private events and other personal privacy and information of a natural person causing damages, the aggrieved party will be entitled to hold the ICP operator liable unless: (i) the natural person has given written consent and the disclosure is within the agreed scope; (ii) the information is disclosed in order to promote the public interest and it is within the necessary extent; (iii) the information is disclosed for the purposes of public interest of academic research or statistics by schools and research institutions that is consented by the natural person in a written form, and the way of disclosure is not sufficient to identify the specific individuals; (iv) the information is self-disclosed by the natural person or has been lawfully disclosed on the Internet; or (v) the personal information is obtained in a lawful manner.

We require our users to accept a user agreement whereby they agree to provide certain personal information to us. However, we cannot assure you that all of our VIEs can fully comply with the requirements under the MIIT Provisions, the Congress' Decision, the MIIT Regulations, the Consumer Rights Protection Law 2013 or other related rules. If an Internet information service provider violates the MIII Provisions, the Congress' Decision, the MIIT Regulations, the Consumer Rights Protection Law 2013 and other related rules, the government agencies may impose penalties and the Internet content provider may be held liable for damages caused to its users.

Anti-Fatigue Compliance System and Real-name Registration System

In April 2007, GAPP and several other government agencies issued a circular requiring the implementation of an anti-fatigue compliance system and a real-name registration system by all PRC online game operators to curb addictive online game playing by minors. Under the anti-fatigue compliance system, three hours or less of continuous playing by minors, defined as game players under 18 years of age, is considered to be "healthy," three to five hours to be "fatiguing," and five hours or more to be "unhealthy." Game operators are required to reduce the value of in game benefits to a game player by half if the game player has reached the “fatiguing” level, and to zero in the case of the “unhealthy” level.

To identify whether a game player is a minor and thus subject to the anti-fatigue compliance system, a real-name registration system must be adopted to require online game players to register their real identity information before playing online games. The online game operators are also required to submit the identity information of game players to the public security authority for verification. In July 2011, GAPP, together with several other government agencies, jointly issued a Circular on Implementing the Verification of Real-name Registration for the Anti-Fatigue Compliance System on for Online Games, or the Real-name Registration Circular to strengthen the implementation of the anti-fatigue compliance and real-name registration system. The main purpose of the Real-name Registration Circular is to curb addictive online game playing by minors and protect their physical and mental health. This circular indicates that the National Citizen Identity Information Center of the Ministry of Public Security shall verify identity information of game players submitted by online game operators. The Real-name Registration Circular also imposes stringent penalties on online game operators that do not implement the required anti-fatigue and real-name registration systems properly and effectively. The most severe punishment could be termination of online game operations. In July 2014, the General Office of SAPPRFT promulgated the Notice on Deepening Work of Anti-Fatigue and Real-name Registration for Online Games, or the SAPPRFT Circular 72, according to which an application to publish an online game shall be rejected if the relevant operator of the online game has not established an anti-fatigue system and a real-name registration system. See Item 3.D. “Risk Factors—Risks Relating to Regulation of Our Business and to Our Structure—Our operations may be adversely affected by the implementation of anti-fatigue-related regulations.”

We have implemented an anti-fatigue compliance system and real-name registration system. Under this system, game players are required to use real identities to create accounts to enable us to identify which of our game players are minors and thus are subject to these regulations. For game players who do not register with their real-name, we assume that they are minors.

Virtual Currency

In January 2007, the Ministry of Public Security, MOC, MIIT and GAPP jointly issued a circular regarding online gambling which has implications for the issuance and use of virtual currency. To curtail online games that involve online gambling as well as address concerns that virtual currency could be used for money laundering or illicit trade, the circular (i) prohibits online game operators from charging commissions in the form of virtual currency in relation to winning or losing of games; (ii) requires online game operators to impose limits on use of virtual currency in guessing and betting games; (iii) bans the conversion of virtual currency into real currency or property and (iv) prohibits services that enable game players to transfer virtual currency to other players. In February 2007, 14 PRC regulatory authorities jointly promulgated a circular to further strengthen the oversight of Internet cafés and online games. Under the circular, the PBOC has authority to regulate virtual currency, including: (i) setting limits on the aggregate amount of virtual currency that can be issued by online game operators and the amount of virtual currency that can be purchased by an individual; (ii) stipulating that virtual currency issued by online game operators can only be used for purchasing virtual products and services within the online games and not for purchasing tangible or physical products; (iii) requiring that the price for redemption of virtual currency shall not exceed the respective original purchase price and (iv) banning the trading of virtual currency.

In June 2009, MOC and MOFCOM jointly issued a notice regarding strengthening the Administration of Online Game Virtual Currency, or the Virtual Currency Notice. The Virtual Currency Notice requires businesses that (i) issue online game virtual currency (in the form of prepaid cards and pre-payment or prepaid card points) or (ii) offer online game virtual currency transaction services to apply for approval from MOC through its provincial branches within three months following the date of such notice. The Virtual Currency Notice also prohibits businesses that issue online game virtual currency from providing services that would enable the trading of such virtual currency. Any business that fails to submit the requisite application will be subject to sanctions, including but not limited to warnings, mandatory corrective measures and fines.

According to the Virtual Currency Notice, an online game virtual currency transaction service provider refers to a business providing platform services with respect to trading of online game virtual currency among game users. The Virtual Currency Notice further requires an online game virtual currency transaction service provider to comply with relevant e-commerce regulations issued by MOFCOM. According to the Guiding Opinions on Online Trading (Interim) issued by MOFCOM in March 2007, online platform services refer to trading services provided to online buyers and sellers through the computer information system operated by the service provider.

In addition, the Virtual Currency Notice regulates, among other things, the amount of virtual currency a business can issue, the retention period of user records, the function of virtual currency, and the return of unused virtual currency upon termination of online services. It also prohibits online game operators from allocating virtual items or virtual currency to players based on random selection through lucky draw, wager or lottery which involves cash or virtual currency directly paid by the players. The Virtual Currency Notice also provides that game operators may not issue virtual currency to game players through means other than purchases with legal currency. Moreover, any businesses that do not provide online game virtual currency transaction services are required to adopt technical measures to restrict the transfer of online game virtual currency among accounts of different game players.

The PRC State Administration of Taxation issued the Reply of the State Administration of Taxation on Issues concerning the Collection of Individual Income Tax on Income Generated from the Sale of Virtual Currency through the Internet in September 2008. Under this reply, if a person purchases the virtual currency from any game player through the Internet and sells it to another person at a higher price, the income and profits generated from the trade shall be subject to an individual income tax of 20%.

We issue online game virtual currency to game players for them to purchase various virtual items to be used in our MMO games. We intend to comply with the Virtual Currency Notice. Shanghai Shulong, Chengdu Aurora, Chengdu Simo, Chengdu Youji, Tianjin Youji, Shulong Computer and Shanghai Hongli have obtained approval from MOC for issuing online game virtual currency, as required under the Virtual Currency Notice. However, we cannot assure you that all of our VIEs can obtain the approval in a timely manner or at all. Certain of our games contain features known as “treasure boxes.” Players may use “yuanbao,” a virtual item they obtain in the games, to acquire keys to open treasure boxes that, if opened, award the players with rewards, such as game points or virtual items. As no cash or virtual currency is directly paid by the players in opening treasure boxes, we believe such feature is distinct from those prohibited by the Virtual Currency Notice. However, we cannot assure you that the PRC regulatory authorities will not take a view contrary to ours. See Item 3.D. “Risk Factors—Risks Relating to Regulation of Our Business and to Our Structure—Restrictions on virtual currency may adversely affect our revenues and results of operations.”

MOFCOM Security Review Rules

In August 2011, MOFCOM promulgated the MOFCOM Security Review Rules to implement Circular 6 promulgated on February 3, 2011. The MOFCOM Security Review Rules became effective on September 1, 2011.

Under the MOFCOM Security Review Rules, a national security review is required for certain mergers and acquisitions by foreign investors raising concerns regarding national defense and security. In addition, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to the national security review, MOFCOM will look into the substance and actual impact of the transaction. The MOFCOM Security Review Rules further prohibit foreign investors from circumventing the national security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions.

The application and interpretation of the MOFCOM Security Review Rules remain unclear. Currently, there are no explicit and public provisions or official interpretations indicating that our current businesses fall within the scope of national security review, and there is no requirement for foreign investors to those merger and acquisition transactions completed prior to the effectiveness of Circular 6 and the MOFCOM Security Review Rules to take initiative to submit such transactions for national security review. Based on our analysis of the rules, we have concluded that there is no need for us to submit our existing contractual arrangements with our VIEs and their shareholders to MOFCOM for national security review. On January 19, 2015, the MOFCOM published the draft Foreign Investment Law, or the draft FIL, which sets forth more specific rules regarding the procedures of national security review. However, if MOFCOM or other PRC regulatory agency subsequently determines that we need to submit our existing contractual arrangements with our VIEs and their shareholders for national security review by interpretation, clarification or amendment of the MOFCOM Security Review Rules or by any new rules, regulations or directives to be promulgated in the future, we may face sanctions by MOFCOM or other PRC regulatory agency. See Item 3.D. “Risk Factors—Risks Relating to Regulation of Our Business and to Our Structure—The existing contractual arrangements with our VIEs and their shareholders may be subject to national security review by MOFCOM, and the failure to receive the national security review could have a material adverse effect on our business, operating results and reputation and trading price of our ADSs."

C. ORGANIZATIONAL STRUCTURE

As of March 31, 2015, we operated our businesses through the following significant direct and indirect subsidiaries:

- Shanda Games Holdings (HK) Limited, which is our wholly owned subsidiary incorporated in Hong Kong;
- Shengqu Information Technology (Shanghai) Co., Ltd., which is a wholly foreign-owned operating entity incorporated in the PRC and a wholly owned subsidiary of Shanda Games (HK);
- Shengji Information Technology (Shanghai) Co., Ltd., which is a wholly foreign-owned operating entity incorporated in the PRC and a wholly owned subsidiary of Shanda Games (HK);
- Lansha Information Technology (Shanghai) Co., Ltd., which is a wholly foreign-owned operating entity incorporated in the PRC and a wholly owned subsidiary of Shanda Games Technology (HK) Limited;
- Shanda Games International (Pte) Ltd., which is our wholly owned subsidiary incorporated in Singapore;

- Kuyin Software (Shanghai) Co., Ltd., which is a majority foreign-owned operating entity incorporated in the PRC and a wholly owned subsidiary of Goldcool Holdings (HK) Limited;

- Eyedentity Games, Inc., which is our majority-owned subsidiary incorporated in South Korea;

- Actoz Soft Co., Ltd., which is our majority-owned subsidiary incorporated in South Korea and is publicly listed on the Korea Exchange; and

- Actoz Soft Europe GmbH, which is Actoz's majority-owned subsidiary incorporated in Germany.

In order to comply with PRC laws restricting foreign ownership in the online game business in China, we operate our online game business in China through our VIEs. We control our VIEs through a series of contractual arrangements, including agreements between our PRC subsidiaries, on the one hand, and our VIEs and their shareholders, on the other hand. The VIE agreements are a series of contractual arrangements relating to business operations, consulting services, and certain shareholder rights and corporate governance matters. As a result of these contractual arrangements, we are considered the primary beneficiary of our VIEs and, accordingly, consolidate the results of operations of our VIEs in our financial statements.

We believe that our ownership structure and the contractual arrangements between our PRC subsidiaries, on the one hand, and our VIEs and their shareholders, on the other hand, comply in all material aspects with current PRC laws and regulations. There are, however, substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations. Accordingly, PRC government agencies may ultimately take a view that is inconsistent with our own opinion. See Item 3.D. "Risk Factors— Risks Relating to Regulation of Our Business and to Our Structure."

The following diagram illustrates our direct and indirect subsidiaries and VIEs as of March 31, 2015.

D. PROPERTY, PLANT AND EQUIPMENT

We lease our office space of approximately 18,100 square meters at No. 1 Office Building, No. 690 Bibo Road, Pudong New Area, Shanghai 201203, and No. 1, Lane 666 Zhangheng Road, Pudong New Area, Shanghai 201204, from Shanda Interactive. In addition, we occupy an aggregate of approximately 15,300 square meters of leased office space in other locations in Shanghai, Chengdu, Nanjing, Hong Kong, Singapore, South Korea and Germany. As our workforce expands, we may need to lease or purchase additional office space.

Item 4A. UNRESOLVED STAFF COMMENTS

None.

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Item 3.D. "Risk Factors" or in other parts of this annual report on Form 20-F.

Overview

We are one of China's leading online game companies in terms of the size and diversity of our game portfolio, our game revenues and our game player base. Through our extensive experience in the online game industry in China and in certain overseas markets, we have created a scalable approach to develop, source and operate online games, as well as license our games to third parties. We develop and source a broad array of game content through multiple channels, including in-house development, licensing, investment and acquisition, joint development and joint operation. Through these channels, we have built a large, diversified game portfolio and a robust game pipeline. In addition, we operate a nationwide, secure network to host hundreds of thousands of users playing simultaneously, and monitor and adjust the game environment to optimize our game players' experience.

As of March 31, 2015, we operated 35 MMO games and 29 mobile games and our in-house development capabilities consisted of approximately 1,350 game development personnel. We use either the item-based or time-based revenue model for the games we operate, with most of our games using the item-based model. Compared with the time-based model, under which players pay for game-playing time, the item based model allows game players to play the basic features of the game for free. Game players may then choose to purchase virtual items that enhance their playing experience, such as weapons, clothing, accessories and pets. Our game players purchase virtual items and access our games primarily through the purchase of electronic or physical prepaid cards.

Our net revenues were RMB3,717.3 million (US$599.1 million) in 2014, compared to RMB4,344.7 million in 2013. Our net income attributable to our company was RMB1,040.5 million (US$167.7 million) in 2014, compared to RMB1,587.9 million in 2013.

Three MMO games accounted in the aggregate for approximately 55.0% and 53.3% of our net revenues in 2013 and 2014, respectively. These games have finite commercial lifespans. While we may be able to extend the commercial lifespans of these games by adding new features that appeal to existing players and by attracting new players, we need to develop and source new games that appeal to game players and that will be commercially successful in order to remain competitive. Furthermore, the online game and mobile game industries may not continue to grow at current levels, and we face uncertainties regarding the continuing market acceptance of our games in China and elsewhere. We need to adapt to new industry trends, including changes in game players' preferences, new revenue models, new game content distribution models, new technologies and new governmental regulations. We evaluate these changes as they emerge and strive to adapt our business and operations in order to improve our competitive position in the industry.

Factors Affecting Results of Operations

Significant factors affecting our financial condition and results of operations include those described below.

Our ability to continue to successfully introduce new games and improve existing games. We have built one of the largest and the most diversified portfolios of MMO games and mobile games through our multi-channel game content development and sourcing strategy. We must continue to generate and acquire attractive games by developing in-house, licensing, acquiring through investment, or jointly operating or developing with third parties, new games and to maintain the popularity of our existing games by introducing updates, expansion packs and other game improvements. Our results of operations may also be significantly affected by the timing of our new game launches.

Our ability to maintain and expand our community of loyal game players. We have built a large community of game players by enhancing their loyalty to our games. The size and loyalty of our community of game players are critical to our business, as loyal game players tend to remain active paying game players and are likely to spend more purchasing our virtual items. Game players are typically attracted to online games in which they can interact with many other players. Our ability to retain and attract game players will depend significantly on our ability to continually strengthen our community of loyal game players and enhance their experience.

Game content sourcing costs. Significant resources are required to develop, acquire and market new MMO and mobile games and maintain their popularity in the market, including game development, game licensing and other game sourcing and acquisition costs. We typically incur significant costs and expenses before such games generate any revenues. If such games are not popular and do not generate substantial revenues, we may not be able to recover such game content sourcing costs.

Competition in China's online game industry. The online game industry is highly competitive. Numerous competitors have entered the online game industry in China, including Boyaa Interactive, Changyou.com Limited, China Mobile Games and Entertainment Group Limited, Forgame Holdings Limited, Giant Interactive, IGG Inc., iDreamSky Technology Limited, Kingsoft, KongZhong, NetEase, Inc., NetDragon Websoft, Inc., Perfect World, Tencent Holdings Limited and The9 Limited. We also compete with other private companies in China devoted to game development or operation, many of which are backed by venture capital funds and international competitors. Competition may also come from international game developers and operators, such as Activision Blizzard, Inc., CJ Entertainment & Media, Com2us Corporation, DeNA Co., Ltd., Electronic Arts, Inc., Gameloft SE, GungHo Online Entertainment, Inc., Glu Mobile, Inc., Gree, Inc., King Digital Entertainment plc., NCSoft Corporation, Nexon Corporation, NHN Corp., SEGA Networks, Square Enix Co., Ltd., Wemade Entertainment Co., Ltd. and Zynga, Inc. The proliferation of the number of online game companies has placed significant pressure on the cost of sourcing and marketing online games, attracting new and retaining existing game players, and recruiting and retaining game development and management talent.

The growth of our international business. As of March 31, 2015, we had licensed the publishing rights to nine of our MMO games and six of our mobile games to game operators in a number of countries and regions. We intend to operate our games in certain overseas markets through our overseas subsidiaries and licensees. To export our games to overseas markets, we need to localize our online games to meet the preferences of game players in those markets.

The growth of mobile games. As of March 31, 2015, we operated 29 mobile games. Mobile games revenues accounted for RMB396.4 million (US$63.9 million), or 10.7% of our revenues in 2014. We intend to continue to grow our mobile game business. Our revenue growth will depend on the competitiveness of our mobile game titles and the overall growth of the mobile games market, and we need to launch mobile games that meet the evolving preferences of game players. As lifecycles of mobile games tend to be substantially shorter than those of the MMO games, we need to execute rapid and effective mobile game development in order to achieve continued growth of our mobile game business and greater market share. In addition, mobile games typically have lower operating margins as compared with our MMO games. As mobile game revenues continue to grow, our overall operating margin may become lower.

A. OPERATING RESULTS

Revenues

Our net revenues are divided into MMO game revenues, mobile game revenues and other revenues. The following table sets forth, for the periods indicated, a breakdown of our net revenues by amount and percentage of our net revenues.

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	% of Net Revenues	RMB	% of Net Revenues	RMB	US$	% of Net Revenues
	(in millions, except percentages)						
Net revenues:							
MMO game revenues	4,561.4	96.7	3,806.4	87.6	3,276.4	528.1	88.1
Mobile game revenues	10.2	0.2	482.2	11.1	396.4	63.9	10.7

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	% of Net Revenues	RMB	% of Net Revenues	RMB	US$	% of Net Revenues
	(in millions, except percentages)						
Other revenues	147.0	3.1	56.1	1.3	44.5	7.1	1.2
Total net revenues	4,718.6	100.0	4,344.7	100.0	3,717.3	599.1	100.0

MMO game revenues

MMO game revenues consist of revenues generated from in-game virtual items and game usage fees purchased by players to play our MMO games, including MMORPGs and advanced casual games. We also enter into licensing arrangements with overseas and domestic licensees to operate our games in other countries or territories, from which we derive a minor portion of our revenue.

We operate our MMO games using one of two revenue models. For games operated using the item-based revenue model, which constitute the majority of our games, the most significant factors that affect our revenues are (i) the number of paying users and (ii) the average revenue per paying user. The number of paying users for any given period is equal to the number of users that spend virtual currency at least once during a given period and includes users who spend virtual currency in our MMO games during beta testing. The number of monthly paying users is equal to the aggregate number of paying users for our MMO games during a calendar month. The average revenue per paying user is equal to the revenue for a given period divided by the number of paying users during the period.

For games operated using the time-based revenue model, the most significant factors that affect our revenues are (i) the number of users playing the game and (ii) the length of time that users play the game, or total user-hours. We calculate our total user-hours based on our average concurrent users. In a given period, the number of total user-hours equals the average concurrent users for that period multiplied by the number of hours in that period. In measuring average concurrent users, we determine the number of users logged on to our games that adopt the time-based revenue model at one minute intervals, and then average that number over the course of a day to derive daily averages. Average daily information is further averaged over a particular period to determine average concurrent users for that period.

Our MMO game business is subject to seasonality factors. Generally, our game players spend more time playing our games in the first and third quarters of each year, which typically have more school holidays, allowing for more time for leisure activities, whereas the second and fourth quarters are generally slower for our business as there are fewer holidays during those quarters. Seasonality may also be caused by launches of new games and expansion packs and other unexpected fluctuations.

Mobile game revenues

Our mobile game revenues consist of revenues generated from in-game virtual items purchased by players to play our mobile games. We operate all of our mobile games using an item-based revenue model. The most significant factors that affect our revenues are (i) the number of active users and (ii) the average revenue per active user. The number of active users for any given period is equal to the number of users who play our mobile games during the period. The average revenue per active user for a given period is equal to the revenue for the period divided by the number of days in that period, further divided by the average daily active users during the period. Our mobile game business is less susceptible to seasonal fluctuations due to the short lifecycles of mobile games.

Other revenues

Our other revenues consist of advertising revenues and revenues generated from platform services and prepaid card distribution services. Advertising revenues are derived from online advertising associated with the online games on our platform. In 2012, 2013 and 2014, advertising revenues amounted to RMB18.6 million, RMB0.5 million and nil, respectively. Platform service fees and prepaid card distribution service fees are derived from the platform and prepaid card distribution services we provide. Revenues generated from platform services and prepaid card distribution services also include platform service fees and prepaid card distribution fees received by Shengzhan and Shengjing from companies controlled by Shanda Interactive. In 2012, 2013 and 2014, we had RMB57.1 million, RMB34.7 million and RMB17.7 million (US$2.9 million), respectively, from these sources.

Cost of Revenues

Our cost of revenues primarily consists of upfront and ongoing licensing fees for games we operate, platform operations costs, and other miscellaneous expenses. The following table sets forth, for the periods indicated, a breakdown of our cost of revenues by amount and percentage of our net revenues.

	For the Year Ended December 31,						
	2012		2013		2014		
	RMB	%	RMB	%	RMB	US$	%
	(in millions, except percentages)						
Total net revenues	4,718.6	100.0	4,344.7	100.0	3,717.3	599.1	100.0
Cost of revenues:							
Upfront and ongoing licensing fees	(599.7)	(12.7)	(667.0)	(15.4)	(509.4)	(82.1)	(13.7)
Platform operations costs	(198.9)	(4.2)	(188.1)	(4.3)	(177.9)	(28.7)	(4.8)
Others	(357.2)	(7.6)	(280.6)	(6.4)	(252.8)	(40.7)	(6.8)
Total cost of revenues	(1,155.8)	(24.5)	(1,135.7)	(26.1)	(940.1)	(151.5)	(25.3)
Gross profit	3,562.8	75.5	3,209.0	73.9	2,777.2	447.6	74.7

Upfront and ongoing licensing fees. The cost of licensing games from third-party game content providers consists of upfront licensing fees, which are generally paid in several installments, and ongoing licensing fees, the majority of which are equal to a percentage of the revenues we generate from the relevant licensed game. In some circumstances, the ongoing licensin