# KINGSOFT

( continued into the Cayman Islands with limited liability )

Stock Code:03888

# KINGSOFT CORPORATION LIMITED
# 2012 ANNUAL REPORT

Beijing / Zhuhai / Chengdu / Dalian / Japan / Malaysia

Kingsoft Corporation Limited



# Contents


| | |
|---|---|
| Corporate Information | 2 |
| Financial Highlights | 4 |
| Chairman's Statement | 6 |
| Management Discussion and Analysis | 8 |
| Directors and Senior Management | 13 |
| Corporate Governance Report | 18 |
| Directors' Report | 28 |
| Independent Auditors' Report | 58 |
| Consolidated Income Statement | 59 |
| Consolidated Statement of Comprehensive Income | 60 |
| Consolidated Statement of Financial Position | 61 |
| Consolidated Statement of Changes in Equity | 63 |
| Consolidated Statement of Cash Flows | 64 |
| Statement of Financial Position | 66 |
| Notes to Financial Statements | 67 |

# CORPORATE INFORMATION

**Legal Name of the Company**

Kingsoft Corporation Limited (the "Company")

**Stock Code**

03888

**Date of Listing**

9 October 2007

**Head Office and Principal Place of Business**

Kingsoft Tower
No.33, Xiaoying West Road
Haidian District
Beijing 100085
PRC

**Principal Place of Business in Hong Kong**

Unit 1309A, 13/F
Cable TV Tower
No. 9 Hoi Shing Road
Tsuen Wan, N.T.
Hong Kong

**Registered Office**

Clifton House
75 Fort Street
P.O. Box 1350 GT
George Town
Grand Cayman KY1-1108
Cayman Islands

**Executive Directors**

Mr. HongJiang Zhang
Mr. Yuk Keung Ng
Mr. Tao Zou

**Non-executive Directors**

Mr. Jun Lei (Chairman)
Mr. Pak Kwan Kau
Mr. Chi Ping Lau

**Independent Non-executive Directors**

Mr. To Thomas Hui
Mr. Guangming George Lu
Ms. Wenjie Wu

**Audit Committee**

Mr. To Thomas Hui
Mr. Guangming George Lu
Ms. Wenjie Wu

**Remuneration Committee**

Mr. Guangming George Lu
Mr. Jun Lei
Mr. To Thomas Hui
Ms. Wenjie Wu

**Nomination Committee**

Mr. Guangming George Lu
Mr. Chi Ping Lau
Ms. Wenjie Wu

**Board Secretary/Company Secretary**

Ms. Michelle Feng Harnett

**Authorised Representatives**

Mr. Pak Kwan Kau
Ms. Michelle Feng Harnett

**Principal Share Registrar and Transfer Office**

Appleby Trust (Cayman) Ltd.

Clifton House

75 Fort Street

P.O. Box 1350 GT

George Town

Grand Cayman KY1-1108

Cayman Islands

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

Computershare Hong Kong Investor Services Limited

Shops 1712–1716, 17/F.

Hopewell Centre

183 Queen's Road East

Hong Kong

**Auditors**

Ernst & Young

Certified Public Accountants

22th Floor, CITIC Tower

1 Tim Mei Avenue

Central

Hong Kong

**Legal Advisers on Hong Kong law**

Hui & Lam

Rooms 1505–6, 15/F

The Center

99 Queen's Road Central

Hong Kong

**Principal Bankers**

Industrial and Commercial Bank of China (Asia) Limited

The Hongkong and Shanghai Banking Corporation Limited

HSBC Bank (China) Company Limited

Hang Seng Bank (China) Limited

The Bank of East Asia, Limited

The Bank of East Asia (China) Limited — Beijing Branch

Bank of Tokyo-Mitsubishi UFJ (China), Ltd. — Tianjin Branch

DBS Bank Limited

DBS Bank (China) Limited — Beijing Branch

Standard Chartered Bank (China) Limited

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

China Merchants Bank Beijing — Beijing Dayuncun sub-branch

Bank of Communications — Zhuhai Jida Branch

**Investor and Media Relations**

Tel: (86) 10 82325515

Fax: (86) 10 82335757

Email: ir@kingsoft.com

Website: www.kingsoft.com

# FINANCIAL HIGHLIGHTS

*Consolidated Income Statement*

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | 2008<br>RMB'000 | 2009<br>RMB'000 | 2010<br>RMB'000 | 2011<br>RMB'000 | 2012<br>RMB'000 |
| **Revenue:** | | | | | |
| Entertainment software | 553,723 | 684,242 | 640,917 | 689,519 | **851,402** |
| Application software | 267,221 | 338,170 | 330,480 | 326,098 | **544,064** |
| Others | — | — | — | 4,891 | **15,695** |
| | 820,944 | 1,022,412 | 971,397 | 1,020,508 | **1,411,161** |
| Cost of revenue | (110,935) | (128,467) | (130,998) | (147,812) | **(186,939)** |
| **Gross profit** | 710,009 | 893,945 | 840,399 | 872,696 | **1,224,222** |
| Research and development costs, net of government grants | (124,926) | (199,611) | (271,046) | (303,848) | **(385,409)** |
| Selling and distribution costs | (148,565) | (171,634) | (129,216) | (125,873) | **(234,115)** |
| Administrative expenses | (93,772) | (101,630) | (111,143) | (127,498) | **(147,954)** |
| Share-based compensation costs | (49,909) | (41,312) | (42,119) | (17,266) | **(48,472)** |
| Other income and gains | 18,898 | 26,867 | 31,528 | 44,051 | **28,609** |
| Other expenses | (4,822) | (2,598) | (38,203) | (10,747) | **(22,971)** |
| **Operating profit** | 306,913 | 404,027 | 280,200 | 331,515 | **413,910** |
| Fair value gain/(loss) on a financial asset at fair value through profit or loss | — | — | 13,785 | (1,973) | **16,010** |
| Gain on disposal of an associate | — | — | 105,189 | — | **—** |
| Finance income | 31,022 | 25,523 | 33,162 | 65,130 | **97,973** |
| Finance costs | — | — | (721) | (3,461) | **(8,702)** |
| Share of profits and losses of: | | | | | |
| Jointly-controlled entities | (1,278) | (6,952) | (6,360) | (1,945) | **9,532** |
| Associates | 27,263 | 25,715 | 14,433 | (4,070) | **(930)** |
| **Profit before tax** | 363,920 | 448,313 | 439,688 | 385,196 | **527,793** |
| Income tax expense | (59,885) | (59,459) | (65,155) | (50,162) | **(61,359)** |
| **Profit for the year** | 304,035 | 388,854 | 374,533 | 335,034 | **466,434** |
| **Attributable to:** | | | | | |
| Owners of the parent | 307,501 | 387,224 | 372,480 | 324,729 | **432,589** |
| Non-controlling interests | (3,466) | 1,630 | 2,053 | 10,305 | **33,845** |
| | 304,035 | 388,854 | 374,533 | 335,034 | **466,434** |
| **Proposed final and special dividends** | 139,723 | 141,575 | 376,000 | 92,241 | **102,132** |
| | RMB | RMB | RMB | RMB | **RMB** |
| **Earnings per share attributable to ordinary equity holders of the parent** | | | | | |
| Basic | 0.2895 | 0.3638 | 0.3416 | 0.2886 | **0.3785** |
| Diluted | 0.2774 | 0.3368 | 0.3213 | 0.2790 | **0.3715** |

*Consolidated Statement of Financial Position (Selected items)*

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | **2008 RMB'000** | **2009 RMB'000** | **2010 RMB'000** | **2011 RMB'000** | **2012 RMB'000** |
| Cash and cash equivalents | 1,007,115 | 1,268,098 | 1,656,157 | 1,953,770 | **2,416,259** |
| Credit-linked deposit | 111,708 | — | — | — | **—** |
| Pledged deposit | — | — | — | 85,000 | **19,000** |
| Assets of a disposal group classified as held for sale | — | — | — | — | **200,621** |
| Total assets | 1,739,223 | 2,040,870 | 2,444,813 | 3,014,519 | **3,641,269** |
| Total equity | 1,328,365 | 1,604,310 | 1,934,061 | 2,213,120 | **2,674,932** |

*Consolidated Statement of Cash Flows (Selected Items)*

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2008 RMB'000** | **2009 RMB'000** | **2010 RMB'000** | **2011 RMB'000** | **2012 RMB'000** |
| Net cash flows from operating activities | 381,472 | 446,874 | 391,336 | 451,768 | **555,946** |
| Net cash flows (used in)/from investing activities | (520,533) | (503,721) | 390,305 | (616,353) | **(1,063,120)** |
| Net cash flows from/(used in) financing activities | (97,073) | (153,411) | 464 | 179,199 | **9,943** |
| Net (decrease)/increase in cash and cash equivalents | (236,134) | (210,258) | 782,105 | 14,614 | **(497,231)** |

# CHAIRMAN'S STATEMENT

2012 was a critical, encouraging and historical year for Kingsoft. The completion of MBO of Kingsoft WPS Office subsidiary in July marked the completion of restructuring our three major subsidiaries. Kingsoft Internet Security has successfully transformed itself into an internet company with advertising revenue continued to break historical highs, supported by a rapid growing user base. JX Online III continued to improve its popularity and doubled its revenue, despite the slow growth of the overall MMO gaming market. As a Chinese leading office software, WPS Office capitalized on a historic opportunity for development as the government continued to improve IPR environment. Leveraging the accelerated growth of mobile internet user base and smart devices in China, the active user base of Kingsoft Kuaipan, the first initiative of our strategic cloud business, has expanded further and topped the list of the similar services. I am pleased to announce Kingsoft's strategy, Three Plus One, has taken shape with three major existing business lines and one strategic new business line.

## Business Review

In 2012 we delivered over 38% annual revenue growth and all business lines had a record year in terms of total revenue and operating metrics.

Our existing games JX series continues its trend of revenue growth. JX Online III, our flagship 3D MMO game, doubled its revenue and APA in 2012, and significantly outpaced the growth rate of MMO gaming market. The successful launch of each expansion pack for JX Online III in 2012 has demonstrated our capabilities of capturing gamer's needs and optimizing gamer's experiences. During the year, we commercially launched three main game titles and further enriched our game portfolios, among which Ma La Jiang Hu, our first Q version of 3D role playing game, has shown promising potential in terms of popularity and revenue. Also, we are actively pursuing the development of web and mobile games. Web game T3 and mobile game Pet Castle are in the pipeline to be released soon. Meanwhile, we invested Shanghai Quwan, a web game R&D studio, to grow our R&D capabilities in web games.

Kingsoft Internet Security has completed its transformation into an internet company and reached new milestones in its monetization capability. Advertising revenue has experienced a fast growth at triple-digit year-over-year, supported by our expanded user base of 150 million and improved monetization capability. We have also been actively developing other value-added services, especially web game operation. On 19 June, we officially launched its internet browser, Cheetah. With its stylish design and outstanding user experiences, the user base of Cheetah Browser has had tremendous growth. The creative marketing efforts for Cheetah, such as train ticket purchase applications, have also accelerated the growth of the install base. We believe that our browser services will further enhance our monetization capabilities in the coming years. In addition, benefiting from the rapid growth of mobile internet and smart phones, the monthly active user base of Kingsoft Mobile Security has recorded rapid growth to 40.7 million.

Benefiting from the government's continued push in IRP protection and our product innovation, revenue from Kingsoft WPS Office continued its strong growth momentum in 2012 and achieved a new record with sales in Mainland China and Japan exceeded RMB195.8 million. The monthly active users of WPS Personal Edition rose to over 43.3 million supported by the improved user experiences. We are more excited to see the global monthly active users of WPS Mobile Office exceeded 11.2 million in 2012. As the leading mobile office software with users in over 226 countries and regions, WPS Mobile Office supports 23 types of main document formats and 46 languages and took the top spot in Google Play in the business APPs category in 25 major countries and regions.

Kingsoft Cloud was established in early 2012 to capture the opportunities in cloud storage and computing services. In order to leverage the accelerated growth of mobile internet user base and smart devices in China, we established strategic collaborations with Xiaomi, Skyworth TV and AIGO in 2012. Xiaomi, invested into Kingsoft Cloud as a strategic partner, in November 2012, to allow Kingsoft Cloud to take advantage of Xiaomi phone's rapid growth to expand its storage services to mobile device users. Total registered users for Kingsoft Cloud expanded further and topped the list of the similar services.

## Prospects

Looking forward, JX Online III, as a leading domestic 3D MMO game, will continue the growth momentum as we continue to introduce new and improved gamer experiences. Ma La Jiang Hu, as a Q version of 3D role playing game, has enriched our 3D game portfolio and will be another growth catalyst of our online game in 2013. We expect that JXs and Ma La Jiang Hu will achieve double-digit growth in terms of gaming revenue and APA in 2013. Two more MMO games: Jiutian Myth ( 九天神話 ), Doomsday Dragon ( 末日屠龍 ), a number of web games and mobile games are in the pipeline to be released in 2013. These focused investments will help us to capture the growth opportunities of web and mobile gaming markets in the coming years.

We would further grow our user base of Kingsoft Internet Security and Cheetah Browser through product innovation, improved user experiences, and strengthened collaboration with our strategic partners. We expect that revenue from advertising would keep strong momentum of growth, supported by the expanded user base of our internet security services and our browser. Revenue from web game operation is currently at its infant stage and is expected to be the next growth catalyst in 2013. Besides, Kingsoft Internet Security would invest heavily in mobile business and launch a series of mobile services in 2013, targeting at transforming itself into a mobile internet company.

In 2013, WPS Office will focus on growing enterprise business and new revenue sources. Also, WPS Office will further nurture the mobile user base worldwide with new functions, improved user experiences and expansion into new mobile platform. In February 2013, WPS Mobile Office for IOS was launched and received positive feedback.

Kingsoft will continue investing heavily in Kingsoft Cloud. In addition to personal data storage service, we will expand into enterprise data storage services and cloud storage platform services in 2013. The growth of user base of Kingsoft Cloud will accelerate in 2013 through product innovation and strategic collaboration with Xiaomi and smart TV producers. This will be a long term strategic investment and will better position us in the coming years.

Looking forward, we believe the top line of the Group would maintain a fast growth as we continue investing heavily in mobile internet business and cloud business. We are confident that, by focusing on product and service innovation, exceptional user experiences and future opportunities, we will deliver long term value to our shareholders.

**Jun Lei**
*Chairman*

The PRC, 19 March 2013

## OPERATIONAL HIGHLIGHTS

| | For the three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **31 December 2012** | **30 September 2012** | **30 June 2012** | **31 March 2012** | 31 December 2011 | 30 September 2011 | 30 June 2011 | 31 March 2011 |
| **Online Games** | | | | | | | | |
| Daily Average Peak Concurrent Users | **633,084** | **611,474** | **615,221** | **631,485** | 661,774 | 608,607 | 653,085 | 684,023 |
| Monthly Average Paying Accounts | **1,650,636** | **1,524,761** | **1,459,883** | **1,330,868** | 1,326,071 | 1,186,481 | 1,250,771 | 1,258,525 |
| Monthly Average Revenue per Paying User (RMB) | **48** | **46** | **47** | **47** | 47 | 46 | 46 | 43 |

**For the Year Ended 31 December 2012**

The following table sets forth the comparative numbers for the years ended 31 December 2012 and 31 December 2011, respectively.

| | Year ended 31 December | |
|---|---|---|
| | **2012** | **2011** |
| | **RMB'000** | **RMB'000** |
| **Revenue:** | | |
| Entertainment software | **851,402** | 689,519 |
| Application software | **544,064** | 326,098 |
| Others | **15,695** | 4,891 |
| | **1,411,161** | 1,020,508 |
| Cost of revenue | **(186,939)** | (147,812) |
| **Gross profit** | **1,224,222** | 872,696 |
| Research and development costs, net of government grants | **(385,409)** | (303,848) |
| Selling and distribution costs | **(234,115)** | (125,873) |
| Administrative expenses | **(147,954)** | (127,498) |
| Share-based compensation costs | **(48,472)** | (17,266) |
| Other income and gains | **28,609** | 44,051 |
| Other expenses | **(22,971)** | (10,747) |
| **Operating profit** | **413,910** | 331,515 |
| Fair value gain/(loss) on a financial asset at fair value through profit or loss | **16,010** | (1,973) |
| Finance income | **97,973** | 65,130 |
| Finance costs | **(8,702)** | (3,461) |
| Share of profits and losses of: | | |
| Jointly-controlled entities | **9,532** | (1,945) |
| Associates | **(930)** | (4,070) |
| **Profit before tax** | **527,793** | 385,196 |
| Income tax expense | **(61,359)** | (50,162) |
| **Profit for the year** | **466,434** | 335,034 |
| Attributable to: | | |
| Owners of the parent | **432,589** | 324,729 |
| Non-controlling interests | **33,845** | 10,305 |
| | **466,434** | 335,034 |
| | **RMB** | RMB |
| **Earnings per share attributable to ordinary equity holders of the parent** | | |
| Basic | **0.3785** | 0.2886 |
| Diluted | **0.3715** | 0.2790 |

| | Year ended 31 December | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| **Profit for the year** | **466,434** | 335,034 |
| **Other comprehensive loss:** | | |
| Exchange differences on translation of foreign operations | **(5,613)** | (3,885) |
| **Other comprehensive loss for the year, net of tax** | **(5,613)** | (3,885) |
| **Total comprehensive income for the year** | **460,821** | 331,149 |
| Attributable to: | | |
| Owners of the parent | **429,251** | 321,339 |
| Non-controlling interests | **31,570** | 9,810 |
| | **460,821** | 331,149 |

## Revenue

Revenue for the year of 2012 increased 38% year-over-year to RMB1,411.2 million. Approximately 60% of the revenue was generated from the entertainment software and 39% of the revenue was generated from the applications software.

*— Entertainment Software*

Revenue from the entertainment software for the year of 2012 increased 23% year-over-year to RMB851.4 million. This was primarily driven by robust growth of paying user base for our flagship 3D MMO JX Online III. APA of JX Online III has jumped to a new record of over 0.9 million in December with an increase of 104% year-over-year stimulated by continuous optimization and innovation through expansion packs.

Daily average peak concurrent users for the Group's online games for the fourth quarter of 2012 increased 4% quarter-over-quarter and decreased 4% year-over-year to 0.63 million. Monthly average paying accounts ("APA") for the Group's online games for the fourth quarter of 2012 increased 8% quarter-over-quarter and 24% year-over-year to 1.65 million. The sequential and year-over-year increase in APA was primarily attributable to the continuous growth of JX Online III gamers.

The monthly average revenue per paying user for the Group's online games increased 4% quarter-over-quarter and 2% year-over-year to RMB48.

*— Application Software*

Revenue from the application software business for the year of 2012 increased 67% year-over-year to RMB544.1 million. The robust increase was mainly due to: i) online advertising revenue from Kingsoft Internet Security recorded triple-digit increase driven by enhanced user base of Kingsoft Internet Security and Cheetah Browser; and ii) strong sales of WPS Office benefiting from favorable policy of copyright protection in China and improved product experiences.

## Cost of Revenue and Gross Profit

Cost of revenue for the year of 2012 increased 26% year-over-year to RMB186.9 million. The increase was mainly attributable to higher bandwidth costs and server depreciation expenses with the increasing user base and expansion into cloud business.

Gross profit for the year of 2012 increased 40% year-over-year to RMB1,224.2 million. The Group's gross profit margin increased by one percentage point year-over-year to 87%.

## Research and Development ("R&D") Costs

R&D costs, net of government grants, for the year of 2012 increased 27% year-over-year to RMB385.4 million. This was primarily due to an increase in headcount and improved salaries and benefits to strengthen our technology and product development capabilities, and expand into new business initiatives.

The following table sets forth a breakdown of R&D costs for the years ended 31 December 2012 and 2011.

| | For the year ended 31 December | |
|---|---|---|
| | **2012** | **2011** |
| | **RMB'000** | **RMB'000** |
| Staff costs | **317,122** | 239,491 |
| Depreciation & Amortization | **31,313** | 32,580 |
| Others | **54,718** | 46,677 |
| | **403,153** | 318,748 |
| Less: Capitalized software costs (excluding share-based compensation costs) | **(13,839)** | (7,518) |
| Add: Amortization of capitalized software costs | **8,926** | 14,399 |
| Less: Government Grants for research and development activities | **(12,831)** | (21,781) |
| Total | **385,409** | 303,848 |

## Selling and Distribution Costs

Selling and distribution costs for the year of 2012 increased 86% year-over-year to RMB234.1 million. The increase was mainly due to intensive marketing and promotion activities to launch our new games, expansion packs for JXs, Kingsoft Internet Security, as well as Cheetah Browser.

## Administrative Expenses

Administrative expenses for the year of 2012 increased 16% year-over-year to RMB148.0 million. This was primarily attributable to higher staff costs and professional costs.

## Share-based Compensation Costs

Share-based compensation costs for the year of 2012 increased 181% year-over-year to RMB48.5 million. The increase was mainly due to the options and awarded shares of the Company and its subsidiaries granted in late 2011 and 2012 as we continued to strengthen our technology, product development and management capabilities.

## Other Income and Gains

Other income and gains for the year of 2012 decreased 35% year-over-year to RMB28.6 million. The decrease was primarily attributable to the decrease in financial incentives received from local government.

## Other Expenses

Other expenses for the year of 2012 increased 114% year-over-year to 23.0 million. The increase was mainly due to write-down of inventories of Android pad in Kingsoft Japan.

## Operating Profit before Share-based Compensation Costs

Operating profit before share-based compensation costs for the year of 2012 increased 33% year-over-year to RMB462.4 million as a result of the combination of above reasons. The margin of operating profit excluding share-based compensation costs decreased by one percentage point year-over-year to 33%. This decrease was mainly due to increased selling and distribution costs.

## Fair Value Gain/(Loss) on a Financial Asset at Fair Value through Profit or Loss ("Fair Value Gain/(Loss)")

Fair value gain/(loss), which reflected the increase/(decrease) of fair value of an option granted by VNG Corporation to the Group to subscribe a number of ordinary shares of VNG Corporation at a predetermined price, recorded a gain of RMB16.0 million for the year of 2012, compared to a loss of RMB2.0 million for the year of 2011.

## Finance Income

Finance income for the year of 2012 increased 50% year-over-year to RMB98.0 million.

## Income Tax Expense

Income tax expense for the year of 2012 increased 22% year-over-year to RMB61.4 million. The Group's effective tax rate (excluding the impact of share-based compensation costs) decreased by one percentage point year-over-year to 11%.

## Profit attributable to Owners of the Parent

For the reasons described above, profit attributable to owners of the parent for the year of 2012 increased 33% year-over-year to RMB432.6 million.

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

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

We believe the profit attributable to owners of the parent before share-based compensation costs will enhance investors' overall understanding of the Company's operating performance. When assessing our operating performance, you should not consider this data in isolation or as a substitute for our profit or any other operating performance measure that is calculated in accordance with IFRSs. In addition, our profit attributable to owners of the parent before share-based compensation costs may not be comparable to similarly titled measures utilized by other companies.

Profit attributable to owners of the parent before share-based compensation costs for the year of 2012 increased 39% year-over-year to RMB473.0 million.

The profit margin excluding the effect of share-based compensation costs for the year of 2012 increased one percentage point year-over-year to 34%.

## Liquidity and Financial Resource

The Group had a strong cash position towards the end of the reporting period. As at 31 December 2012, the Group had major financial resources in the forms of cash and cash equivalent and time deposits with initial term of over three months amounting to RMB619.8 million and RMB1,796.5 million, respectively, which totally represented 66% of the Group's total assets.

As at 31 December 2012, the Group's gearing ratio, which represents total liabilities divided by total assets, was 27%, held flat from 27% as at 31 December 2011. As at 31 December 2012, the Group had HKD510.0 million (equivalent of RMB413.6 million) interest-bearing bank loans.

## Foreign Currency Risk Management

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

As at 31 December 2012, RMB141.1 million of the Group's financial assets were held in deposits and investment denominated in non-RMB currencies. As there are no cost-effective hedges against the fluctuation of RMB, there is a risk that we may experience a loss as a result of any foreign currency exchange rate fluctuation in connection with our deposits and investments.

## Deferred Revenue

Deferred revenue (including current and non-current portion) as at 31 December 2012 was RMB199.7 million compared to RMB181.5 million as at 31 December 2011. The increase was primarily due to the increased sales of prepaid cards in the year of 2012.

## Net Cash Generated from Operating Activities

Cash generated from our operating activities reflects our profit for reporting year, as the case may be, as adjusted for non-cash items, such as depreciation, amortization of capitalized software costs, and share-based compensation costs, as well as the effect of changes in certain items of statement of financial position, such as deferred revenue and accrued expenses and accruals.

Net cash generated from operating activities increased 23% year-over-year to RMB555.9 million for the year ended 31 December 2012.

## Capital Expenditures

Capital expenditures represent cash payments for acquisition of property, land use right, fixed assets and intangible assets. Cash used for capital expenditures was RMB84.8 million and RMB168.0 million for the years ended 31 December 2012 and 31 December 2011, respectively.

# DIRECTORS AND SENIOR MANAGEMENT

## Executive Directors

**HongJiang ZHANG**, aged 52, is an executive director and the CEO of the Company, he is also the chief executive officer of Kingsoft Cloud, an independent subsidiary of the Company. Before joining the Company he was the chief technology officer for Microsoft Asia-Pacific Research and Development Group (ARD) and the managing director of the Microsoft Advanced Technology Center (ATC) and Microsoft Distinguished Scientist (DS). In his duals role, Dr. Zhang led Microsoft's research and development agenda in China, including strategy, planning, R&D and incubation for products, services and solutions. With his leadership, ARD has been developed into a key global research, innovation and product development base for Microsoft, with a team of over three thousands engineers and researchers, covering all Microsoft core product lines and emerging businesses. Dr. Zhang was also a member of Executive Management Committee of Microsoft (China) Limited, a committee that defines and leads Microsoft's strategy and business development in the Greater China.

Dr. Zhang was the deputy managing director and a founding member of Microsoft Research Asia. His outstanding leadership and achievement, marked by high impact in academia and Microsoft's products, are critical in establishing Microsoft Research Asia into a world class basic research center in computer science, and a technology powerhouse in Microsoft, and have made him one of the 10 Microsoft Distinguished Scientists.

As a Fellow of the Institute of Electric and Electronic Engineers (IEEE) and Association of Computing Machines (ACM), Dr. Zhang is well known in the research community for his leadership in media computing and his pioneering work in video and image content analysis and search. He was the recipient of the 2010 IEEE Computer Society Technical Achievement Award, 2012 ACM SIGMM Outstanding Technical Achievement Award, and the winner of 2008 "Asian-American Engineer of the Year" award. He has authored four books, over 400 scientific papers and holds over 102 US patents, and many of his research works have become classic references in their respective research areas.

Dr. Zhang received a Ph.D. in Electrical Engineering from the Technical University of Denmark, and a Bachelor of Science degree from Zhengzhou University, China. Prior to joining Microsoft, Dr. Zhang was a research manager at Hewlett-Packard Labs at Palo Alto, CA. He also worked at the Institute of Systems Science, National University of Singapore.

Dr. Zhang became the CEO of the Company in October 2011 and has been an executive director of our Company since 14 December 2011.

Dr. Zhang is also a director of certain subsidiaries of our Group.

**Yuk Keung NG**, aged 48, is currently an executive director and the chief financial officer of the Company. Mr. Ng graduated from the University of Hong Kong with a Bachelor's degree in Social Sciences in 1988 and obtained a Master of Science degree in Global Business Management and E-commerce in 2002. Mr. Ng is a professional accountant and a fellow member of both the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants and a member of the Institute of Chartered Accountants in England and Wales.

Mr. Ng has more than twenty years of experience in financial management, corporate finance and merger and acquisition. Before joining the Company, Mr. Ng was the Executive Director, Chief Financial Officer and Company Secretary of China NT Pharma Group Company Limited, a major pharmaceutical company listed on the Stock Exchange (Stock Code: 1011). Mr. Ng worked with PricewaterhouseCoopers for over 12 years from 1988 to 2001. From 2001 to 2003, Mr. Ng was the Chief Financial Officer of International School of Beijing, an academic institution in Beijing, China. In 2003, Mr. Ng joined Australian Business Lawyers, a law firm in Australia and was later appointed as a special consultant in 2004 responsible for advising on accounting matters. From 2004 to 2006, Mr. Ng was the deputy Chief Financial Officer, a joint Company Secretary and the Qualified Accountant of IRICO Group Electronics Company Limited (Stock Code: 438), a company listed on the Stock Exchange. From 2006 to 2010, Mr. Ng was the Vice President and the Chief Financial Officer of China Huiyuan Juice Group Ltd. (Stock Code: 1886), a company listed on the Stock Exchange. Mr. Ng is also currently an independent non-executive director of Sany Heavy Equipment International Holdings Company Limited (Stock Code: 631), and also an independent non-executive director and the chairman of the audit committee of Beijing Capital Land Limited (Stock Code: 2868), Winsway Coking Coal Holdings Limited (Stock Code: 1733) and Zhongsheng Group Holdings Limited (Stock Code: 881), all of these companies are listed on the Stock Exchange. From 2007 to 2011, Mr. Ng was also an independent non-executive director of Xinjiang Xinxin Mining Industry Company Limited (Stock Code: 3833), a company listed on the Stock Exchange.

Mr. Ng was appointed as the chief financial officer of the Company in 2012 and became an executive director with the Company from 1 March 2013. Mr. Ng is also a director of certain subsidiaries of the Company.

**Tao ZOU**, aged 37, is currently a senior vice president and the chief executive officer of Westhouse Holdings Limited who is responsible for the overall management of Westhouse Holdings Limited and its subsidiaries of our Group, including the research and development of online games of Westhouse Studios and also participates in major decision making of our Group's gaming business sector. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our Kingsoft PowerWord. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became a senior vice president of the Group in December 2007 and has been an executive director of our Company since August 2009.

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

## Non-executive Directors

**Jun LEI**, aged 43, is a non-executive Director, the Chairman of the Board, a member of the remuneration committee, and co-founder of our Company. Mr. Lei has been employed by us since 1992 and has played a key role in developing the operation of our Group and expanding our business operations. He had been our CEO since 1998, and under his leadership, we further expanded application software businesses into utilities software, Internet security software and online games. He also played a major role in transforming our Group from a traditional software company into an on demand software company which extensively utilizes the Internet. In December 2007, Mr. Lei relinquished his position as CEO, chief technology officer and president of the Company. In August 2008, Mr. Lei was re-designated from an executive director to a non-executive director. Mr. Lei was appointed as the Chairman of the Board of our Company on 5 July 2011. On 28 July 2011, Mr. Lei was appointed as the chairman of the remuneration committee of our Company and subsequently with effect from 30 March 2012, Mr. Lei ceased to be the chairman of the remuneration committee, but remains as a member of the remuneration committee. Mr. Lei is also a director of certain subsidiaries of our Group.

Mr. Lei was co-founder of Joyo.com, which was founded in April 2000 and sold to Amazon.com in 2004. Mr. Lei has held directorship in 2020 CHINACAP ACQUIRCO, INC.— an AMEX listed company from January 2007 to October 2009. 2020 CHINACAP ACQUIRCO, INC. is listed on AMEX since 8 November 2007. Mr. Lei is the chairman of YY Inc. (NASDAQ:YY) which was listed on NASDAQ in November 2012. Mr. Lei was named "2012 Economic Influentials — Innovation" by China central television CCTV.

Mr. Lei graduated from Wuhan University in 1991 with a bachelor degree in Computer Science. He has been a member of the board of Wuhan University since 2003.

Mr. Lei is also famous angel investor in China, and he has invested in various companies including Vancl and became the director of Vancl in 2007.

**Pak Kwan KAU**, aged 48, was re-designated from an executive director to a non-executive director of our Company with effect from 24 October 2011. Mr. Kau has been employed by us since 1988. He graduated from National Defense University of Science and Technology in China in 1984 with a bachelor degree in Information Management Systems. Between 1984 and 1987, Mr. Kau worked at various Chinese companies as a software developer.

Mr. Kau started Kingsoft Software in 1988, and he was primarily responsible for the development of WPS 1.0 in 1988. Mr. Kau was named as one of the Top Ten Business Persons of the Year in 2000, one of the China Top Financial Figures of the Year in 2001 by CCTV, one of the Ten Most Influential Leaders in China's Games Industry at the inaugural China Game Industry Annual Conference in January 2005, and one of the Most Outstanding Entrepreneurs at 2009 China Game Industry Annual Conference held in December 2009. Mr. Kau has never held directorship in any other listed public companies. Mr. Kau was appointed as an acting CEO of the Company in December 2007. He was the CEO of the Company from May 2008 to 24 October 2011 when he resigned from the post. Mr. Kau was the Chairman of the board of our Company until 5 July 2011.

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

**Chi Ping LAU**, aged 39, is a non-executive director and a member of the nomination committee of the Company. He is also an executive director and president of Tencent Holdings Limited ("Tencent") (a company listed on the Stock Exchange, Stock Code: 700), a substantial shareholder of the Company. He joined Tencent in 2005 as a chief strategy and investment officer and was responsible for corporate strategies, investments, merger and acquisitions and investor relations. In 2006, he was promoted as president of Tencent to assist Mr. Huateng Ma, chairman of the board of directors and chief executive officer of Tencent, in managing the day-to-day operation of Tencent. In 2007, he was appointed as an executive director of Tencent. Prior to Tencent, he was an executive director at Goldman Sachs (Asia) L.L.C's investment banking division and a chief operating officer of its Telecom, Media and Technology Group. Prior to that, he worked at Mckinsey & Company, Inc. as a management consultant.

Mr. Lau received his Bachelor of Science Degree in Electrical Engineering from the University of Michigan, a Master of Science Degree in Electrical Engineering from Stanford University and a MBA from Kellogg Graduate School of Management, Northwestern University. Mr. Lau was appointed as a non-executive director of the Company on 28 July 2011.

## Independent Non-executive Directors

**To Thomas HUI**, aged 40, is an independent non-executive director, a member of the remuneration committee, and a member and chairman of the audit committee of our Company. Before joining the Company, Mr. Hui was the president, chief operation officer and an executive director of GigaMedia Limited ("GigaMedia"), a company listed on the NASDAQ stock market (NASDAQ: GIGM). Over his 7 years of services at GigaMedia, from August 2004 to December 2011, Mr. Hui successfully led the transformation of the company from a Taiwan based internet service provider and physical music distributor to a gaming software provider in Europe and an online game operator in Asia. Mr. Hui was also the chief financial officer of GigaMedia from 2004 to 2008. From April 2010 to January 2012, Mr. Hui also served as a non-executive director of JC Entertainment Corporation, a Korean online game company listed on the KOSDAQ stock market. Previously, Mr. Hui was an executive director in the investment banking division of Goldman Sachs (Asia) L.L.C., Hong Kong, where he has executed and advised on capital markets and M&A advisory transactions in the Greater China region. Prior to that, Mr. Hui served as an investment banker at Merrill Lynch & Co. and as a management consultant at McKinsey & Company.

Mr. Hui holds a Master Degree of Engineering in Electrical Engineering from Cornell University and a Bachelor Degree of Science in Electrical Engineering from the University of Wisconsin, Madison.

**Guangming George LU**, aged 48, is an independent non-executive director of our Company. He is also a member of the audit committee, the chairman of the nomination committee, and the chairman of the remuneration committee of the Company. Mr. Lu graduated from Huazhong Normal University in 1984 and obtained a master degree of science from the University of Memphis in 1989.

Mr. Lu founded Surfmax Corporation in November 1997, a private investment firm in the U.S. From April 2004 to December 2010, Mr. Lu served as the vice chairman of Xingda International Holdings Limited (a Surfmax portfolio investment) whose shares are listed on the Stock Exchange. Mr. Lu also currently serves as the chairman of 2020 International Capital Group. From August 2006 to October 2009, Mr. Lu served as the chairman and chief executive officer of a listed acquisition company — Exceed Company Limited (a 2020 portfolio investment), whose shares were listed on NASDAQ.

Since March 2008, Mr. Lu has been the Chairman and group chief executive of Acquity Group Limited (a 2020 portfolio investment), whose shares are listed on NYSE (NYSE MKT: AQ).

Mr. Lu joined us in April 2007.

**Wenjie WU**, aged 38, is an independent non-executive director, a member of the audit committee, the remuneration committee and the nomination committee of the Company. Ms. Wu has been serving as the chief financial officer of Ctrip.com International, Ltd. ("Ctrip.com", Stock Code: CTRP), a company listed on NASDAQ and China's leading online travel services provider, since May 2012. Ms. Wu joined Ctrip.com as deputy CFO in December 2011. Prior to joining Ctrip.com, Ms. Wu was an equity research analyst covering China Internet and Media industries in Morgan Stanley Asia Limited and in Citigroup Global Markets Asia Limited from 2005 to 2011. Prior to that, Ms. Wu worked for China Merchants Holdings (International) Company Limited (Stock Code: 0144), a company listed on the Stock Exchange for three years.

Ms. Wu has a Ph.D. degree in finance from the University of Hong Kong, a Master's degree in philosophy in finance from the Hong Kong University of Science and Technology, and both a Master's degree and a Bachelor's degree in economics from Nan Kai University, China. Ms. Wu has been a Chartered Financial Analyst (CFA) since 2004.

## Senior Management

**HongJiang ZHANG**, aged 52, is an executive director and the CEO of the Company, he is also the chief executive officer of Kingsoft Cloud, an independent subsidiary of the Company. Before joining the Company he was the chief technology officer for Microsoft Asia-Pacific Research and Development Group (ARD) and the managing director of the Microsoft Advanced Technology Center (ATC) and Microsoft Distinguished Scientist (DS). In his duals role, Dr. Zhang led Microsoft's research and development agenda in China, including strategy, planning, R&D and incubation for products, services and solutions. With his leadership, ARD has been developed into a key global research, innovation and product development base for Microsoft, with a team of over three thousands engineers and researchers, covering all Microsoft core product lines and emerging businesses. Dr. Zhang was also a member of Executive Management Committee of Microsoft (China) Limited, a committee that defines and leads Microsoft's strategy and business development in the Greater China.

Dr. Zhang was the deputy managing director and a founding member of Microsoft Research Asia. His outstanding leadership and achievement, marked by high impact in academia and Microsoft's products, are critical in establishing Microsoft Research Asia into a world class basic research center in computer science, and a technology powerhouse in Microsoft, and have made him one of the 10 Microsoft Distinguished Scientists.

As a Fellow of the Institute of Electric and Electronic Engineers (IEEE) and Association of Computing Machines (ACM), Dr. Zhang is well known in the research community for his leadership in media computing and his pioneering work in video and image content analysis and search. He was the recipient of the 2010 IEEE Computer Society Technical Achievement Award, 2012 ACM SIGMM Outstanding Technical Achievement Award, and the winner of 2008 "Asian-American Engineer of the Year" award. He has authored four books, over 400 scientific papers and holds over 102 US patents, and many of his research works have become classic references in their respective research areas.

Dr. Zhang received a Ph.D. in Electrical Engineering from the Technical University of Denmark, and a Bachelor of Science degree from Zhengzhou University, China. Prior to joining Microsoft, Dr. Zhang was a research manager at Hewlett-Packard Labs at Palo Alto, CA. He also worked at the Institute of Systems Science, National University of Singapore.

Dr. Zhang became the CEO of the Company in October 2011 and has been an executive director of our Company since 14 December 2011.

Dr. Zhang is also a director of certain subsidiaries of our Group.

**Yuk Keung NG**, aged 48, is currently an executive director and the chief financial officer of the Company. Mr. Ng graduated from the University of Hong Kong with a Bachelor's degree in Social Sciences in 1988 and obtained a Master of Science degree in Global Business Management and E-commerce in 2002. Mr. Ng is a professional accountant and a fellow member of both the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants and a member of the Institute of Chartered Accountants in England and Wales.

Mr. Ng has more than twenty years of experience in financial management, corporate finance and merger and acquisition. Before joining the Company, Mr. Ng was the Executive Director, Chief Financial Officer and Company Secretary of China NT Pharma Group Company Limited, a major pharmaceutical company listed on the Stock Exchange (Stock Code: 1011). Mr. Ng worked with PricewaterhouseCoopers for over 12 years from 1988 to 2001. From 2001 to 2003, Mr. Ng was the Chief Financial Officer of International School of Beijing, an academic institution in Beijing, China. In 2003, Mr. Ng joined Australian Business Lawyers, a law firm in Australia and was later appointed as a special consultant in 2004 responsible for advising on accounting matters. From 2004 to 2006, Mr. Ng was the deputy Chief Financial Officer, a joint Company Secretary and the Qualified Accountant of IRICO Group Electronics Company Limited (Stock Code: 438), a company listed on the Stock Exchange. From 2006 to 2010, Mr. Ng was the Vice President and the Chief Financial Officer of China Huiyuan Juice Group Ltd. (Stock Code: 1886), a company listed on the Stock Exchange. Mr. Ng is also currently an independent non-executive director of Sany Heavy Equipment International Holdings Company Limited (Stock Code: 631), and also an independent non-executive director and the chairman of the audit committee of Beijing Capital Land Limited (Stock Code:

2868), Winsway Coking Coal Holdings Limited (Stock Code: 1733) and Zhongsheng Group Holdings Limited (Stock Code: 881), all of these companies are listed on the Stock Exchange. From 2007 to 2011, Mr. Ng was also an independent non-executive director of Xinjiang Xinxin Mining Industry Company Limited (Stock Code: 3833), a company listed on the Stock Exchange.

Mr. Ng was appointed as the chief financial officer of the Company in 2012 and became an executive director with the Company from 1 March 2013. Mr. Ng is also a director of certain subsidiaries of the Company.

**Tao ZOU**, aged 37, is currently a senior vice president and the chief executive officer of Westhouse Holdings Limited who is responsible for the overall management of Westhouse Holdings Limited and its subsidiaries of our Group, including the research and development of online games of Westhouse Studios and also participates in major decision making of our Group's gaming business sector. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our Kingsoft PowerWord. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became a senior vice president of the Group in December, 2007 and has been an executive director of our company since August, 2009.

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

**Sheng FU**, aged 35, is currently a senior vice president and the chief executive officer of Kingsoft Internet Securities Software Holdings Limited who is responsible for the overall business of Kingsoft internet security business sector. Mr. Fu joined the Company in November 2010. Mr. Fu was the product manager of 3721 Internet Real Name and 3721 Internet Assistant, as well as the general manager of 360 Security Guard. He was the vice president of Matrix Partners China from November 2008, and chief executive officer and chairman of Conew Network Technology (Beijing) Co., Ltd. from September 2009. Mr. Fu has become a senior vice president of the Group since March 7, 2011. Mr. Fu graduated from the faculty of Information Management and Information System in Shandong Institute of Business and Technology in 1999.

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

**Ke GE**, aged 39, is currently a senior vice president of the Group, and the chief executive officer of Kingsoft Application Software Holdings Limited. Mr. Ge joined us in 1999 and was appointed as the assistant to our chief executive officer in 1999. He was the chief officer in our distribution department from 2000 to 2001. He was appointed the assistant president in 2001 and had overall responsibilities for our internal operations and management. He was appointed as a vice president in 2002. He became a senior vice president of the Company in December, 2007, in charge of overall office software business of the Company.

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

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

# CORPORATE GOVERNANCE REPORT

## OVERVIEW OF CORPORATE GOVERNANCE PRACTICES

The Company and its subsidiaries (the "Group" or "Kingsoft") is committed to maintaining high standards of corporate governance to safeguard the interests of shareholders and to enhance corporate value and accountability. The revised Appendix 14 to the Rules Governing the Listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), Corporate Governance Code and Corporate Governance Report (the "Revised Code") took effect on 1 April 2012 and applies to financial reports covering periods after 1 April 2012. The directors of the Company ("Directors"), having reviewed the corporate governance practices of the Company, confirmed that the Company has complied with all of the applicable code provisions as set out in the Code on Corporate Governance Practices (for the period from 1 January 2012 to 31 March 2012) (the "Code") and Revised Code (for the period from 1 April 2012 to 31 December 2012) contained in Appendix 14 to the Listing Rules except for the code provision A.6.7 and C.1.2 of the Revised Code.

The code provision A.6.7 of the Revised Code requires non-executive Directors' to attend general meetings. Non-executive directors Mr. Pak Kwan Kau and Mr. Chi Ping Lau, and independent non-executive Directors Mr. Tat Joel, Chang, Mr. Guangming George Lu and Mr. Chuan Wang did not attend the annual general meeting of the Company held on 23 May 2012 as they were traveling at that time attending other engagements. Non-executive Directors Mr. Jun Lei, Mr. Pak Kwan Kau and Mr. Chi Ping Lau, and independent non-executive Directors Mr. To Thomas Hui and Mr. Chuan Wang did not attend the extraordinary general meeting held on 17 October 2012 as they had to attend to previous arranged engagements. The code provision C.1.2 of the Revised Code requires management to provide all members of the board with monthly updates on the issuer's business. The management of the Company currently reports to the board of Directors ("Board") quarterly on the Group's performance, position and prospects. The Board believes that with the executive Directors overseeing the daily operation of the Group and the effective communication between the executive Directors, the management and the non-executive Directors (including the independent non-executive Directors) on the Group's affairs, the current practice is sufficient enough for the members of the Board to discharge their duties. The Board will continue to review this practice and shall make necessary changes when appropriate and report to the shareholders accordingly.

The following is a summary of work performed by the Board in determining the policy for the corporate governance of the Company during the year ended 31 December 2012:

(1) Developed and reviewed the Company's policies and practices on corporate governance;

(2) Reviewed and monitored the training and continuous professional development of Directors and senior management;

(3) Reviewed and monitor the Company's policies and practices on compliance with legal and regulatory requirements;

(4) Developed, reviewed and monitored the code of conduct and compliance manual applicable to employees and Directors; and

(5) Reviewed the Company's compliance with the Code and the Revised Code and disclosure in the corporate governance report.

The Company will continue to review and enhance its corporate governance practices to ensure compliance with the Revised Code.

## BUSINESS MODEL AND STRATEGY

The Group always endeavours to enhance its enterprise value, ensure the Company's long-term and stable development and benefit its shareholders and other stakeholders. The Group emphasises on long term business growth instead of short term reward by focusing on innovation and R&D to continue improving products and services. The discussion and analysis of the Group's performance for the year ended 31 December 2012 are set out on pages 8 to 12 under Management Discussion and Analysis of this annual report.

## DIRECTORS' SECURITIES TRANSACTIONS

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

Specific enquiry has been made of all the Directors and each of the Directors has confirmed that they have complied with the required standards set out in the Model Code during the year ended 31 December 2012 and up to the date of this annual report. The designated senior management of the Company also has adopted the Model Code.

Details of security interests in the Company held by the Directors are set out in the Directors' Report under the subtitle of "Directors' and Chief Executive's Interests in Securities" on pages 36 to 37 of this annual report.

The Company has also established written guidelines on no less exacting terms than the Model Code (the "Guidelines") for securities transactions by employees who are likely to be in possession of unpublished inside information of the Company.

No incident of non-compliance of the Guidelines by the employees of the Group was noted by the Company during the year ended 31 December 2012.

## THE BOARD

### *The Responsibilities of the Board*

The Board is the core function of the Company's corporate governance structure. The principal responsibilities of the Board are to set an overall framework of corporate governance within which the management conducts business and to monitor the Group's operations. The Company's overall framework of corporate governance contains many internal guidelines, internal control policies and procedures that have been formed over the years. The Board has delegated the authority and responsibility for the Group's daily management and operation to senior management of the Group which is under the supervision of the chief executive officer ("CEO") who reports to the Board.

The Board has formulated a clear written policy that stipulates the circumstances under which the management should report and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Group. The Board regularly reviews our corporate governance practices and updates them as and when appropriate.

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

The Board is responsible for the preparation of financial statements, so that such financial statements meet the requirements of laws and regulations and applicable accounting standards, and truly and fairly reflect the financial position, the operating results and cash flows of the Group for each reporting period. The Directors also ensures the timely publication of the Group's financial statements. In preparing the financial statements for the year ended 31 December 2012, the Directors adopted appropriate accounting policies and made fair and reasonable judgments and estimates, and the Board was not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue on a going concern basis. The external auditors' responsibilities to shareholders are set out in the Independent Auditors' Report on page 58 of this annual report.

### *Composition of the Board*

As at the date of this annual report, the Board of Directors comprises nine Directors with three executive Directors, three non-executive Directors and three independent non-executive Directors. The independent non-executive Directors constitute one-third of the Board members which complies with the new rule 3.10A of the Listing Rules and are possessing appropriate professional qualifications or accounting or related financial management expertise. All of the independent non-executive Directors of the Company act in diligent manner to uphold the interests of the Company and the shareholders by maintaining the independence of their opinions and providing professional advice on the long-term development of the Company.

The Company has received, from each of the independent non-executive Directors, a written annual confirmation of his independence to the Company pursuant to the requirements of the Listing Rules. The Company considers all independent non-executive Directors to be independent in accordance with the independence guidelines as set out in the Listing Rules.

A list of Directors, their respective biographies and their relationship with others, if any, are set out on pages 13 to 17 of this annual report. Save for the disclosure in the biographies of the Directors set out on pages 13 to 15 of this annual report, there is no other relationship among the Board members to the best knowledge of the Board as at the date of this annual report.

During the year ended 31 December 2012, the Board comprises the following Directors:

**Executive Directors:**

Mr. HongJiang Zhang

Mr. Tao Zou

Mr. Shun Tak Wong (resigned on 15 July 2012)

**Non-executive Directors:**

Mr. Jun Lei

Mr. Pak Kwan Kau

Mr. Chi Ping Lau

**Independent Non-executive Directors:**

Mr. To Thomas Hui (appointed on 25 May 2012)

Mr. Guangming George Lu

Mr. Tat Joel, Chang (resigned on 25 May 2012)

Mr. Chuan Wang (resigned on 1 March 2013)

The list of Directors (by category) is also disclosed in all corporate communications issued by the Company pursuant to the Listing Rules from time to time.

Pursuant to the resolution of the Board passed on 1 March 2013, with effect from 1 March 2013 1) Mr. Chuan Wang resigned as an independent non-executive Director; 2) Ms. Wenjie Wu has been appointed as an independent non-executive Director; and 3) Mr. Yuk Keung Ng has been appointed as an executive Director of the Company.

### *Supply of and Access to Information and Resource*

All the Directors have direct access to the legal counsels. Written procedures are also in place for Directors to seek, at the Company's expenses, independent professional advice in performing their duties. The Company has arranged appropriate insurance to cover the liabilities of the Directors arising from corporate activities. The insurance coverage is reviewed on an annual basis. The management supplies the Board and its committees with adequate, complete and reliable information in a timely manner to enable them to make informed decisions.

### *Continuing Development*

Every newly appointed Director of the Company should receive a comprehensive, formal and tailored induction on the first occasion of his appointment, and subsequently such briefing and professional development as is necessary, to ensure that he has a proper understanding of the operations and business of the Company and that he is fully aware of his responsibilities under statute and common law, the Listing Rules, applicable legal requirements and other regulatory requirements and the business and governance policies of the Company.

Pursuant to the Revised Code which became effective on 1 April 2012, all Directors should participate in continuous professional development to develop and refresh their knowledge and skills. This is to ensure that their contribution to the Board remains informed and relevant. During the year ended 31 December 2012, all Directors namely, the executive Directors Mr. HongJiang Zhang, Mr. Tao Zou and Mr. Shun Tak Wong (resigned on 15 July 2012); the non-executive Directors Mr. Jun Lei, Mr. Pak Kwan Kau and Mr. Chi Ping Lau; and the independent non-executive Directors Mr. To Thomas Hui (appointed on 25 May 2012), Mr. Guangming George Lu, Mr. Tat Joel, Chang (resigned on 25 May 2012) and Mr. Chuan Wang (resigned on 1 March 2013) have participated in continuous professional development by attending training course or external seminars to develop and refresh their knowledge and skills in relation to their contribution to the Board.

During the year ended 31 December 2012, the company secretary of the Company ("Company Secretary") has taken no less than 15 hours of relevant professional training in compliance with rule 3.29 of the Listing Rules.

### *Board Meetings*

The Board meets at least 4 times a year at approximately quarterly intervals to review the financial performance of the Group, internal re-organisation plans, the overall group strategy and operations with active participation of the majority of Directors. Certain regular Board meetings held during the year ended 31 December 2012 were convened with at least 14 days' notice, in compliance with code provision A.1.3 of the Revised Code. The Company adopted a flexible approach in convening Board meetings and ensuring that sufficient time and adequate information were given to Directors in advance.

A regular meeting does not include the practice of obtaining Board consent through the circulation of written resolutions. For any ad hoc Board meetings, our Directors are given as much notice as is reasonable and practicable under the circumstances. Senior managements are invited to attend Board meetings from time to time to advise on business developments, financial and accounting matters, statutory and regulatory compliance, corporate governance and other major aspects of the Company.

The Company Secretary is responsible for drafting meeting agenda and obtaining comments from all Directors and approval of meeting agenda by the Chairman, preparing and circulating meeting materials that contain analysis and background information to all meeting attendees at least 3 days in advance, drafting minutes of meetings of the Board and Board committees and obtaining comments from all Directors and approval of the meetings minutes by the Chairman. The approved meetings minutes are open for inspection by the Directors within reasonable advance notice.

The articles of association of the Company (the "Articles of Association") contains provisions requiring Directors to abstain from voting and not to be counted in the quorum at meetings for approving transactions in which such Directors or any of their associates have a material interest.

If a substantial shareholder or a Director has a conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter shall not be dealt with by way of circulation or by a committee (except an appropriate Board committee set up for that purpose pursuant to a resolution passed at a Board meeting) but a Board meeting shall be held. Independent non-executive Directors who have no material interest in the transaction should be present and vote at such Board meeting.

**Directors' Attendance Records**

There were 8 Board meetings held during the year ended 31 December 2012 including 1 board meeting held by the chairman of the Board ("Chairman") and non-executive Directors including independent non-executive Directors. The attendance records of each Director at the Board meetings during the year of 2012 are set out below:

| Name of Director | Attendance/Number of meetings |
|---|---|
| *Executive Directors* | |
| Mr. HongJiang Zhang | 7/7 |
| Mr. Tao Zou | 7/7 |
| Mr. Shun Tak Wong (resigned on 15 July 2012) | 4/4 |
| *Non-Executive Directors* | |
| Mr. Jun Lei | 8/8 |
| Mr. Pak Kwan Kau | 7/8 |
| Mr. Chi Ping Lau | 7/8 |
| *Independent Non-Executive Directors* | |
| Mr. To Thomas Hui (appointed on 25 May 2012) | 4/4 |
| Mr. Guangming George Lu | 8/8 |
| Mr. Tat Joel, Chang (resigned on 25 May 2012) | 4/4 |
| Mr. Chuan Wang (resigned on 1 March 2013) | 8/8 |

There were 2 general meetings held during the year ended 31 December 2012. For the general meeting held on 23 May 2012, Mr. Jun Lei, Mr. HongJiang Zhang, Mr. Shun Tak Wong and Mr. Tao Zou attended and Mr. Pak Kwan Kau, Mr. Chi Ping Lau, Mr. Tat Joel, Chang, Mr. Guangming George Lu and Mr. Chuan Wang were absent from the meeting. For the general meeting held on 17 October 2012, Mr. Tao Zou and Mr. Guangming George Lu attended and Mr. Jun Lei, Mr. HongJiang Zhang, Mr. Pak Kwan Kau, Mr. Chi Ping Lau, Mr. Chuan Wang and Mr. To Thomas Hui were absent from the meeting.

### *Chairman and Chief Executive Officer*

The Company fully supports the division of responsibility between the Chairman of the Board and the CEO to ensure a balance of power and authority. Their respective responsibilities are clearly defined and set out in writing. The Chairman provides leadership and is responsible for the effective functioning of the Board in accordance with good corporate governance practice. The CEO focuses on implementing objectives, policies and strategies approved and delegated by the Board. As at the date of this annual report, the posts of Chairman and CEO of the Company were held by Mr. Jun Lei and Mr. HongJiang Zhang, respectively, and there is a clear division of power and responsibility between them.

### *Appointment and Re-election*

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

The Company may from time to time elect any person to be a Director either to fill a casual vacancy or as an additional Director. Any Director so appointed shall hold office only until the next general meeting of the Company and shall then be eligible for re-election at the meeting but shall not be taken into account in determining the Directors or the number of Directors who are to retire by rotation at such meeting. According to the Articles of Association of the Company, at each annual general meeting one-third of the Directors for the time being, or, if their number is not 3 or a multiple of 3, then the number nearest to but not less than one-third, shall retire from office by rotation provided that every Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every 3 years. A retiring Director shall be eligible for re-election at the general meeting of the Company, at which a Director who retires may fill the vacated office.

## BOARD COMMITTEES

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

Written terms of reference of our Audit Committee, Remuneration Committee and Nomination Committee cover their respectively specific role, authority and functions, which are available on our website. The Audit Committee, Remuneration Committee and Nomination Committee mainly consist of the independent non-executive Directors and non-executive Directors.

In order to discharge their dedicated functions, each of our Board committees is provided with sufficient resources, including the provision of external advisors such as financial advisors and valuation firms, to provide professional advice as required at our cost.

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

### *Audit Committee*

**Membership and Responsibilities**

During the year ended 31 December 2012, the Audit Committee comprises all the three independent non-executive Directors namely, Mr. Tat Joel, Chang (resigned as chairman and member of the Audit Committee on 25 May 2012), Mr. To Thomas Hui (appointed as chairman and member of the Audit Committee on 25 May 2012), Mr. Guangming George Lu and Mr. Chuan Wang. In compliance with rule 3.21 of the Listing Rules, both Mr. Tat Joel, Chang and Mr. To Thomas Hui of the Audit Committee possess the appropriate professional qualifications or accounting or related financial management expertise. None of the Audit Committee members is a member of the previous or existing auditors of the Company.

Pursuant to the resolution of the Board passed on 1 March 2013, Mr. Chuan Wang resigned as a member and Ms. Wenjie Wu was appointed as a member of the Audit Committee.

The terms of reference of our Audit Committee sets out its authority, responsibilities, membership and frequency of meetings. The primary duties of the Audit Committee include:

- making recommendations to the Board on the appointment, reappointment and removal of the external auditor;
- approving the remuneration and terms of engagement of the external auditors, and resignation or dismissal of the auditors;
- reviewing and monitoring the external auditor's independence, the objectivity and the effectiveness of the audit process in accordance with applicable standard, and reviewing financial information of the Company;
- reviewing the effectiveness and adequacy of the Company's financial reporting system, internal control procedures and risk management system;
- assessing work performed by the Company's internal audit team, and the adequacy of resources, qualifications and experience of the accounting staff of the Company;
- assisting our Board in supervising the truthfulness and completeness of the Company's financial statements;
- reviewing the external auditor's management letter, any material queries raised by the auditor to management about the accounting records, financial accounts or systems of control and management's response; and
- maintaining a whistle blower system to identify and prevent frauds against the Company.

**Summary of principal work performed**

Principal work performed by the Audit Committee during the year ended 31 December 2012 includes reviewing and/or approving:

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

**Meetings attendance**

The Audit Committee held 4 meetings during the year ended 31 December 2012, the attendance records of each member of the Audit Committee are set out below:

| Members | Attendance/ Number of meetings held |
|---|---|
| Mr. Tat Joel, Chang (resigned as chairman and a member of Audit Committee on 25 May 2012) | 2/2 |
| Mr. To Thomas Hui (appointed as chairman and a member of Audit Committee on 25 May 2012) | 2/2 |
| Mr. Guangming George Lu | 4/4 |
| Mr. Chuan Wang | 4/4 |

### *Remuneration Committee*

**Membership and Responsibilities**

The Remuneration Committee currently consists of four Directors with three of them being independent non-executive Directors, namely, Mr. Guangming George Lu (chairman of the Remuneration Committee), Mr. Tat Joel, Chang (resigned as member of Remuneration Committee on 25 May 2012), Mr. To Thomas Hui (appointed as member of Remuneration Committee on 25 May 2012), Mr. Chuan Wang and Mr. Jun Lei.

Pursuant to the resolution of the Board passed on 1 March 2013, Mr. Chuan Wang resigned as a member and Ms. Wenjie Wu was appointed as a member of the Remuneration Committee.

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

The basic salary and director's fees depend on individual's experience, responsibilities and relevant market rate. The bonus depends on actual performance of the Company's targets and individual performance. Details for the stock option scheme and the share award scheme (the "Share Award Scheme") can be found under the subtitle of "Share Option Schemes" and "Share Award Scheme" in the Directors' Report. The awarded shares are offered to qualified employees to reward them for their high level of performance and foster loyalty with the Group. The information regarding the remuneration of the Directors during the year ended 31 December 2012 is set out in note 8 to the financial statements. When a meeting is convened to discuss certain Directors' remuneration, the Directors in discussion cannot determine his own remuneration.

**Summary of principal work performed**

During the year ended 31 December 2012, the Remuneration Committee performed the following summary of work:

- Reviewed and approved the service contracts and remuneration packages (including year-end bonuses, awarded shares and share options) of our executive Directors and senior management;
- Reviewed and recommended director's fee for non-executive Directors and independent non-executive Directors; and
- Reviewed and recommended performance bonus scheme of the Company to the Board.

**Meetings attendance**

There was 2 meetings of the Remuneration Committee held during the year ended 31 December 2012. The attendance records of each member of the Remuneration Committee are set out below:

| Members | Attendance/ Number of meetings held |
|---|---|
| Mr. Guangming George Lu (chairman of the Remuneration Committee) | 2/2 |
| Mr. Tat Joel, Chang (resigned as a member of Remuneration Committee on 25 May 2012) | 1/1 |
| Mr. To Thomas Hui (appointed as a member of Remuneration Committee on 25 May 2012) | 1/1 |
| Mr. Chuan Wang | 2/2 |
| Mr. Jun Lei | 2/2 |

### *Nomination Committee*

**Membership and Responsibilities**

The Nomination Committee comprises three members, namely Mr. Guangming George Lu (chairman of the Nomination Committee), Mr. Chuan Wang and Mr. Chi Ping Lau, the majority of them are independent non-executive Directors.

Pursuant to the resolution of the Board passed on 1 March 2013, Mr. Chuan Wang resigned as a member and Ms. Wenjie Wu was appointed as a member of the Nomination Committee.

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

**Summary of principal work performed**

The following is a summary of work performed by the Nomination Committee during the year ended 31 December 2012:

- Recommended candidates for the position of independent non-executive Directors;
- Reviewed the structure, size and composition of the Board, reviewed the Company's policies on nomination of Directors and its committees and make recommendations regarding any proposed changes; and
- Reviewed and assessed each independent non-executive Director's annual confirmation of independence pursuant to rule 3.13 of the Listing Rules.

**Meetings attendance**

There was 2 meeting of the Nomination Committee held during the year ended 31 December 2012. The attendance records of each member of the Nomination Committee are set out below:

| Members | Attendance/ Number of meetings held |
|---|---|
| Mr. Guangming George Lu (chairman of the Nomination Committee) | 2/2 |
| Mr. Chuan Wang | 2/2 |
| Mr. Chi Ping Lau | 2/2 |

## EXTERNAL AUDITORS AND AUDITORS' REMUNERATION

Ernst & Young, Certified Public Accountants, Hong Kong, were engaged as the Company's external auditors for the year ended 31 December 2012. External auditors may provide certain non-audit services to the Group as long as these services do not involve any management or decision making functions for and on behalf of the Group; or performing any self-assessments; or acting in an advocacy role for the Group. Before any engagement with external auditor for non-audit services, external auditors must comply with the independence requirements under Code of Ethics for Professional Accountants issued by Hong Kong Institute of Certified Public Accountants. The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditors' Report on page 58 of this annual report.

During the year ended 31 December 2012, the remunerations paid or payable to Ernst & Young regarding to the audit and non-audit services (together with the comparative figures for 2011) are set out as follows:

| | **2012 RMB' Mil** | 2011 RMB' Mil |
|---|---|---|
| Audit services | **6.91** | 6.74 |
| Non-audit services | **2.34** | 2.53 |
| Total | **9.25** | 9.27 |

## INTERNAL CONTROL

Our internal control system is designed to provide reasonable assurance in safeguarding our shareholders' investment and assets, improving corporate governance and risk management, preventing and detecting frauds and irregularities, providing reliable financial information, and ensuring compliance with applicable law and regulations. The Board acknowledges its responsibility to ensure the Company to maintain a solid, complete and effective internal control system and to monitor the effective implementation of such system. The Company has established an integrated framework of internal controls which is consistent with the COSO (the Committee of Sponsoring Organizations of the Treadway Commission) framework.

The Company's internal control framework covers the setting of objectives, budgets and targets; the establishment of regular reporting of financial information, in particular, the tracking of deviations between actual performances and budgets/targets; the delegation of authority; and the establishment of clear lines of accountability. Well defined policies and procedures that are properly documented and communicated to employees are essential to the internal control system. Over the past few years, within its internal control framework, the Company has formulated manuals, implemented systems and adopted rules in relation to internal control, which are available on the Company's intranet. The Company's employees receive training of its code of conduct on a regular basis. The Company's internal control system is designed to manage, rather than eliminate, the risk of failure to achieve our business objectives, and aims at providing a reasonable, as opposed to an absolute, assurance in this respect.

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

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

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

## COMMUNICATION WITH SHAREHOLDERS

The Company considers that effective communication with shareholders is essential for enhancing investor relations and understanding of the Group's business, performance and strategies. The Company also recognises the importance of timely and non-selective disclosure of information, which will enable shareholders and investors to make the informed investment decisions.

To promote effective communication, the Company maintains the website at www.kingsoft.com where up-to-date information on the Company's business operations and developments, financial information, corporate governance practices and other information are available for public access. Latest information on the Group including annual and interim reports, announcements and press releases are updated on the Company's website in a timely fashion.

The Board endeavours to maintain an on-going dialogue with our shareholders and in particular, use annual general meetings or other general meetings to communicate with our shareholders and encourage them to participate in these meetings. All annual general meeting materials including but not limited to circular, notice and proxy form will be sent to shareholders in time including all adequate information according to the Listing Rules. The 2013 annual general meeting of the Company ("AGM") will be held on 23 May 2013. The notice of AGM will be sent to shareholders at least 20 clear business days before the AGM.

## INVESTOR RELATIONS

Kingsoft establishes an investor relations team to promote open, ongoing and effective communications with shareholders, investors and equity analysts. We are committed to proactively providing the investment community all necessary information in a timely manner so that participants in the investment community can make a fair investment decision.

During the year ended 31 December 2012, the Company's senior management presented its results in Hong Kong, Beijing and various other cities in the PRC. Through various activities such as analyst briefings, press conferences, conference calls and investor non-deal road shows, our senior management presented and answered the key issues of which investors were mainly concerned. In addition to regular one-on-one investor meetings, our senior management participated in a number of investor conferences held by major international investment banks in order to maintain active communications with global institutional investors. Site visits were also arranged at Kingsoft's R&D centre in Zhuhai in China for participants. The Company's website, www.kingsoft.com, provides information of the Company such as financial, investor relations, corporate information and other latest information in a timely manner and is updated regularly.

## SHAREHOLDERS' RIGHT

### *Procedures for shareholders to convene an Extraordinary General Meeting*

Pursuant to article 64 of the Articles of Association of the Company, any one or more shareholders holding at the date of deposit of the requisition not less than one-tenth of the paid up capital of the Company carrying the right of voting at general meetings of the Company shall at all times have the right, by written requisition to the Board or the Company Secretary, to require an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition.

Such a requisition must be signed by the shareholders.

### *Procedures for putting forward proposals at shareholders' meeting*

Shareholders are welcomed to suggest proposals relating to the operations, strategy and/or management of the Group to be discussed at shareholders' meeting. Proposal shall be sent to the Board or the Company Secretary by written requisition at the Company's principal place of business in Hong Kong at Unit 1309A, 13/F, Cable TV Tower, No.9 Hoi Shing Road, Tsuen Wan, N.T. Hong Kong or at the Company's headquarter in the PRC at Kingsoft Tower, No. 33, Xiaoying West Road, Haidian District, Beijing 100085, the PRC.

### *Shareholders' enquiries*

Shareholders should direct their questions about their shareholdings to the Company's share registrar. Shareholders and the investment community may at any time make a request for the Company's information to the extent that such information is publically available. Shareholders may also make enquiries to the Board by writing to the Company Secretary at the Company's principal place of business office in Hong Kong at Unit 1309A, 13/F, Cable TV Tower, No.9 Hoi Shing Road, Tsuen Wan, N.T. Hong Kong or at the Company's headquarter in the PRC at Kingsoft Tower, No. 33, Xiaoying West Road, Haidian District, Beijing 100085, the PRC.

## CONSTITUTIONAL DOCUMENTS

There are no changes in the Company's constitutional documents during the year ended 31 December 2012.

On behalf of the Board
**Jun Lei**
*Chairman*

The PRC, 19 March 2013

# DIRECTORS' REPORT

The Board of the Company submits its report together with the audited financial statements of the Company and the Group for the year ended 31 December 2012.

## Principal Business

The principal activity of the Company is investment holding. The principal activities of its subsidiaries comprise the research, development, operation and distribution of online game, mobile game and casual game services; and the research, development, operation and distribution of internet security software, dictionary software and office application software online and offline products. There were no significant changes in the nature of the Group's principal activities during the year. The analysis of the Group's revenues by operating segments and certain geographical information are set out in note 4 to the financial statements.

## Results and Appropriations

The results of the Group for the year ended 31 December 2012 are set out in the consolidated income statement on page 59 of this annual report.

The state of affairs of the Group and the Company as at 31 December 2012 is set out in the consolidated statement of financial position on pages 61 to 62 of this annual report and in the statement of financial position on page 66 of the annual report respectively.

The consolidated statement of cash flows of the Group for the year is set out on page 64 to 65 of this annual report.

During the year, a final dividend for year 2011 of HKD0.10 per ordinary share, which excluded the dividend related to the shares held under the Share Award Scheme, was paid to shareholders on 19 June 2012.

The Directors recommend the payment of a final dividend of HKD0.11 per ordinary share (2011: HKD0.10 per ordinary share) totalling approximately HKD126.0 million (2011: HKD113.8 million), which excluded the dividend related to the shares held under the Share Award Scheme, based on the number of total issued shares of 1,171,791,433 as at 31 December 2012 in respect of the year to shareholders whose names appear on the register of members of the Company on 3 June 2013. Such proposed dividends will be subject to approval of the shareholders at the forthcoming AGM to be held on 23 May 2013. Such proposed dividends will be payable on 19 June 2013. This recommendation has been incorporated in the financial statements within the equity section of the statement of financial position.

For the year ended 31 December 2012, the Company is not aware of any arrangement under which a shareholder has waived or agreed to waive any dividends.

The register of members of the Company will be closed from Friday, 17 May 2013 to Thursday, 23 May 2013, and from Wednesday, 29 May 2013 to Monday, 3 June 2013, both dates inclusive, during which period no transfer of shares will be affected. In order to qualify for the proposed final dividend and the right to attend and vote at the forthcoming AGM, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong for registration not later than 4:30 p.m. on Tuesday, 28 May 2013 and Thursday, 16 May 2013 respectively.

## Reserves

For the year ended 31 December 2012, the profit attributable to owners of the parent company amounted to RMB432.6 million. The Company's reserves available for distribution comprise share premium and retained earnings. Under the Companies Law of the Cayman Islands, the Company's share premium account may be applied by the Company in paying distributions or dividend to shareholders of the Company provided that immediately following the date on which the distribution or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

As at 31 December 2012, the Company had distributable reserves amounting to RMB692.0 million, calculated in accordance with any statutory provisions applicable in Cayman Islands. Details of movements in the reserves of the Group and the Company during the year ended 31 December 2012 are set out in the consolidated statement of changes in equity on page 63 of this annual report, and in note 34(b) to the financial statements, respectively.

## Donations

During the year ended 31 December 2012, the Group made charitable and other donations totalling RMB50,000 (2011: RMB500,000).

## Retirement Schemes

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

## Employee and Remuneration Policy

As at 31 December 2012, the Group employed approximately 2,916 full-time employees (2011: 2,782) inclusive of all its staff in Mainland China and overseas offices, most of whom are based at the Company's offices in Beijing and Zhuhai.

The remuneration policy and package of the Group's employees are periodically reviewed. The principle of the Group's remuneration policy is fairness, motivating, performance-oriented and market-competitive. Apart from salaries, medical insurance, discretionary bonuses and state managed retirement benefit scheme, the Group has also adopted share option scheme and share award scheme for its employees, providing incentives and rewards to eligible participants with reference to their contribution.

The staff costs of the Group including Directors' and senior management's emoluments in 2012 and 2011 were approximately RMB517.7 million and RMB387.1 million, respectively.

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

## Subsidiaries

Details of the Company's principal subsidiaries as at 31 December 2012 are set out in note 33 to the financial statements.

## Material Investment and Acquisition

There was no material investment and acquisition incurred during the year ended 31 December 2012.

## Financial Summary

A summary of the published results, assets, and liabilities of the Group for the last five financial years as extracted from the consolidated financial statements for the year ended 31 December 2008, 2009, 2010, 2011 and 2012, is set out as below. The summary does not form part of the audited financial statements.

| | YEAR ENDED 31 DECEMBER | | | | |
|---|---|---|---|---|---|
| | 2008 RMB'000 | 2009 RMB'000 | 2010 RMB'000 | 2011 RMB'000 | 2012 RMB'000 |
| Profit for the year | 304,035 | 388,854 | 374,533 | 335,034 | **466,434** |

| | AS AT 31 DECEMBER | | | | |
|---|---|---|---|---|---|
| | 2008 RMB'000 | 2009 RMB'000 | 2010 RMB'000 | 2011 RMB'000 | 2012 RMB'000 |
| Total assets | 1,739,223 | 2,040,870 | 2,444,813 | 3,014,519 | **3,641,269** |
| Total liabilities | 410,858 | 436,560 | 510,752 | 801,399 | **966,337** |

## Contract of Significance

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

## Bank Borrowings

Particulars of bank loans as at 31 December 2012 are set out in note 29 to the financial statements.

## Property, Plant and Equipment

Details of the movements in the property, plant and equipment of the Group and the Company for the year ended 31 December 2012 are set out in note 13 to the financial statements. No assets of the Group are charged during the year ended 31 December 2012.

## Future Plans for Material Investments or Capital Assets

Save as those disclosed in note 37 to the financial statements, there was no specific plan for material investments and acquisition of material capital assets as at 31 December 2012.

## Principal properties

During the year ended 31 December 2012, the Group held a piece of land via 成都百銘房地產有限公司 (Chengdu Baiming Real Estate Company Limited) for investment purposes whose relevant percentage ratios exceeded 5%. The aforesaid piece of land is located within 四川成都高新技術產業開發區 (the Advanced Technology and Industry Exploration Zone of Chengdu, Sichuan), and bears the State-owned Construction Land Use Rights Certificate, 成高國用 (2012) 第 22133 號建設用地, which is issued by the Chengdu Land and Resources Bureau. The piece of land was not developed and has a long lease term. On 5 February 2013, the Company announced that it disposed of its 80% interest in 成都百銘房地產有限公司 (Chengdu Baiming Real Estate Company Limited) for a total consideration of RMB200 million.

## Share Capital

Details of the movements in share capital of the Company for the year ended 31 December 2012 are set out in note 32 to the financial statements.

## Share Option Schemes

The Company adopted the 2004 and 2007 Pre-IPO Share Option Schemes which were approved by resolutions in writing of all the shareholders passed on 30 June 2004 and 22 January 2007. The 2011 Share Option Scheme was also adopted by the Company and was approved and effective on 9 December 2011. The details of these schemes and Kingsoft Japan Share Options are stated in note 7 to the financial statements.

Details of the movements in share options of the Company for the year ended 31 December 2012 are set out in note 7 to the financial statements. During the year ended 31 December 2012, 3,000,000 number of share options have been granted under the 2011 Share Option Scheme, details of these granted share options were included in note 7 to the financial statements.

On 27 February 2013 (the "KC Share Option Adoption Date"), the shareholders of the Company and Kingsoft Cloud Holdings Limited ("KC Holdings") a subsidiary of the Company, approved and adopted a share option scheme (the "KC Share Option Scheme") for the purpose of providing incentives and rewards to eligible participants, in which selected employees of KC and its subsidiaries ("KC Group") are entitled to participate. During the year ended 31 December 2012, 37,700,000 share options were granted, through grant intention letters, subject to the approval of the Company's shareholders and KC Holdings' shareholders, to a number of employees with a vesting period of five years and the employees began to provide services from the grant intention letter date. More details regarding the KC Share Option Scheme are set out in note 7 to the financial statements.

## Summary of The Share Option Schemes

| | Detail | 2004 Pre-IPO Share Option Scheme | 2007 Pre-IPO Share Option Scheme | Kingsoft Japan Pre-IPO Share Option Scheme | 2011 Share Option Scheme |
|---|---|---|---|---|---|
| 1. | Purposes | To retain the best available personnel, to provide additional incentive to employees, senior management and directors of the Group and to promote the success of the business of the Group | Same as 2004 Pre-IPO Share Option Scheme | To enhance the operational efficiency of Kingsoft Japan and to provide additional incentive for its employees and other related persons. | To provide incentives or rewards to participants thereunder for their contribution to the Group and/or to enable the Group to recruit and retain high-calibre employees and attract human resources that are valuable to the Group and any entity in which the Group holds any equity interest |
| 2. | Qualifying participants | Any employee (whether full time or part time), chief executive or director (including executive or non-executive or independent non-executive) of any member of the Group or any associated company, in which the Company directly or indirectly holds more than 20% of its issued share capital or the voting power at general meetings or in which any equity interest is held by the Company for long term purpose and a significant influence is exercised over its management, or such other person as may be determined by the Board from time to time | Same as 2004 Pre-IPO Share Option Scheme | Not specified in the Scheme | Any employee (whether full time or part time), directors (including executive or non-executive or independent non-executive) of the Company, its subsidiaries or any entity in which the Group holds any equity interest |
| 3. | Maximum number of shares | The maximum number of ordinary shares in respect of which options may be granted under the 2004 Pre-IPO Share Option Scheme shall not in aggregate exceed 10% of the total number of ordinary shares in issue. On August 12, 2005, the shareholders approved that the maximum number of ordinary shares in respect of which options may be granted shall not in aggregate exceed 18% of the total number of ordinary shares in issue of 35,410,000. Pursuant to a Share Subscription and Purchase Agreement dated July 21, 2006 ("Agreement Date"), the aggregate of all options issued from the Agreement Date to an initial public offering shall not constitute more than 15% of the issued capital of the Company. | The maximum number of ordinary shares in respect of which options may be granted under the 2007 Pre-IPO Share Option Scheme shall not in aggregate exceed 13% of the total number of issued Shares on the fully diluted basis of inclusion of all of the issued and outstanding shares of the Company, as well as 6,373,800 options under the 2004 Pre-IPO Share Option Scheme. | The maximum number of the shares which may be issued upon exercise of all issued and outstanding options shall be 1,000 ordinary shares of Kingsoft Japan in aggregate. | The maximum number of shares which may be issued upon exercise of all share options to be granted under the 2011 Share Option Scheme and other share option schemes of the Company shall not in aggregate exceed 10% of the total number of shares in issue on 9 December 2011 |

| | Detail | 2004 Pre-IPO Share Option Scheme | 2007 Pre-IPO Share Option Scheme | Kingsoft Japan Pre-IPO Share Option Scheme | 2011 Share Option Scheme |
|---|---|---|---|---|---|
| 4. | Maximum entitlement of each participant | Not specified in the scheme | Not specified in the scheme | Not specified in the scheme | The maximum number of shares issuable under share options to each eligible participant in the 2011 Share Option Scheme within any 12-month period is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting. Any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their respective associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the price of the Company's shares at the date of grant) in excess of HKD5,000,000, within any 12-month period, are subject to shareholders' approval in advance in a general meeting |
| 5. | Option period | The period set out in the relevant offer letter within which the option may be exercisable provided that such period must expire on the date falling on the tenth anniversary of the offer date | Same as 2004 Pre-IPO Share Option Scheme | (1) the option period of options granted on January 4, 2007 is from January 5, 2009 to November 1, 2016<br>(2) the option period of options granted on March 30, 2007 is from March 30, 2007 to March 30, 2017<br>(3) the option period of options granted on July 31, 2007 is from August 1, 2009 to November 1, 2016 | The period set out in the relevant offer letter to each grantee, save that such period shall not be more than ten years from the offer date subject to the provisions for early termination set out in the scheme and that the board may at its discretion determine the minimum period for which the option has to be held before the exercise of the subscription right attaching thereto |
| 6. | Acceptance of offer | The offer of a grant of share options must be accepted within 28 business days from the date of offer, upon payment of a consideration of HKD1 in total by the grantee | The offer of a grant of share options must be accepted within 28 business days from the date of offer | Options shall be issued free | Same as 2004 Pre-IPO Share Option Scheme |
| 7. | Subscription price | The exercise price shall be determined and notified by the Board and shall be at least a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time. | The exercise price shall be determined and notified by the Board and shall be a price USD4.80 per share or a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time. | Note | The exercise price shall be determined by the board, and shall not be less than the highest of (i) the Stock Exchange closing price of the Company's shares on the date of offer of the share options; (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of offer; and (iii) the nominal value of a share |
| 8. | Remaining life of the Scheme | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect | It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect | It will expire on the tenth anniversary of the date on which the scheme is deemed to take effect |

Note:

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

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

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

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

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

## Share Award Scheme

The Share Award Scheme was adopted by the Board on 31 March 2008 (the "Adoption Date"). Unless terminated earlier by the Board, the Share Award Scheme shall be valid and effective for a term of five years commencing on the Adoption Date. On 25 November 2010, the Board approved to extend the term of the Share Award Scheme until 30 March 2017, for which the Company released an announcement on 1 December 2010. During the year ended 31 December 2012, the Company granted 8,092,000 awarded shares.

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

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

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

## Share Award Scheme (adopted by Kingsoft Internet Security Software Holdings Limited ("KIS Holdings"))

On 26 May 2011 (the "KIS Adoption Date"), the directors of KIS Holdings, a subsidiary of the Company, approved and adopted a share award scheme (the "KIS Share Award Scheme"). Unless early terminated by the directors of KIS Holdings, the KIS Share Award Scheme shall be valid and effective for a term of ten years commencing on the KIS Adoption Date. During the year ended 31 December 2012, 29,270,000 shares were awarded to a number of employees under the KIS Share Award Scheme.

The purpose of the KIS Share Award Scheme is to recognise the contributions by certain employees and to give incentives thereto in order to retain them for the continual operation and development of KIS Holdings and its subsidiaries ("KIS Group") and to attract suitable personnel for further development of KIS Group.

Pursuant to the terms of the KIS Share Award Scheme, the board of KIS Holdings may, from time to time, at its absolute discretion and subject to such terms and conditions as it may think fit (including the basis of eligibility of each employee determined by the board of KIS Holdings from time to time) select an employee for participation in the KIS Share Award Scheme and determine the number of the KIS awarded shares. The directors of KIS Holdings will not grant any award of shares which would result in the total number of shares which are subject to awards granted by the board of directors of KIS Holdings under the KIS Share Award Scheme (but not counting any of which have lapsed or have been forfeited) being greater than 100,000,000 shares as at the date of such grant.

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

## Share Award Scheme (adopted by Kingsoft Office Software Holdings Limited ("KOS Holdings"))

On 3 December 2012 (the "KOS Adoption Date"), the directors of KOS Holdings, a subsidiary of the Company, approved and adopted a share award scheme (the "KOS Share Award Scheme"), for the purpose of providing incentives and rewards to eligible participants, in which selected employees of KOS Holdings and its subsidiaries ("KOS Group") are entitled to participate. Unless early terminated by the directors of KOS Holdings, the KOS Share Award Scheme shall be valid and effective for a term of ten years commencing on the KOS Adoption Date. The directors of KOS Holdings will not grant any award of shares which would result in the total number of shares (but not counting any which have lapsed or have been forfeited) being greater than 50,000,000 shares, as at the date of such grant.

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

## Share Award Scheme (adopted by KC Holdings)

On 22 February 2013 (the "KC Adoption Date"), the directors of KC Holdings approved and adopted a share award scheme (the "KC Share Award Scheme") for the purpose of providing incentives and rewards to eligible participants, in which selected employees of KC Group are entitled to participate. Unless early terminated by the directors of KC Holdings, the KC Share Award Scheme shall be valid and effective for a term of ten years commencing on the KC Adoption Date. The directors of KC Holdings will not grant any award of shares which would result in the total number of shares (but not counting any which have lapsed or have been forfeited) being greater than 48,000,000 shares, as at the date of such grant.

During the year ended 31 December 2012, 25,000,000 awarded shares under KC Share Award Scheme were granted, through grant intention letters, subject to the approval of the KC Holdings' board of directors, to a number of employees and the employees began to provide services from the grant intention letter date.

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

## Directors

Up to the date of this report, the Board comprises 9 directors, of which 3 were executive Directors, 3 were non-executive Directors and 3 were independent non-executive Directors, whose names are as follows:

| | APPOINTMENT DATE | RESIGNATION DATE | RE-DESIGNATION DATE |
|---|---|---|---|
| **EXECUTIVE DIRECTORS** | | | |
| Mr. HongJiang ZHANG (張宏江) | 14 December 2011 | N/A | N/A |
| Mr. Shun Tak WONG (王舜德) | 14 December 2011 | 15 July 2012 | N/A |
| Mr. Tao ZOU (鄒濤) | 25 August 2009 | N/A | N/A |
| Mr. Yuk Keung NG (吳育強) | 1 March 2013 | N/A | N/A |
| **NON-EXECUTIVE DIRECTORS** | | | |
| Mr. Jun LEI (雷軍) | 27 July 1998 | N/A | 28 August 2008 |
| Mr. Pak Kwan KAU (求伯君) | 27 July 1998 | N/A | 24 October 2011 |
| Mr. Chi Ping LAU (劉熾平) | 28 July 2011 | N/A | N/A |
| **INDEPENDENT NON-EXECUTIVE DIRECTORS** | | | |
| Mr. Tat Joel, CHANG (鄭達祖) | 1 October 2011 | 25 May 2012 | N/A |
| Mr. Guangming George LU (魯光明) | 30 April 2007 | N/A | N/A |
| Mr. Chuan WANG (王川) | 28 July 2011 | 1 March 2013 | N/A |
| Mr. To Thomas HUI (許濤) | 25 May 2012 | N/A | N/A |
| Ms. Wenjie WU (武文洁) | 1 March 2013 | N/A | N/A |

In accordance with Article 108 of the Articles of Association of the Company, Mr. Chi Ping Lau and Mr.Guangming George Lu, and in accordance with Article 112 of the Articles of Association of the Company, Mr. Yuk Keung Ng and Mr. To Thomas Hui, and Ms. Wenjie Wu will retire at the forthcoming AGM of the Company to be held on 23 May 2013 and, being eligible, will offer themselves for re-election.

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

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

Biographical details of the Directors of the Company and the senior management of the Group are set out on pages 13 to 17 of the annual report.

### *Directors' Service Contracts*

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

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

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

### *Interests of the Directors in Contracts*

Save as disclosed in the section of "Related Party Transaction and Connected Transaction" in the Directors' Report, no Directors had any direct or indirect material interests in any contracts of significance to the business of the Group to which the Company or any of its subsidiaries was a party at the end of the year or at any time during the year ended 31 December 2012.

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

As at 31 December 2012, the interests and short positions of the Directors and the chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO); or (b) were required, pursuant to section 352 of the SFO, to be recorded in the register required to be kept by the Company; or (c) were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange were as follows:

*Interests in the ordinary shares of the Company*

| NAME OF DIRECTOR | NATURE OF INTERESTS | NUMBER OF SHARES HELD | PERCENTAGE OF ISSUED SHARE CAPITAL |
|---|---|---|---|
| Pak Kwan Kau | Founder of a discretionary trust (Note 1) | 108,032,566 | 9.22% |
| | Personal (Note 2) | 1,500,000 | 0.13% |
| Jun Lei | Interest of controlled corporation (Note 3) | 145,493,580 | 12.42% |
| | Other (Note 4) | 143,214,003 | 12.22% |
| Tao Zou | Personal | 191,600 | 0.02% |

*Interests in underlying shares of the Company:*

| NAME OF DIRECTOR | INTERESTS IN UNDERLYING SHARES | NUMBER OF INTERESTS DIRECTLY BENEFICIALLY OWNED |
|---|---|---|
| HongJiang Zhang | Share options (Note 5) | 7,500,000 |
| | Awarded shares (Note 6) | 7,000,000 |
| Tao Zou | Awarded shares (Note 7) | 500,000 |

Notes:

1. Mr. Pak Kwan Kau is beneficially interested in these 108,032,566 shares of the Company through Topclick Holdings Limited, a BVI company wholly controlled by Kau Management Limited. Kau Management Limited is a company indirectly owned by a discretionary trust, the beneficiaries of which include Mr. Pak Kwan Kau and his family members. Mr. Jun Lei has interest in these shares because under a voting consent agreement entered into amongst Mr. Jun Lei, Mr. Pak Kwan Kau and Mr. Shuen Lung Cheung, Mr. Pak Kwan Kau will vote in the same manner as Mr. Jun Lei with these shares.

2. Mr. Jun Lei has interest in the number of 500,000 out of these shares because under a voting consent agreement entered into amongst Mr. Jun Lei, Mr. Pak Kwan Kau and Mr. Shuen Lung Cheung, Mr. Pak Kwan Kau will vote in the same manner as Mr. Jun Lei with these shares.

3. These shares are held by Color Link Management Limited, a BVI company wholly owned by Mr. Jun Lei.

4. Mr. Jun Lei has interest in these shares because under a voting consent agreement entered into amongst Mr. Jun Lei, Mr. Pak Kwan Kau and Mr. Shuen Lung Cheung, Mr. Pak Kwan Kau and Mr. Shuen Lung Cheung will vote in the same manner as Mr. Jun Lei with these shares.

5. The relevant interests include number of options of 7,500,000 which was granted on 20 December 2011, and its exercise period is from 20 December 2012 to 19 December 2021 with exercise price of HKD2.89.

6. The relevant interests include number of 7,000,000 awarded shares granted on 29 November 2011 under the Share Award Scheme, out of which 1,800,000 number of awarded shares will be matured and exercisable on 29 November 2012 and one fourth of the remaining 5,200,000 awarded shares will be matured and exercisable on 29 November 2013, 29 November 2014, 29 November 2015 and 29 November 2016 respectively. The price for the grant of awarded shares is nil.

7. The relevant interests include number of 500,000 awarded shares granted on 1 June 2012 under the Share Award Scheme, subject to the satisfaction of certain conditions attached to these awarded shares, one fifth of which will be matured and exercisable on 1 June 2013, 1 June 2014, 1 June 2015, 1 June 2016 and 1 June 2017 respectively. The price for the grant of awarded shares is nil.

Save as disclosed above, none of the directors or chief executive and their associates, had interests or short positions in any shares, underlying shares or debentures of the Company and its associated corporations as at 31 December 2012.

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

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

## Substantial Shareholders

As at 31 December 2012, as far as the Directors are aware of, the following, other than the Directors and chief executive of the Company, had an interest in the shares or underlying shares in the Company which would fall to be disclosed to the Company under the provision of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company under section 336 of the SFO, or who was, directly or indirectly, interested in 5% or more of the issued capital of the Company:

*Long position in the shares in the Company*

| NAME OF SHAREHOLDER | CAPACITY | NUMBER OF ORDINARY SHARES HELD IN THE COMPANY | PERCENTAGE OF ISSUED SHARE CAPITAL AS AT 31 DECEMBER 2012 |
|---|---|---|---|
| Color Link Management Limited | Beneficial owner (Note 1) | 145,493,580 | 12.42% |
| Tencent Holdings Limited | Interest of a controlled corporation | 178,407,183 | 15.23% |
| Topclick Holdings Limited | Beneficial owner (Note 2) | 108,032,566 | 9.22% |
| Credit Suisse Trust Limited | Trustee (Note 2) | 108,032,566 | 9.22% |
| Kau Management Limited | Interest of a controlled corporation (Note 2) | 108,032,566 | 9.22% |
| The Kau's Family Trust | Interest of a controlled corporation (Note 2) | 108,032,566 | 9.22% |
| FIL Limited | Investment manager | 69,763,000 | 5.95% |

1. Mr. Jun Lei is deemed to be interested in Color Link Management Limited's interest in the Company pursuant to Part XV of the SFO because Color Link Management Limited is wholly owned by Mr. Jun Lei.

2. The 108,032,566 shares are held by Topclick Holdings Limited, which is in turn, held by Credit Suisse Trust Limited as the trustee of The Kau's Family Trust. The Kau's Family Trust is a discretionary trust established by Mr. Pak Kwan Kau as settlor and the Credit Suisse Trust Limited as trustee in January 2012. The beneficiaries of The Kau's Family Trust include family members of Mr. Pak Kwan Kau. Mr. Pak Kwan Kau is deemed to be interested in the 108,032,566 shares held by Topclick Holdings Limited pursuant to Part XV of the SFO.

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

## Public Float

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

## Purchase, Sale or Redemption of Shares

During the year ended 31 December 2012, the Company repurchased a total of 1,983,000 of its own ordinary shares on the Stock Exchange at a total cost of approximately HKD7.1 million, inclusive of transaction cost. All the repurchased shares were cancelled by the Company upon such repurchase and accordingly the issued share capital of the Company was reduced by the nominal value of these shares. The premium paid on the repurchase was charged to the share premium account. An amount equivalent to the par value of the ordinary shares cancelled was transferred to the issued capital as set out in the consolidated statement of changes in equity. The Company considered that it is in the best interest of the shareholders to return some surplus funds to them which will in turn enhance shareholders' value. During the year ended 31 December 2012, the Company has not repurchased any shares under its Share Award Scheme. Details of the Share Award Scheme are set out above in this report.

Details of the repurchases by the Company on the Stock Exchange during the year ended 31 December 2012 were as follows:

| | | Repurchase Consideration Per Share | | |
|---|---|---|---|---|
| **Month of Repurchase in 2012** | **No. of Shares Repurchased** | **Highest Price Paid HKD** | **Lowest Price Paid HKD** | **Aggregate Consideration Paid HKD** |
| August | 1,630,000 | 3.60 | 3.56 | 5,867,305 |
| September | 353,000 | 3.60 | 3.57 | 1,269,657 |

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year ended 31 December 2012.

## Competing Interest

As of 31 December 2012, none of the Directors, controlling shareholders or their respective associates (as defined in the Listing Rules) had any interest in a business which competed or might compete with the business of the Group.

## Major Customers and Suppliers

For the year ended 31 December 2012, the 5 largest customers of the Group accounted for 29% of the total revenue, while the largest customer accounted for 10% of the total revenue. For the year ended 31 December 2012, the 5 largest suppliers of the Group accounted for 24% of the total purchases, while the largest supplier accounted for 13% of the total purchases.

Aside from Tencent who is one of the five largest customers of the Group, one of the Directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the Directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and suppliers.

## Related Party Transaction and Connected Transaction

### 1. Connected Transaction

#### *Deemed Disposal of Kingsoft Office Shares and Loan to WPS Holdings Limited*

On 21 May 2012, the Company and its subsidiary, Kingsoft Office Software Holdings Limited ("Kingsoft Office"), entered into an ordinary share purchase agreement (the "Share Purchase Agreement") with WPS Holdings Limited and other relevant parties, whereby Kingsoft Office will issue 200,000,000 new shares to WPS Holdings Limited at an aggregate consideration of USD6 million. Concurrently, the Company entered into a loan agreement (the "Loan Agreement") with WPS Holdings Limited, pursuant to which the Company will provide a loan in the amount of USD4.5 million to WPS Holdings Limited at an interest rate equivalent to HIBOR plus 1.3% per annum for the purpose of acquiring Kingsoft Office shares. The loan tenure was one year commencing from date on which the principal amount was disbursed by the Company and shall be automatically extended for another one year upon expiration. The 200,000,000 new shares issued as fully paid up and registered in the name of WPS Holdings Limited have been charged in favour of the Company pursuant to the deed of charge signed by the Company and WPS Holdings Limited.

According to the Share Purchase Agreement, WPS Holdings Limited shall fully pay at the date of closing of the Share Purchase Agreement by wire transfer of immediately available funds to an account designated by Kingsoft Office. Proceeds from the subsciption of Kingsoft Office shares will be utilized to fund for further research and development of the WPS Office software and other application software owned by Kingsoft Office and its subsidiaries and to be the working capital of Kingsoft Office and its subsidiaries.

WPS Holdings Limited is a company owned as to 100% by founding employees. As WPS Holdings Limited is an associate of Ke GE, a director of certain subsidiaries of the Group, WPS Holdings Limited is a connected person of the Company pursuant to Chapter 14A of the Listing Rules. As a result, transactions contemplated under the Share Purchase Agreement and Loan Agreement between WPS Holdings Limited and the Company constitute connected transactions. As the relevant applicable percentage ratios (as defined in the Listing Rules) are less than 5%, the transactions are subject to reporting and announcement requirements. The Company publised an announcement on 21 May 2012 and a supplementary announcement on 24 May 2012.

#### *Deemed Disposal of Kingsoft Cloud Shares to Xiaomi*

On 30 November 2012, the Company, Kingsoft Cloud Holdings Limited ("Kingsoft Cloud") and its subsidiaries and companies indirectly controlled by Kingsoft Cloud (the "Kingsoft Cloud Group"), KSC Partner Holdings Limited ("KSC") and KSC Shareholders entered into a share purchase agreement (the "Xiaomi Share Purchase Agreement") with Xiaomi Corporation ("Xiaomi"), whereby Kingsoft Cloud will issue an aggregate of 91,000,000 Kingsoft Cloud shares to Xiaomi for an aggregate consideration of USD1.82 million.

According to the Xiaomi Share Purchase Agreement, the total transaction amount shall be fully paid at the date of completion by wire transfer of immediately available funds to an account designated by Kingsoft Cloud.

Proceeds from the sale of Kingsoft Cloud shares will be utilized by Kingsoft Cloud Group for the development of the principal business or for the capital expenditures and general working capital of Kingsoft Cloud Group or the other purposes as approved by the board of Kingsoft Cloud.

Mr. Jun Lei is a Director and a substantial shareholder of the Company. Mr Jun Lei and his associates are connected persons of the Company pursuant to Chapter 14A of the Listing Rules. As Xiaomi is an associate of Mr. Jun Lei, Xiaomi is a connected person of the Company. As a result, transaction contemplated under the Xiaomi Share Purchase Agreement constitutes connected transaction of the Company. As the relevant applicable percentage ratios (as defined in the Listing Rules) are less than 5%, the transaction is subject to reporting and announcement requirements. The Company published an announcement on 30 November 2012.

## 2. Structure Contracts

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

### Pre-existing Structure Contracts During the 2012 Financial Year

To streamline the corporate structure of the Group, the Group has commenced an internal reorganization exercise. In 2010, the Group has entered into (i) structure contracts relating to Zhuhai Qiwen Application Software Co., Ltd. ("Zhuhai Qiwen"); and (ii) structure contracts relating to Beijing Conew Technology Development Co., Ltd. ("Conew Technology"). In 2011, the Group has entered into (i) structure contracts relating to Shell Internet (Beijing) Security Technology Co., Ltd. ("Shell Internet"); and structure contracts relating to (ii) Zhuhai Kingsoft Online Game Technology Co., Ltd. ("Zhuhai Online Game"). As part of the Group's internal restructuring, the Group has also recloned the structure contracts in relation to Zhuhai Qiwen in 2011.

The structure contracts which were in place during the year ended 31 December 2012 were as follows:

### *Structure Contracts Relating to Kingsoft Qijian*

(i) A loan agreement dated 30 March 2007 between Weiqin Qiu, Peili Lei and Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment") which provided for an interest free loan by Chengdu Interactive Entertainment of RMB1,200,000 to Weiqin Qiu and of RMB300,000 to Peili Lei, entirely for the purpose of repaying the loan provided by Zhuhai Kingsoft Software Co. Ltd. ("Zhuhai Software"). The loans have no definite maturity date and Chengdu Interactive Entertainment may request repayment at any time. Weiqin Qiu and Peili Lei shall repay the loans by transferring the equity interest they hold in Kingsoft Qijian to Chengdu Interactive Entertainment or any person or entity as it may direct.

(ii) A shareholder voting agreement dated 30 March 2007 among Chengdu Interactive Entertainment, Weiqin Qiu, Peili Lei and Kingsoft Qijian, under which Weiqin Qiu and Peili Lei irrevocably entrusted all of their shareholder rights in Kingsoft Qijian to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Kingsoft Qijian.

(iii) A call option agreement dated 30 March 2007 among Weiqin Qiu, Peili Lei, Kingsoft Qijian and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, part or all of Weiqin Qiu's and Peili Lei's equity interest in Kingsoft Qijian at anytime, at a nominal amount subject to applicable PRC laws.

(iv) An equity pledge agreement dated 30 March 2007 among Weiqin Qiu, Peili Lei, Chengdu Interactive Entertainment and Kingsoft Qijian, pursuant to which Weiqin Qiu and Peili Lei pledged all of their equity interests in Kingsoft Qijian (and any increase in their capital contributions) in favor of Chengdu Interactive Entertainment as security for the performance of their respective obligations under the above loan agreement, the shareholder voting agreement and the call option agreement, the performance by Kingsoft Qijian of its obligations under the above shareholder voting agreement and the call option agreement, the performance by Chengdu Digital Entertainment of its obligations under the intellectual property license agreements (as described below in "Structure Contracts Relating to Chengdu Digital Entertainment" (v)) and the performance by Beijing Digital Entertainment of its obligations under the intellectual property license agreements (as described below).

(v) Zhuhai Software (as the licensor) and Beijing Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on 15 June 2007 for a term of 10 years from 1 January 2007 which will be automatically renewed for one year at the end of the term or any renewed term, unless the licensor notifies otherwise. Zhuhai Software agreed to enter into agreements to license certain intellectual property rights to Beijing Digital Entertainment on a case by case basis.

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

(i) A loan agreement dated 30 March 2007 between Weiqin Qiu and Chengdu Interactive Entertainment which provided for an interest free loan of RMB100,000 by Chengdu Interactive Entertainment to Weiqin Qiu entirely for the purpose of capital funding of Chengdu Digital Entertainment. The loan has no definite maturity date and Chengdu Interactive Entertainment may request repayment at any time. Weiqin Qiu shall repay the loan by transferring the equity interest she holds in Chengdu Digital Entertainment to Chengdu Interactive Entertainment or any person or entity nominated by Chengdu Interactive Entertainment.

(ii) A shareholder voting agreement dated 30 March 2007 among Chengdu Interactive Entertainment, Weiqin Qiu and Chengdu Digital Entertainment, under which Weiqin Qiu irrevocably entrusted all of her shareholder rights in Chengdu Digital Entertainment to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Chengdu Digital Entertainment.

(iii) A call option agreement dated 30 March 2007 among Weiqin Qiu, Chengdu Digital Entertainment and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, part or all of Weiqin Qiu's equity interest in Chengdu Digital Entertainment at any time, at a nominal amount subject to applicable PRC laws.

(iv) An equity pledge agreement dated 30 March 2007 among Weiqin Qiu, Chengdu Interactive Entertainment, Chengdu Digital Entertainment and Beijing Digital Entertainment, pursuant to which Weiqin Qiu pledged her 1% equity interest in Chengdu Digital Entertainment (and any increase in her capital contribution) in favor of Chengdu Interactive Entertainment as security for the performance of her obligations under the above loan agreement, shareholder voting agreement and call option agreement as well as the performance by Chengdu Digital Entertainment of its obligations under the above shareholder voting agreement, the call option agreement, and the intellectual property license agreements (as described below).

(v) Chengdu Interactive Entertainment (as the licensor) and Chengdu Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on 15 June 2007 for a term of 10 years from 1 January 2007 which will be automatically renewed for one year at the end of the term or any renewed term, unless the licensor notifies otherwise. Chengdu Interactive Entertainment agreed to enter into agreements to licence certain intellectual property rights to Chengdu Digital Entertainment.

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

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

- these structure contracts remain unchanged and are consistent with their disclosure in the prospectus of the Company dated 24 September 2007;
- no dividends or other distributions were made by Kingsoft Qijian, Beijing Digital Entertainment, or Chengdu Digital Entertainment to the holders of their equity interests for the year ended 31 December 2012; and
- the terms of such structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the shareholders and the Company as a whole.

### *Original Structure Contracts Relating to Zhuhai Qiwen*

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

(ii) A loan agreement dated 3 August 2010 among Weiqin Qiu, Jin Wang and Zhuhai Software which provided for interest free loans by Zhuhai Software of RMB60,000,000 to Weiqin Qiu and Jin Wang, entirely for the purpose of repaying the liabilities incurred by Weiqin Qiu and Jin Wang in acquiring the 88.235% equity interest in Zhuhai Qiwen. The loans have no definite maturity date and Zhuhai Software may request repayment at any time. Weiqin Qiu and Jin Wang shall, subject to the applicable laws, repay the loans by transferring the equity interest they hold in Zhuhai Qiwen to Zhuhai Software or as it may direct.

(iii) A shareholder voting entrustment agreement dated 8 February 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, under which Weiqin Qiu and Jin Wang irrevocably entrusted all of their shareholder rights in Zhuhai Qiwen to Zhuhai Software, including but not limited to the voting rights and the right to nominate directors of Zhuhai Qiwen.

(iv) A call option agreement dated 8 February 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, under which Zhuhai Software was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, part or all of Weiqin Qiu's and Jin Wang's equity interests in Zhuhai Qiwen at anytime, at a nominal amount subject to applicable PRC laws.

(v) An equity pledge agreement dated 8 February 2010 was entered into among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen, pursuant to which Weiqin Qiu and Jin Wang pledged all of their equity interests in Zhuhai Qiwen (and any increase in their capital contribution) in favor of Zhuhai Software as security for the performance of their obligations under the above loan agreement dated 8 February 2010, shareholder voting agreement and call option agreement, and the performance of the obligation by Zhuhai Kingsoft Application Software Co., Ltd. ("Zhuhai Kingsoft Application"), a domestic corporation wholly-owned by Zhuhai Qiwen, under the intellectual property license agreement (as described below).

(vi) An equity pledge agreement dated 3 August 2010 among Weiqin Qiu, Jin Wang, Zhuhai Software and Zhuhai Qiwen was entered into entered into following an increase of the authorized and paid-up capital of Zhuhai Qiwen, pursuant to which Weiqin Qiu and Jin Wang pledged all of their equity interests in Zhuhai Qiwen (and any increase in their capital contribution) in favor of Zhuhai Software as security for the performance of their obligations under the above loan agreements, shareholder voting agreement and call option agreement, and the performance by Zhuhai Kingsoft Application of its obligation under the intellectual property license agreement (as described below).

(vii) Zhuhai Software (as the licensor) and Zhuhai Kingsoft Application (as the licensee) entered into a framework intellectual property license agreement on 8 February 2010, for a term of 10 years from 22 October 2009 which will be automatically renewed for one year at the end of the term or any renewed term, unless the licensor notifies otherwise. Pursuant to the agreement, Zhuhai Software agreed to license certain intellectual property rights to and permitted Zhuhai Kingsoft Application to develop the value-added telecommunications services and other business as permitted by its scope of business.

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

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

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

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated 24 September 2007;
- no dividends or other distributions were made by Zhuhai Qiwen to the holders of their equity interest for the year ended 31 December 2012; and
- these structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the Company and its shareholders as a whole.

The said structure contracts in relation to Zhuhai Qiwen were recloned in 2011, the details of which are disclosed herein below.

### *Structure Contracts Relating to Conew Technology*

(i) Each of Sheng Fu and Ming Xu executed a power of attorney dated 25 August 2010 in favour of Conew Network Technology (Beijing) Co., Ltd. ("Conew Network"), under which each of Sheng Fu and Ming Xu irrevocably entrusted all his shareholder rights in Conew Technology to Conew Network, including but not limited to the voting rights and the right to nominate directors of Conew Technology.

(ii) A call option agreement dated 25 August 2010 was entered into between Sheng Fu and Conew Network, under which Conew Network was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, part or all of Sheng Fu's equity interest in Conew Technology at any time, at a nominal amount subject to applicable PRC laws.

(iii) A call option agreement dated 25 August 2010 was entered into between Ming Xu and Conew Network, under which Conew Network was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, part or all of Ming Xu's equity interest in Conew Technology at any time, at a nominal amount subject to applicable PRC laws.

(iv) An equity pledge agreement dated 25 August 2010 was entered into among Sheng Fu, Ming Xu and Conew Network, pursuant to which each of Sheng Fu and Ming Xu pledged all of their equity interests in Conew Technology (and any increase in their capital contributions) in favor of Conew Network as security for their obligations and Conew Technology's performance of its obligations under the above call option agreements, and the performance by Conew Technology of its obligations under the exclusive technology support and consultancy agreement (as described below) and the business operation agreement (as described below).

(v) Conew Network (as service provider) and Conew Technology entered into an exclusive technology support and consultancy agreement on 25 August 2010, commencing from 24 April 2009 for an indefinite term, unless otherwise terminated by either party in accordance with the terms of the agreement.

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

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

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

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

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated 24 September 2007;
- no dividends or other distributions were made by Conew Technology to the holders of their equity interest for the year ended 31 December 2012; and
- these structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the Company and its shareholders as a whole.

### *Structure Contracts Relating to Zhuhai Qiwen*

(i) Weiqin Qiu and each of the other 26 employees of our Group including Ke Ge, Qingyuan Zhang and Bin Xiao ("the 26 New Shareholders") entered into 26 equity transfer agreements on 30 November 2011, pursuant to which Weiqin Qiu transferred part of her equity interests in Zhuhai Qiwen to the 26 New Shareholders at the price calculated based on Weiqin Qiu's contribution amount in registered capital of Zhuhai Qiwen and percentage of the transferred equity interest to each of the 26 New Shareholders. In connection with the above equity transfer agreements, Weiqin Qiu, the 26 New Shareholders and Zhuhai Software entered into a debt assumption agreement on 30 November 2011, pursuant to which the 26 New Shareholders agreed to assume the liability of RMB13,957,896 which was the proportion liable to be paid by Weiqin Qiu to Zhuhai Software under the loan agreements dated 8 February 2010 and 3 August 2010 as a settlement for the transfer of 20.5263% registered capital in Zhuhai Qiwen from Weiqin Qiu.

(ii) Weiqin Qiu, Jin Wang and the 26 New Shareholders (collectively referred to as "New Shareholders") entered into a revised loan agreement ("New Loan Agreement") on 30 November 2011 to replace the loan agreements dated 8 February 2010 and 3 August 2010. Pursuant to the New Loan Agreement, Zhuhai Software provided interest free replacement loans of RMB68,000,000 to New Shareholders for the purpose of repaying the liability incurred by New Shareholders for the acquisition of the entire equity interests in Zhuhai Qiwen. The loans have no fixed maturity date, and Zhuhai Software may demand repayment at any time. Subject to the applicable laws, New Shareholders shall repay the loans by transferring their equity interests in Zhuhai Qiwen to Zhuhai Software or its designated third party.

(iii) New Shareholders, Zhuhai Software and Zhuhai Qiwen entered into a revised shareholder voting entrustment agreement on 30 November 2011 to replace the shareholder voting entrustment agreement ("New Shareholder Voting Agreement") dated 8 February 2010. Pursuant to the New Shareholder Voting Agreement, New Shareholders irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Zhuhai Qiwen) in Zhuhai Qiwen to any party designated by Zhuhai Software.

(iv) New Shareholders, Zhuhai Software and Zhuhai Qiwen entered into a call option agreement (the "New Call Option Agreement") on 30 November 2011 to replace the call option agreement dated 8 February 2010. Pursuant to the New Call Option Agreement, Zhuhai Software was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interests owned by New Shareholders in Zhuhai Qiwen at any time at an amount equal to the corresponding portion of liability borne by the respective New Shareholders under the New Loan Agreement.

(v) New Shareholders, Zhuhai Software and Zhuhai Qiwen entered into a revised equity pledge agreement (the "New Equity Pledge Agreement") on 30 November 2011 to replace the equity pledge agreement dated 8 February 2010 and 3 August 2010 respectively. Pursuant to the New Equity Pledge Agreement, New Shareholders agreed to pledge all equity interests they respectively held in Zhuhai Qiwen and any increase in capital contributions in favor of Zhuhai Software, as security for the performance of their obligations under the above New Loan Agreement, New Shareholder Voting Agreement and New Call Option Agreement dated 30 November 2011, and the performance of the obligations by Zhuhai Kingsoft Application under the intellectual property license agreement dated 8 February 2010.

(vi) Zhuhai Software, Beijing Kingsoft Office Software Co., Ltd. ("Beijing Office Software") and New Shareholders entered into a debt transfer agreement ("Debt Transfer Agreement") on 29 December 2011, pursuant to which Zhuhai Software transferred the loan in the amount of RMB68,000,000 receivable from New Shareholders under the New Loan Agreement to Beijing Office Software for a cash consideration of RMB68,000,000 and hence New Shareholders were liable to Beijing Office Software for a loan totaling RMB68,000,000.

(vii) In connection with the Debt Transfer Agreement, Zhuhai Software, Zhuhai Qiwen, New Shareholders and Zhuhai Kingsoft Application entered into a termination agreement on 29 December 2011, pursuant to which Zhuhai Software, Zhuhai Qiwen, New Shareholders and Zhuhai Kingsoft Application agreed to terminate the following agreements, including (1) New Loan Agreement; (2) New Shareholder Voting Agreement; (3) New Call Option Agreement; (4) New Equity Pledge Agreement, and (5) the intellectual property license agreement entered into between Zhuhai Software and Zhuhai Kingsoft Application on 8 February 2010.

(viii) New Shareholders and Beijing Office Software entered into a loan agreement on 29 December 2011 to specify the debt arrangements under the Debt Transfer Agreement, pursuant to which Beijing Office Software provided interest free loans of RMB68,000,000 to New Shareholders. The loans have no fixed maturity date, and Beijing Office Software may demand repayment at any time. Subject to the PRC laws, New Shareholders shall repay the loans by transferring their equity interests in Zhuhai Qiwen to Beijing Office Software or its designated third party.

(ix) New Shareholders, Beijing Office Software and Zhuhai Qiwen entered into a shareholder voting entrustment agreement on 29 December 2011, pursuant to which New Shareholders irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Zhuhai Qiwen) in Zhuhai Qiwen to such persons designated by Beijing Office Software.

(x) Beijing Office Software, New Shareholders and Zhuhai Qiwen entered into an exclusive option agreement on 29 December 2011, pursuant to which Beijing Office Software was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by New Shareholders in Zhuhai Qiwen at any time at an amount equal to the corresponding portion of liability borne by the respective New Shareholders under a loan agreement entered into on 29 December 2011 as stated in (viii) above.

(xi) Beijing Office Software (as the licensor) and Zhuhai Kingsoft Application (as the licensee) entered into an intellectual property license agreement on 29 December 2011 for a term of 10 years from the date of the agreement which will be automatically renewed for one year at the end of the term or any renewed term, unless Beijing Office Software notifies otherwise, pursuant to which Beijing Office Software agreed to license to Zhuhai Kingsoft Application certain intellectual property rights.

(xii) New Shareholders, Beijing Office Software and Zhuhai Qiwen entered into an equity pledge agreement on 29 December 2011, pursuant to which New Shareholders agreed to pledge all equity interests they respectively held in Zhuhai Qiwen and any increase in their capital contribution in favor of Beijing Office Software as security for the performance of contractual obligations by themselves and Zhuhai Kingsoft Application and the settlement in respect of the relevant guranteed debts. The contractual obligations referred herein represents all contractual obligations of the New Shareholders under the above Loan Agreement, the shareholder voting entrustment agreement, the exclusive option agreement and this equity pledge agreement dated 29 December 2011, as well as all contractual obligations under the intellectual property licence dated 29 December 2011 by Zhuhai Kingsoft Application and the license agreement of to be signed (hereinafter referred to as the "License Agreement"). The guranteed debts herein represents all direct, indirect, resulting loss and expected interest loss of Beijing Office Software arising from any default by New Shareholders, Zhuhai Qiwen or Zhuhai Kingsoft Application and all expenses generated by Beijing Office Software for enforcing mandatory performance of the contractual obligations by New Shareholders and Zhuhai Qiwen. The defaults herein represents the defaults in any contractual obligations by New Shareholders under the above loan agreement, shareholder voting entrustment agreement, exclusive option agreement and this equity pledge agreement dated 29 December 2011 as well as in any contractual obligations by Zhuhai Kingsoft Application under the License Agreement.

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

- these Zhuhai Qiwen structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated 24 September 2007.
- no dividends or any other distributions were made by Zhuhai Qiwen to the holders of its equity interest for the year ended 31 December 2012.
- the terms of such structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the shareholders and the Company as a whole.

### *Structure Contracts Relating to Shell Internet*

(i) Sheng Fu, Weiqin Qiu and Beijing Kingsoft Internet Security Software Co., Ltd. ("Beijing Security Software") entered into a loan agreement on 1 January 2011, pursuant to which Beijing Security Software provided interest free loans of RMB700,000 to Sheng Fu and Weiqin Qiu for repaying the liability incurred by Sheng Fu and Weiqin Qiu for the acquisition of the entire registered capital in Shell Internet. The loans have no fixed maturity date, and Beijing Security Software may demand repayment at any time. Subject to the PRC Laws, Sheng Fu and Weiqin Qiu shall repay the loans by transferring their equity interests in Shell Internet to Beijing Security Software or its designated third party.

(ii) Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into a shareholder voting entrustment agreement on 1 January 2011, pursuant to which Sheng Fu and Weiqin Qiu irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Shell Internet) in Shell Internet to such persons designated by Beijing Security Software.

(iii) Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into an exclusive option agreement on 1 January 2011, pursuant to which Beijing Security Software was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interests owned by Sheng Fu and Weiqin Qiu in Shell Internet at any time at a nominal amount subject to applicable PRC laws.

(iv) Beijing Security Software and Shell Internet entered into an exclusive technology development, support and consultation agreement on 1 January 2011, pursuant to which Beijing Security Software agreed to provide to Shell Internet exclusively and Shell Internet agreed to accept the technology development, support and consultation services exclusively provided by Beijing Security Software for an indefinite term unless otherwise terminated by both party in accordance with the terms of the agreement.

(v) Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into a business operation agreement on 1 January 2011, pursuant to which, Sheng Fu, Weiqin Qiu and Shell Internet will make relevant undertakings and guarantee to Beijing

Security Software for the daily operation of Shell Internet for a term of 10 years, unless otherwise terminated by Beijing Security Software, to ensure that Shell Internet would perform the obligations under the above exclusive technology development, support and consultation agreement entered into on the same date.

(vi) Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into an equity pledge agreement on 1 January 2011, pursuant to which, Sheng Fu and Weiqin Qiu agreed to pledge all equity interests they respectively held in Shell Internet and any increase in capital contributions in favor of Beijing Security Software, as security for the performance of their obligations under the above loan agreement, shareholder voting entrustment agreement, exclusive option agreement, exclusive technology development, support and consultation agreement and business operation agreement dated 1 January 2011. In order to comply with the State Administration of Industry and Commerce's requirements relating to equity pledge registration, upon the completion of share registration of Shell Internet, Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into further equity pledge agreement on 17 February 2011 with content substantially the same as the equity pledge agreement dated 1 January 2011.

### *Original Structure Contracts Relating to Zhuhai Online Game*

(i) Tao Zou, Feizhou Chen, Xi Liu and other parties (the "Borrowers") and Chengdu Westhouse Interactive Entertainment Co., Ltd. ("Chengdu Westhouse") entered into a loan agreement on 24 January 2011, pursuant to which Chengdu Westhouse provided interest free loans of RMB3,636,750 to the Borrowers for the purpose of repaying the liabilities incurred by the Borrowers for the acquisition of the 19.5% registered capital in Zhuhai Online Game. The loans have no fixed maturity date, and Chengdu Westhouse may demand repayment at any time. Subject to the PRC laws, the Borrowers shall repay the loans by transferring their equity interests in Zhuhai Online Game to Chengdu Westhouse or its designated third party.

(ii) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into a shareholder voting entrustment agreement on 24 January 2011, pursuant to which the Borrowers irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Zhuhai Online Game) in Zhuhai Online Game to such persons designated by Chengdu Westhouse.

(iii) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into an exclusive option agreement on 24 January 2011, pursuant to which Chengdu Westhouse was granted an irrevocable exclusive option to acquire, or designate third parties to acquire, all or part of the equity interests owned by the Borrowers in Zhuhai Online Game at any time at a nominal amount subject to applicable PRC laws.

(iv) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into an equity pledge agreement on 24 January 2011, pursuant to which the Borrowers agreed to pledge all equity interests they respectively held in Zhuhai Online Game and any increase in capital contributions in favor of Chengdu Westhouse, as security for the performance of their obligations under the above loan agreement, shareholder voting entrustment agreement and exclusive option agreement entered into on the same day.

The said structure contracts in relation to Zhuhai Online Game were recloned in 2012, the details of which are disclosed herein below.

The independent non-executive Directors have reviewed the structure contracts relating to Shell Internet and Zhuhai Online Game and have confirmed that:

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated 24 September 2007.
- no dividends or any other distributions to the holders of their equity interests were made by Shell Internet and Zhuhai Online Game for the year ended 31 December 2012.
- the terms of such structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the shareholders and the Company as a whole.

### *Structure Contracts Entered Into in the 2012 Financial Year*

In 2012, the Group entered into several sets of structure contracts with: (i) 北京金山網絡科技有限公司(Beijing Kingsoft Network Technology Co., Ltd. ("Beijing Network Technology"), Wei Liu and Ming Xu, existing employees of the Group; (ii) 珠海金山雲科技有限公司 (Zhuhai Cloud Technology Co., Ltd.) ("Zhuhai Cloud Technology"), Weiqin Qiu, the sister of Pak Kwan Kau, director of the Company, and Jin Wang, the husband of Weiqin Qiu, and 19 existing employees of the Group; (iii) 成都西山居世游科技有限公司 (Chengdu Westhouse Shiyou Technology Co., Ltd.) ("Chengdu Westhouse Shiyou"), 珠海西山居世游科技有限公司 (Zhuhai Westhouse Shiyou Technology Co., Ltd.) ("Zhuhai Westhouse Shiyou"), Tao Zou, executive Director of the Company, and Weiqin Qiu, the sister of Pak Kwan Kau, director of the Company; (iv) Shell Internet (Beijing) Security Technology Co., Ltd. ("Shell Internet") and its shareholders Sheng Fu, a substantial shareholder of a subsidiary of the Company, and Weiqin Qiu, the sister of our Director, Pak Kwan Kau, which is in relation to capital increase in Shell Internet; and (v) as part of the Group's internal restructuring, the Group has also recloned several structure contracts in relation to Zhuhai Online Game and entered into by 25 existing employees of the Group (including Tou Zou, the executive Director of the Company), enabling the Group to exercise its control over Beijing Network Technology, Zhuhai Cloud Technology, Zhuhai Westhouse Shiyou, Chengdu Westhouse Shiyou, Shell Internet and Zhuhai Online Game and consolidated these companies' financial results into the results of the Group. Such arrangements were substantially similar to the arrangement under the existing structure contracts relating to Kingsoft Qijian and Chengdu Digital Entertainment. Subject to the relevant disclosures in the annual report of the Company, cloning of structure contracts similar to those relating to Kingsoft Qijian and Chengdu Digital Entertainment will not be subject to the strict requirements of announcement and shareholders' approval under Chapter 14A of the Listing Rules.

### *Structure Contracts Relating to Beijing Network Technology*

(i) A loan agreement dated 20 June 2012 was entered into between Ming Xu, Wei Liu and Conew Network Technology (Beijing) Co., Ltd. ("Conew Network") which provided for interest free loans by Conew Network of RMB10,000,000 to Ming Xu and Wei Liu, entirely for the purpose of repaying the liabilities incurred by Ming Xu and Wei Liu in establishing the entire registered capital in Beijing Network Technology. The loans have no definite maturity date and Conew Network may request repayment at any time. Ming Xu and Wei Liu shall, subject to the PRC Laws, repay the loans by transferring the equity interest they hold in Beijing Network Technology to Conew Network or as it may direct.

(ii) Ming Xu, Wei Liu, Conew Network and Beijing Network Technology entered into a shareholder voting entrustment agreement on 18 July 2012, pursuant to which Ming Xu and Wei Liu irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Beijing Network Technology) in Beijing Network Technology to such persons designated by Conew Network.

(iii) Ming Xu, Wei Liu, Conew Network and Beijing Network Technology entered into an exclusive option agreement on 18 July 2012, pursuant to which Conew Network was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by Ming Xu and Wei Liu in Beijing Network Technology at any time at exercise price equal to the corresponding portion of liability of Conew Network borne by the respective existing shareholders under the loan agreement. However, if the lowest conversion price permitted by the PRC Laws is higher than the amounts of those liabilities, the conversion price shall be the lowest price permitted by the PRC Laws. Despite the above, the existing shareholders shall jointly waive the obligations of Conew Network for paying the shortfall in the case that the lowest price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC.

(iv) Conew Network and Beijing Network Technology entered into an exclusive technology development, support and consultation agreement on 18 July 2012, pursuant to which Conew Network agreed, on the terms, conditions and pricing as required by the agreement, to provide to Beijing Network Technology exclusively and Beijing Network Technology agreed to accept the technology development, support and consultation services exclusively provided by Conew Network for an indefinite term unless otherwise terminated by both parties in accordance with the terms of the agreement.

(v) Ming Xu, Wei Liu, Conew Network and Beijing Network Technology entered into a business operation agreement on 18 July 2012, pursuant to which, Ming Xu, Wei Liu and Beijing Network Technology will make relevant undertakings and guarantee to Conew Network for the daily operation of Beijing Network Technology for a term of 10 years, unless otherwise terminated by Conew Network, to ensure that Beijing Network Technology would perform the obligations under the above exclusive technology development, support and consultation agreement entered into on the same date.

(vi) Ming Xu, Wei Liu, Conew Network and Beijing Network Technology entered into an equity pledge agreement on 18 July 2012, pursuant to which, Ming Xu and Wei Liu agreed to pledge all equity interests they respectively held in Beijing Network Technology and any increase in capital contributions in favor of Conew Network, as security for the performance of their obligations specified in above (i) to (v) in respect of the loan agreement, shareholder voting entrustment agreement, exclusive option agreement, exclusive technology development, support and consultation agreement and business operation agreement.

### *Structure Contracts Relating to Zhuhai Cloud Technology*

(i) Weiqin Qiu, Jin Wang and Beijing Kingsoft Digital Entertainment Technology Co., Ltd. ("Beijing Digital Entertainment") entered into a loan agreement on 2 May 2012, pursuant to which Beijing Digital Entertainment provided interest free loans of RMB99,000 and RMB1,000 to Weiqin Qiu and Jin Wang respectively. The loans have no fixed maturity date, and Beijing Digital Entertainment may at any time demand repayment by transferring their equity interests in 珠海奇盾安全軟件有限公司 (Zhuhai Qi Dun Security Software Limited) (subsequently remaned as 珠海金山雲科技有限公司 (Zhuhai Cloud Technology Co., Ltd.) ("Zhuhai Cloud Technology")) to Beijing Digital Entertainment or its designated third party. Moreover, the ratio of the transferred equity interests in Zhuhai Cloud Technology to the equity interests in Zhuhai Cloud Technology held by these borrowers on the date of signing the loan agreement shall be the same as that of the requested repayment to the loans of these borrowers on the date of signing the loan agreement.

(ii) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into a shareholder voting entrustment agreement on 2 May 2012, pursuant to which Weiqin Qiu and Jin Wang irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to designate and nominate the senior management (such as executive directors and managers) of Zhuhai Cloud Technology) in Zhuhai Cloud Technology to Beijing Digital Entertainment.

(iii) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into an exclusive option agreement on 2 May 2012, pursuant to which Beijing Digital Entertainment was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by Weiqin Qiu and Jin Wang in Zhuhai Cloud Technology at any time. The exercise price shall equal to the corresponding portion of liability of Beijing Digital Entertainment borne by Weiqin Qiu and Jin Wang respectively under the above loan agreement. However, if the lowest conversion price permitted by the PRC Laws is higher than the amounts of those liabilities, the exercise price shall be the lowest price permitted by the PRC Laws. Despite the above, Weiqin Qiu and Jin Wang shall jointly waive the obligations of Beijing Digital Entertainment for paying the shortfall in the case that the lowest price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC.

(iv) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into an equity pledge agreement on 2 May 2012, pursuant to which, Weiqin Qiu and Jin Wang agreed to pledge all equity interests they respectively held in Zhuhai Cloud Technology and any increase in capital contributions in favor of Beijing Digital Entertainment, as security for the performance of their resepctive obligations under the above loan agreement, shareholder voting entrustment agreement and exclusive option agreement, and for the performance of obligations by Zhuhai Cloud Technology under the above shareholder voting entrustment agreement and exclusive option agreement.

(v) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into the restated and revised shareholder voting entrustment agreement on 12 June 2012, pursuant to which Weiqin Qiu and Jin Wang irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to designate and nominate the senior management (such as executive directors and managers) of Zhuhai Cloud Technology) in Zhuhai Cloud Technology to Beijing Digital Entertainment.

(vi) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into the restated and revised exclusive option agreement on 12 June 2012, pursuant to which Beijing Digital Entertainment was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by Weiqin Qiu and Jin Wang in Zhuhai Cloud Technology at any time. The exercise price shall equal to the corresponding portion of liability of Beijing Digital Entertainment borne by Weiqin Qiu and Jin Wang respectively under the above loan agreement. However, if the lowest conversion price permitted by the PRC Laws is higher than the amounts of those liabilities, the conversion price shall be the lowest price permitted by the PRC Laws. Despite the above, Weiqin Qiu and Jin Wang shall jointly waive the obligations of Beijing Digital Entertainment for paying the shortfall in the case that the lowest conversion price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC.

(vii) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and Zhuhai Cloud Technology entered into an equity pledge agreement on 12 June 2012, pursuant to which, Weiqin Qiu and Jin Wang agreed to pledge all equity interests they respectively held in Zhuhai Cloud Technology and any increase in capital contributions in favor of Beijing Digital Entertainment, as security for the performance of their respective obligations under the above loan agreement, shareholder voting entrustment agreement and exclusive option agreement, and for the performance of obligations by Zhuhai Cloud Technology under the above shareholder voting entrustment agreement and exclusive option agreement.

(viii) Weiqin Qiu, Jin Wang, Beijing Digital Entertainment and 北京金山雲科技有限公司 (Beijing Kingsoft Cloud Technology Co., Ltd.) ("Beijing Cloud Technology") entered into a debt assignment agreement on 9 November 2012, pursuant to which Beijing Digital Entertainment assigned the debts with an aggregate amount of RMB100,000 borne by Weiqin Qiu and Jin Wang to Beijing Cloud Technology, therefore, Beijing Cloud Technology owned the debts of an aggregate amount of RMB100,000 borne by Weiqin Qiu and Jin Wang.

(ix) Weiqin Qiu, Jin Wang and Beijing Cloud Technology entered into a loan agreement on 9 November 2012, pursuant to which Beijing Cloud Technology provided interest free loans of RMB99,000 and RMB1,000 to Weiqin Qiu and Jin Wang respectively. The loans have no fixed maturity date, and Beijing Cloud Technology may at any time demand repayment by transferring their equity interests in Zhuhai Cloud Technology to Beijing Cloud Technology or its designated third party. Moreover, the ratio of the transferred equity interests in Zhuhai Cloud Technology to the equity interests in Zhuhai Cloud Technology held by these borrowers on the date of signing the loan agreement shall be the same as that of the requested repayment to the loans of these borrowers on the date of signing the loan agreement.

(x) Weiqin Qiu, Jin Wang, 19 existing employees of the Group, Beijing Digital Entertainment (the above 21 natural persons and Beijing Digital Entertainment, collectively referred to as "All Shareholders of Zhuhai Cloud Technology"), Zhuhai Cloud Technology and Beijing Cloud Technology entered into a shareholder voting entrustment agreement on 9 November 2012, pursuant to which All Shareholders of Zhuhai Cloud Technology irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to designate and nominate the senior management (such as executive directors and managers) of Zhuhai Cloud Technology) in Zhuhai Cloud Technology to Beijing Cloud Technology.

(xi) All Shareholders of Zhuhai Cloud Technology, Zhuhai Cloud Technology and Beijing Cloud Technology entered into an exclusive option agreement on 9 November 2012, pursuant to which Beijing Cloud Technology was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by All Shareholders of Zhuhai Cloud Technology in Zhuhai Cloud Technology at any time. The exercise price in respect of the equity interests of Weiqin Qiu and Jin Wang shall equal to the corresponding portion of liability of Beijing Digital Entertainment borne by Weiqin Qiu and Jin Wang respectively under the above loan agreement. However, if the lowest conversion price permitted by the PRC Laws is higher than the amounts of those liabilities, the conversion price shall be the lowest price permitted by the PRC Laws. Despite the above, Weiqin Qiu and Jin Wang shall jointly waive the obligations of Kingsoft Digital

Entertainment for paying the shortfall in the case that the lowest conversion price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC. The exercise price in respect of equity interests of shareholders other than Weiqin Qiu and Jin Wang shall be RMB1(one). However, if there are any mandatory requirements imposed by the PRC Laws in respect of the conversion price, the conversion price shall be the lowest price permitted by the PRC Laws. Despite the above, the existing shareholders shall jointly waive the obligations of Beijing Cloud Technology for paying the shortfall in the case that the lowest conversion price permitted by the PRC Laws is higher than RMB1(one), subject to the laws and regulations of the PRC.

(xii) All Shareholders of Zhuhai Cloud Technology, Zhuhai Cloud Technology and Beijing Cloud Technology entered into an equity pledge agreement on 9 November 2012, pursuant to which, All Shareholders of Zhuhai Cloud Technology, agreed to pledge all equity interests they respectively held in Zhuhai Cloud Technology and any increase in capital contributions in favor of Beijing Cloud Technology, as security for the performance of their respective obligations under the above loan agreement, shareholder voting entrustment agreement and exclusive option agreement, for the performance of obligations by Zhuhai Cloud Technology under the above shareholder voting entrustment agreement and exclusive option agreement, and for the performance of obligations by 北京金山雲網絡技術有限公司 (Beijing Kingsoft Cloud Network Technology Co., Ltd.) ("Beijing Cloud Network") which is wholly owned by Zhuhai Cloud Technology under the exclusive consultation and technological services agreement.

(xiii) Beijing Cloud Network and Beijing Cloud Technology entered into an exclusive consultation and technological services agreement on 9 November 2012, pursuant to which Beijing Cloud Technology provided exclusive services related to the business of Beijing Cloud Network to Beijing Cloud Network and Beijing Cloud Network shall pay the service fee to Beijing Cloud Technology on an annual basis. The relevant service fees shall be comprised of the results service fee (the remaining 100% of business income of Beijing Cloud Network for the year, net of the mutually agreed business cost of Beijing Cloud Network) and the mutually-agreed service fee (for the specified consultation services and technology services provided by Beijing Cloud Technology at the request of Beijing Cloud Network from time to time). Beijing Cloud Technology shall be entitled to the rights to adjust the above service fees at its discretion.

### *Structure Contracts Relating to Zhuhai Westhouse Shiyou and Chengdu Westhouse Shiyou*

(i) Tao Zou, Weiqin Qiu and Chengdu Westhouse entered into a loan agreement on 3 September 2012, pursuant to which Chengdu Westhouse provided interest free loans of RMB10,000,000 to Tao Zou and Weiqin Qiu for repaying the liability incurred by Tao Zou and Weiqin Qiu for the acquisition of the entire registered capital in Zhuhai Westhouse Shiyou. The loans have no fixed maturity date, and Chengdu Westhouse may demand repayment at any time. Subject to the PRC Laws, Tao Zou and Weiqin Qiu shall repay the loans by transferring their equity interests in Zhuhai Westhouse Shiyou to Chengdu Westhouse or its designated third party.

(ii) Tao Zou, Weiqin Qiu, Chengdu Westhouse and Zhuhai Westhouse Shiyou entered into a shareholder voting entrustment agreement on 3 September 2012, pursuant to which Tao Zou and Weiqin Qiu irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Zhuhai Westhouse Shiyou) in Zhuhai Westhouse Shiyou to such persons designated by Chengdu Westhouse.

(iii) Tao Zou, Weiqin Qiu, Chengdu Westhouse and Zhuhai Westhouse Shiyou entered into an exclusive option agreement on 3 September 2012, pursuant to which Chengdu Westhouse was granted an irrevocable exclusive option to acquire, or designate a third party to acquire, all or part of the equity interest owned by Tao Zou and Weiqin Qiu in Zhuhai Westhouse Shiyou at any time at an exercise price equal to the corresponding portion of liability of Chengdu Westhouse borne by Tao Zou and Weiqin Qiu under the loan agreement. However, if the lowest conversion price permitted by the PRC Laws is higher than the amounts of those liabilities, the exercise price shall be the lowest price permitted by the PRC Laws. Despite the above, Tao Zou and Weiqin Qiu shall jointly waive the obligations of Chengdu Westhouse for paying the shortfall in the case that the lowest price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC. When the option is exercised by Chengdu Westhouse, Chengdu Westhouse is entitled to the rights to pay the exercise price by directly waiving the corresponding portion of liability of Chengdu Westhouse borne by Tao Zou and Weiqin Qiu. The ratio of the waived liability of Tao Zou and Weiqin Qiu to their total liabilities shall be the same as that of the transferred equity interest held by Tao Zou and Weiqin Qiu to their total equity interest in Zhuhai Westhouse Shiyou.

(iv) Chengdu Westhouse and Chengdu Westhouse Shiyou entered into an exclusive technology development, support and consultation agreement on 3 September 2012, pursuant to which Chengdu Westhouse agreed, on the terms, conditions and pricing as required by the agreement, to provide to Chengdu Westhouse Shiyou exclusively and Chengdu Westhouse Shiyou agreed to accept the technology development, support and consultation services exclusively provided by Chengdu Westhouse for an indefinite term unless otherwise terminated by Chengdu Westhouse in accordance with the terms of the agreement.

(v) Tao Zou, Weiqin Qiu, Zhuhai Westhouse Shiyou, Chengdu Westhouse Shiyou and Chengdu Westhouse entered into a business operation agreement on 3 September 2012, pursuant to which, Tao Zou, Weiqin Qiu, Zhuhai Westhouse Shiyou and Chengdu Westhouse Shiyou will make relevant undertakings and guarantee to Chengdu Westhouse for the daily operation of Chengdu Westhouse Shiyou for a term of 10 years, unless otherwise terminated by Chengdu Westhouse, to ensure that Chengdu Westhouse Shiyou would perform the obligations under the above exclusive technology development, support and consultation agreement entered into on the same date.

(vi) Tao Zou, Weiqin Qiu, Zhuhai Westhouse Shiyou and Chengdu Westhouse entered into an equity pledge agreement on 3 September 2012, pursuant to which, Tao Zou and Weiqin Qiu agreed to pledge all equity interests they respectively held in Zhuhai Westhouse Shiyou and any increase in capital contributions in favor of Chengdu Westhouse, and granted the priority of pledge compensation while Zhuhai Westhouse Shiyou agreed to utilise these equity pledge arrangement as a security for the performance of their obligations under the above loan agreement, shareholder voting entrustment agreement, exclusive option agreement, exclusive technology development, support and consultation agreement and business operation agreement dated 3 September 2012 and the settlement in respect of the relevant guranteed debts. Guranteed debts represents all direct, indirect, resulting loss and expected interest loss arising from any default by Tao Zou, Weiqin Qiu, Zhuhai Westhouse Shiyou and Chengdu Westhouse Shiyou, and all expenses generated by Chengdu Westhouse for enforcing mandatory performance of all agreed obligations by Tao Zou, Weiqin Qiu, Zhuhai Westhouse Shiyou under the above loan agreement, shareholder voting entrustment agreement, exclusive option agreement, exclusive technology development, support and consultation agreement and business operation agreement all dated 3 September 2012.

### *Structure Contracts Relating to Shell Internet*

(i) Sheng Fu, Weiqin Qiu and Beijing Kingsoft Internet Security Software Co., Ltd. ("Beijing Security Software") entered into a loan agreement on 21 September 2012, pursuant to which Beijing Security Software provided interest free loans of RMB6,500,000 to Sheng Fu and Weiqin Qiu for repaying the liability incurred by Sheng Fu and Weiqin Qiu for the increase of the entire registered capital in Shell Internet. The loans have no fixed maturity date, and Beijing Security Software may demand repayment at any time. Subject to the PRC Laws, Sheng Fu and Weiqin Qiu shall repay the loans by transferring their equity interests in Shell Internet to Beijing Security Software or its designated third party.

(ii) Sheng Fu, Weiqin Qiu, Beijing Security Software and Shell Internet entered into a supplementary equity pledge agreement on 11 October 2012, pursuant to which, Sheng Fu and Weiqin Qiu agreed to pledge all equity interests they respectively held in Shell Internet and any increase in capital contributions in favor of Beijing Security Software, as security for the performance of their obligations under the above loan agreement dated 21 September 2012, and loan agreement, shareholder voting entrustment agreement, exclusive option agreement, exclusive technology development, support and consultation agreement and business operation agreement dated 1 January 2011.

### *Structure Contracts Relating to Zhuhai Online Game*

(i) Tao Zou, Feizhou Chen, Xi Liu, etc. (the "Borrowers") and Chengdu Westhouse entered into a loan agreement on 24 January 2011. Yi Hu and Zhi Gang Ni (the "Additional Borrowers"), Borrowers and Chengdu Westhouse entered into a supplementary loan agreement 1 on 31 August 2012. Since the 2 former employees of the Group transferred their entire equity interest held in Zhuhai Online Game, thus all their rights and obligations under the loan agreement was transferred to the respective transferees who accepted the equity interest transfer, therefore, Chengdu Westhouse provided interest free loans of RMB3,487,550 to the Borrowers (other than the 2 former employees of the Group) and the Additional Borrowers for the purpose of repaying the liabilities incurred by the Borrowers (other than the 2 former employees of the Group) and the Additional Borrowers for the acquisition of the 18.7% registered capital in Zhuhai Online Game. The loans have no fixed maturity date, and Chengdu Westhouse may demand repayment at any time. Subject to the PRC laws, the Borrowers and the Additional Borrowers shall repay the loans by transferring their equity interests in Zhuhai Online Game to Chengdu Westhouse or its designated third party.

(ii) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into a shareholder voting entrustment agreement on 24 January 2011. The Borrowers, the Additional Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into a supplementary shareholder voting entrustment agreement 1 on 31 August 2012, pursuant to which the Borrowers (other than the 2 former employees of the Group) and the Additional Borrowers irrevocably entrusted their shareholder rights (including but not limited to the voting rights and the right to nominate executive directors of Zhuhai Online Game) in Zhuhai Online Game to persons designated by Chengdu Westhouse.

(iii) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into an exclusive option agreement on 24 January 2011. The Borrowers, the Additional Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into a supplementary exclusive option agreement 1 on 31 August 2012, pursuant to which Chengdu Westhouse was granted an irrevocable exclusive option to acquire, or designate third parties to acquire, all or part of the equity interests owned by the Borrowers and the Additional Borrowers in Zhuhai Online Game at anytime at an exercise price equal to the corresponding portion of liability of Chengdu Westhouse borne by the respective Borrowers and the Additional Borrowers under the exclusive option agreement and the supplementary exclusive option agreement 1. However, if the lowest exercise price permitted by the PRC Laws is higher than the amounts of those liabilities, the exercise price shall be the lowest price permitted by the PRC Laws. Despite the above, the Borrowers and the Additional Borrowers shall jointly waive the obligations of Chengdu Westhouse for paying the shortfall in the case that the lowest exercise price permitted by the PRC Laws is higher than the portion of liability, subject to the laws and regulations of the PRC. When the option is exercised by Chengdu Westhouse, Chengdu Westhouse is entitled to the rights to pay the exercise price by directly waiving the corresponding portion of liability of Chengdu Westhouse borne by the Borrowers and the Additional Borrowers. The ratio of the waived liability of the Borrowers and the Additional Borrowers to their total liabilities shall be the same as that of the transferred equity interests held by the Borrowers and the Additional Borrowers to their total equity interest in Zhuhai Online Game.

(iv) The Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into an equity pledge agreement on 24 January 2011. The Borrowers, the Additional Borrowers, Chengdu Westhouse and Zhuhai Online Game entered into a supplementary equity pledge agreement 1 on 31 August 2012, pursuant to which the Borrowers (other than the 2 former employees of the Group) and the Additional Borrowers agreed to pledge all equity interests they respectively held in Zhuhai Online Game and any increase in capital contributions in favor of Chengdu Westhouse, as security for the performance of their obligations under the above loan agreement and/or supplementary loan agreement 1, shareholder voting entrustment agreement and/or supplementary shareholder voting entrustment agreement 1, exclusive option agreement and/or supplementary exclusive option agreement 1.

The independent non-executive Directors have reviewed the structure contracts relating to Beijing Network Technology, Zhuhai Cloud Technology, Zhuhai Online Game, Shell Internet, Zhuhai Westhouse Shiyou and Chengdu Westhouse Shiyou, and have confirmed that:

- these structure contracts are similar and consistent with those as disclosed in the prospectus of the Company dated 24 September 2007.
- no dividends or any other distributions to the holders of their equity interests were made by Beijing Network Technology, Zhuhai Cloud Technology, Zhuhai Online Game, Shell Internet, Zhuhai Westhouse Shiyou, Chengdu Westhouse Shiyou for the year ended 31 December 2012.
- the terms of such structure contracts are fair and reasonable so far as the Group is concerned and in the interests of the shareholders and the Company as a whole.

### 3. Continuing Connected Transactions and Continuing Transactions

#### Continuing Connected Transactions

*Transactions between KIS and Tencent Shenzhen*

On 27 September 2012, Kingsoft Internet Security Software Holdings Limited ("KIS"), a subsidiary of the Company, entered into a framework agreement ("Tencent Framework Agreement") with Shenzhen Tencent Computer Systems Company Limited (深圳市騰訊計算機系統有限公司, "Tencent Shenzhen"), a subsidiary of Tencent Holdings Limited ("Tencent"), pursuant to which, KIS and its subsidiaries would provide various marketing platforms and channels to Tencent and its subsidiaries ("Tencent Group") for the promotion of Tencent Group's internet services and products, thereby receiving relevant income and enhancing the returns of the Group. The price will be based on 1) the prevailing fair market pricing practice and pricing policy adopted by independent third parties among industry participants for similar transactions; and if no such pricing information is available; 2) the actual cost incurred thereof plus a reasonable profit margin, such profit margin will be made reference to the profit margin of products with similar nature/function in historical transactions of the Group conducted with independent third parties and/or connect persons, whichever is more favourable to the Company. The pricing of services and products provided by KIS and its subsidiaries to Tencent Group should be no less favourable than the terms of services and products offered by KIS and its subsidiaries to independent third parties. KIS and its subsidiaries will adopt relevant supervision and internal control procedures to ensure that the pricing basis for each of the transactions of services and products are carried out in accordance with the above terms. The payment terms will be settled with reference to the similar payment terms of the respective transactions' practice among industry participants during the transaction period. Shell Internet and Beijing Security Software mentioned below are both subsidiaries of KIS.

The term of Tencent Framework Agreement commenced from 1 January 2012 to 31 December 2013. The annual cap for the year ended 31 December 2012 and 31 December 2013 is RMB120 million and RMB200 million respectively. The transactions mentioned below, Shell Internet Transaction (relevant announcements were issued by the Company on 15 February 2012, 18 July 2012 and 7 August 2012) and Beijing Security Software Marketing Platform Service (relevant announcement was issued by the Company on 30 March 2012), will be covered within the Tencent Framework Agreement. The annual caps of the transactions below, Shell Internet Transaction and Beijing Security Software Marketing Platform Service, for the year ended 31 December 2012 will be replaced by the annual cap set under the Tencent Framework Agreement.

For the year ened 31 December 2012, the actual amount of the transactions conducted pursuant to the agreement above is RMB69.40 million.

Tencent is a substantial shareholder of the Company by virtue of its shareholding interest that exceeds 10% in the total issued share capital of the Company. Tencent is therefore, a connected person of the Company under the Listing Rules. As a result, the services provided by KIS and its subsidiaries and the service fees received from Tencent Group under the Tencent Framework Agreement constitute continuing connected transactions of the Company. As the relevant applicable percentage ratios in respect of the annual caps of the transactions under the Tencent Framework Agreement are higher than 5%, the Tencent Framework Agreement and the transactions contemplated thereunder are subject to the reporting, announcement and independent shareholders' approval requirements under rule 14A.35 of the Listing Rules. The Company issued an announcement on 27 September 2012 and convened an extraordinary general meeting on 17 October 2012, the Tencent Framework Agreement and the transactions contemplated thereunder are approved by the shareholders of the Company.

Shell Internet Transaction and Beijing Security Software Marketing Platform Service covered within the Tencent Framework Agreement:

### *(i) Shell Internet Transaction*

On 15 February 2012, Shell Internet (Beijing) Security Technology Co., Ltd. ("Shell Internet"), a subsidiary of the Company, entered into an agreement ("Tencent Agreement") with Tencent Shenzhen, a subsidiary of Tencent, pursuant to which, Shell Internet would incoporate Tencent Shenzhen's search engine on Shell Internet's websites to provide Tencent Shenzhen with search interface ("Shell Internet Transaction"). The original agreement and supplemental agreement signed between Shell Internet and Tencent Shenzhen in 2011 in regard of this business cooperation were terminated on 31 December 2011. Shell Internet will calculate the monthly service charge to be received based on market price and the average daily search volume created from Shell Internet's websites as a return for such services.

The term of the Tencent Agreement would be from 1 January 2012 to 31 December 2012, with a relevant annual cap of RMB18 million for the year ended 31 December 2012. The annual cap is determined based on the monthly expected number of search by users of Shell Internet's relevant websites.

Tencent is a substantial shareholder of the Company, and therefore a connected person of the Company under the Listing Rules. As a result, the transactions contemplated under the Tencent Agreement constituted continuing transactions of the Company and in respect of which an announcement was published on 15 February 2012 by the Company.

On 18 July 2012, taking into account the estimated increase in the recent monthly search volume created from Shell Internet's websites and softwares, the Directors considered that it would exceed the original annual cap under the Tencent Agreement. After considering the currently available data, the Directors revised the annual cap for the year ended 31 December 2012 under the Tencent Agreement to RMB50 million. Save for the revision to the annual cap for the year ended 31 December 2012, all other terms and conditions of the Tencent Agreement remain unchanged. An announcement was issued on 18 July 2012 by the Company in this regard. On 7 August 2012, Shell Internet and Tencent Shenzhen entered into a supplemental agreement to extend the term of Tencent Agreement to 31 January 2013 and in respect of which an announcement was issued on 7 August 2012 by the Company.

### *(ii) Beijing Security Software Marketing Platform Service*

On 12 December 2011, Beijing Kingsoft Internet Security Software Co., Ltd. ("Beijing Security Software") entered into an agreement with Tencent Shenzhen ("Marketing Platform Service Agreement"), pursuant to which, Beijing Security Software would provide its marketing platform to Tencent Shenzhen ("Beijing Security Software Marketing Platform Service"). In turn, Beijing Security Software would charge a monthly service fee calculated based on the total monthly installation volume of Tencent's software.

The term of the Marketing Platform Service Agreement would be from 17 October 2011 to 17 October 2012, extendable upon request by either party and agreement by both parties. The actual amount for transactions conducted pursuant to the Marketing Platform Service Agreement for the period ended 31 December 2011 was RMB0.22 million. The relevant annual cap set for the period from 1 January 2012 to 17 October 2012 was RMB2 million, which was determined with reference to the historical transaction amount of the Company.

Tencent is a substantial shareholder of the Company and was therefore a connected person of the Company under the Listing Rules. As a result, the transactions contemplated under the Marketing Platform Service Agreement constituted continuing connected transactions, and in respect of which an announcement was published on 30 March 2012.

### *Beijing Xiaomi Cell Phone Supply Agreement*

On 24 May 2012, Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment"), a wholly owned subsidiary of the Company, entered into an agreement with Beijing Xiaomi Technology Co., Ltd. ("Beijing Xiaomi") in relation to the sale and purchase of smart cell phone and cell phone accessories, pursuant to which, Chengdu Digital Entertainment shall purchase smart cell phones and cell phone accessories from Beijing Xiaomi.

The term of the agreement would be from 1 January 2012 and expired on 31 December 2012. The annual cap set for the period ended 31 December 2012 was RMB8 million, which was determined mainly based on the expected growth of marketing promotion expense in relation to the expected business growth of Chengdu Digital Entertainment.

For the year ended 31 December 2012, the actual amount for transactions conducted pursuant to the agreement above was RMB5.28 million.

Beijing Xiaomi is an associate of Jun Lei, a director and substantial shareholder of the Company and therefore a connected person of the Company under the Listing Rules. As a result, the transactions contemplated under the agreement constituted continuing connected transactions of the Company and in respect of which an announcement was published on 24 May 2012.

### *Kingsoft Japan Framework Agreement*

On 28 December 2012, Kingsoft Japan Inc. ("Kingsoft Japan") entered into a framework agreement with Mobile In Style Inc. ("Mobile In Style"), pursuant to which, Kingsoft Japan would cooperate with Mobile In Style to leverage on the sales channel of both Kingsoft Japan and Mobile In Style in order to cross market each other's products and services, would provide loan and guarantee services to Mobile In Style and cooperate in terms of software development services.

According to the agreement, the term of KJ Sales Agency Services, MIS Sales Agency Services, Loan Services and Guarantee Services would be from 28 December 2012 to 31 December 2014; while the term of KJ Software Development Services and MIS Software Development Services would be from 1 January 2013 to 31 December 2014.

The proposed annual caps for KJ Sales Agency Services for the year ended 31 December 2012, 31 December 2013 and 31 December 2014 are JPY30 million, JPY60 million and JPY60 million respectively; the proposed annual caps for KJ Software Development Services for the year ended 31 December 2013 and 31 December 2014 are JPY30 million and JPY30 million respectively; the proposed annual caps for Loan Services for the year ended 31 December 2012, 31 December 2013 and 31 December 2014 are JPY300 million, JPY300 million and JPY300 million respectively; the proposed annual caps for Guarantee Services for the year ended 31 December 2012, 31 December 2013 and 31 December 2014 are JPY300 million, JPY300 million and JPY300 million respectively; the proposed annual caps for MIS Sales Agency Services for the year ended 31 December 2012, 31 December 2013 and 31 December 2014 are JPY30 million, JPY50 million and JPY50 million respectively; the proposed annual caps for MIS Software Development Services for the year ended 31 December 2013 and 31 December 2014 are JPY20 million and JPY20 million respectively.

For the year ended 31 December 2012, the actual amount of the transactions of loan service conducted under the agreement above is RMB18.26 million (approximately JPY248.27 million), the actual amount of MIS sales agency service is RMB0.66 million (approximately JPY8.97 million), and the actual amount of KJ Sales Agency Services is RMB0.33 million (approximately JPY4.49 million).

Kingsoft Japan is a 51% owned subsidiary of the Company and Mobile In Style is a 85% owned subsidiary of Kingsoft Japan. As Jun Lei, a non-executive director, is interested in 15% of Mobile In Style through Xiaomi Technology Co., Limited, an associate of Jun Lei, Mobile In Style is a connected person of the Company. As a result, the transactions contemplated under the framework agreement between Kingsoft Japan and Mobile In Style constituted continuing connected transactions of the Company and in respect of which an announcement was published on 28 December 2012.

## Continuing Transactions

### *Continuing Transactions Relating to KIS and its subsidiary*

Reference is made to the announcement of the Company dated 16 March 2012. Kingsoft Internet Security Software Holdings Limited ("KIS") and its subsidiaries ("KIS Sub-group") are the subsidicaries of the Group. As Tencent held approximately 10% of the then issued share capital of KIS, and was also a substantial shareholder and a connected person at the level of the Company, KIS Sub-group would become connected persons of the Company pursuant to Rule 14A.11(5) of the Listing Rules. The agreements entered into between KIS Sub-group and the other members of the Group in respect of various aspects of the operations in the ordinary and usual course of business of the Group may constitute continuing connected transactions. An announcement was issued on 16 March 2012 in this regard, and relevant disclosures had been made in the 2011 annual report. Soon after the announcement was released, KIS issued news shares to the Company after which Tencent's holding in KIS was below 10% and Tencent was no longer a substantial shareholder of KIS, hence KIS Sub-group would no longer be considered connected persons of the Company. The possible continuing connected transactions within the Group between KIS Sub-group and other members of the Group would no longer be considered connected transactions.

In respect of the above continuing connected transactions and continuing transactions of the Group, the independent non-executive Directors have reviewed the related agreements and transactions contemplated thereunder and confirmed that these transactions were:

(i) entered into in the ordinary and usual course of the business of the Group;

(ii) conducted on normal commercial terms or on terms no less favourable to the Group than the terms available to or from independent third parties;

(iii) entered into in accordance with the terms of respective agreements and were fair and reasonable and in the interests of the Company and its shareholders as a whole; and

(iv) the aggregate annual amounts were within the relevant annual caps (if any).

Ernst & Young, the Company's auditors, were engaged to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. Ernst & Young have issued their unqualified letter containing their findings and conclusions in respect of the continuing connected transactions disclosed above by the Group in accordance with Rule 14A.38 of the Listing Rules. A copy of the auditors' letter has been provided by the Company to the Hong Kong Stock Exchange.

### *Related Party Transactions*

Details of the related party transactions for the year are set out in note 38 to the financial statements. Certain related party transactions disclosed in note 38 to the financial statements also constitute connected transactions or continuing connected transactions as disclosed above. The transactions between connected persons and the Group as shown above have been entered into and/or are ongoing during the year and the Company had made relevant disclosures to the extent required in accordance with the requirements of the Listing Rules.

## Compliance with the Code on Corporate Governance Practice

During the year ended 31 December 2012, the Company complied with all code provisions of the Code on Corporate Governance Practices contained in Appendix 14 of the Listing Rules with the exception of the deviation from code provision A.6.7 and C1.2. Please also refer to the Corporate Governance Report on page 18 of this annual report for full details.

## Auditors

The consolidated financial statements of the Company for the year ended 31 December 2012 have been audited by Ernst & Young, who will retire and, being eligible, offer themselves for reappointment at our forthcoming AGM.

## Pre-Emptive Rights

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

By order of the Board
**Jun Lei**
*Chairman*
The PRC, 19 March 2013

# INDEPENDENT AUDITORS' REPORT

**ERNST & YOUNG**
**安 永**

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

We have audited the consolidated financial statements of Kingsoft Corporation Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 59 to 152, which comprise the consolidated and company statements of financial position as at 31 December 2012, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

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

**AUDITORS' RESPONSIBILITY**

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

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

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

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

**OPINION**

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2012, and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**Ernst & Young**
*Certified Public Accountants*
22/F CITIC Tower
1 Tim Mei Avenue
Central, Hong Kong

19 March 2013

# CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2012

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **REVENUE** | 5 | **1,411,161** | 1,020,508 |
| Cost of revenue | | **(186,939)** | (147,812) |
| Gross profit | | **1,224,222** | 872,696 |
| Research and development costs, net of government grants | | **(385,409)** | (303,848) |
| Selling and distribution expenses | | **(234,115)** | (125,873) |
| Administrative expenses | | **(147,954)** | (127,498) |
| Share-based compensation costs | 6 | **(48,472)** | (17,266) |
| Other income and gains | 5 | **28,609** | 44,051 |
| Other expenses | 6 | **(22,971)** | (10,747) |
| Fair value gain/(loss) on a financial asset at fair value through profit or loss | 21 | **16,010** | (1,973) |
| Finance income | 6 | **97,973** | 65,130 |
| Finance costs | 6 | **(8,702)** | (3,461) |
| Share of profits and losses of: | | | |
| Jointly-controlled entities | 18 | **9,532** | (1,945) |
| Associates | 19 | **(930)** | (4,070) |
| **PROFIT BEFORE TAX** | 6 | **527,793** | 385,196 |
| Income tax expense | 9 | **(61,359)** | (50,162) |
| **PROFIT FOR THE YEAR** | | **466,434** | 335,034 |
| Attributable to: | | | |
| Owners of the parent | | **432,589** | 324,729 |
| Non-controlling interests | | **33,845** | 10,305 |
| | | **466,434** | 335,034 |
| | | **RMB** | RMB |
| **EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT** | 12 | | |
| Basic | | **37.85 cents** | 28.86 cents |
| Diluted | | **37.15 cents** | 27.90 cents |

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

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2012

| | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|---|---|
| **PROFIT FOR THE YEAR** | **466,434** | 335,034 |
| **OTHER COMPREHENSIVE LOSS:** | | |
| Exchange differences on translation of foreign operations | **(5,613)** | (3,885) |
| **OTHER COMPREHENSIVE LOSS FOR THE YEAR, NET OF TAX** | **(5,613)** | (3,885) |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | **460,821** | 331,149 |
| Attributable to: | | |
| Owners of the parent | **429,251** | 321,339 |
| Non-controlling interests | **31,570** | 9,810 |
| | **460,821** | 331,149 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 December 2012

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| Property, plant and equipment | 13 | **371,213** | 395,328 |
| Lease prepayments | 14 | **43,201** | 44,142 |
| Goodwill | 15 | **14,559** | 14,559 |
| Other intangible assets | 16 | **53,261** | 68,170 |
| Long-term prepayment | 17 | **—** | 80,109 |
| Investments in jointly-controlled entities | 18 | **20,122** | 10,622 |
| Investments in associates | 19 | **—** | 930 |
| Available-for-sale investments | 20 | **7,182** | 4,990 |
| Other financial asset | 21 | **27,822** | 11,812 |
| Loan receivables | 22 | **5,864** | 4,500 |
| Deferred tax assets | 9 | **32,962** | 27,547 |
| Total non-current assets | | **576,186** | 662,709 |
| **CURRENT ASSETS** | | | |
| Inventories | 23 | **17,006** | 3,311 |
| Trade receivables | 24 | **130,346** | 80,366 |
| Prepayments, deposits and other receivables | 25 | **120,476** | 90,956 |
| Due from related parties | 38 | **161,262** | 137,502 |
| Deferred cost | | **113** | 905 |
| Pledged deposit | 26 | **19,000** | 85,000 |
| Cash and cash equivalents | 26 | **2,416,259** | 1,953,770 |
| | | **2,864,462** | 2,351,810 |
| Assets of a disposal group classified as held for sale | 27 | **200,621** | — |
| Total current assets | | **3,065,083** | 2,351,810 |
| **CURRENT LIABILITIES** | | | |
| Trade payables | 28 | **23,089** | 16,568 |
| Interest-bearing bank loans | 29 | **413,559** | 346,655 |
| Other payables and accruals | 30 | **298,827** | 219,400 |
| Deferred revenue | 31 | **185,462** | 161,210 |
| Income tax payable | | **11,022** | 17,221 |
| | | **931,959** | 761,054 |
| Liabilities directly associated with the assets classified as held for sale | 27 | **753** | — |
| Total current liabilities | | **932,712** | 761,054 |
| **NET CURRENT ASSETS** | | **2,132,371** | 1,590,756 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **2,708,557** | 2,253,465 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)

31 December 2012

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **2,708,557** | 2,253,465 |
| **NON-CURRENT LIABILITIES** | | | |
| Deferred revenue | 31 | **14,252** | 20,321 |
| Deferred tax liabilities | 9 | **19,373** | 20,024 |
| Total non-current liabilities | | **33,625** | 40,345 |
| **Net assets** | | **2,674,932** | 2,213,120 |
| **EQUITY** | | | |
| **Equity attributable to owners of the parent** | | | |
| Issued capital | 32 | **4,690** | 4,677 |
| Share premium account | 32 | **347,965** | 440,974 |
| Shares held for share award scheme | 32 | **(82,127)** | (93,754) |
| Statutory reserves | 34(a) | **156,462** | 146,654 |
| Employee share-based reserve | | **160,833** | 145,435 |
| Capital reserve | 34(a) | **275,739** | 253,914 |
| Foreign currency translation reserve | | **(75,353)** | (72,015) |
| Retained earnings | | **1,624,488** | 1,201,707 |
| Proposed final dividend | 11 | **102,132** | 92,241 |
| | | **2,514,829** | 2,119,833 |
| **Non-controlling interests** | | **160,103** | 93,287 |
| **Total equity** | | **2,674,932** | 2,213,120 |

**Hong Jiang Zhang**
*Director*

**Yuk Keung NG**
*Director*

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2012

| | ATTRIBUTABLE TO OWNERS OF THE PARENT | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | ISSUED CAPITAL (NOTE 32) RMB'000 | SHARE PREMIUM ACCOUNT (NOTE 32) RMB'000 | SHARES HELD FOR SHARE AWARD SCHEME (NOTE 32) RMB'000 | STATUTORY RESERVES (NOTE 34(a)) RMB'000 | EMPLOYEE SHARE-BASED RESERVE RMB'000 | CAPITAL RESERVE (NOTE 34(A)) RMB'000 | FOREIGN CURRENCY TRANSLATION RESERVE RMB'000 | RETAINED EARNINGS RMB'000 | PROPOSED FINAL AND SPECIAL DIVIDENDS RMB'000 | TOTAL RMB'000 | NON-CONTROLLING INTERESTS RMB'000 | TOTAL EQUITY RMB'000 |
| **At 1 January 2011** | 4,527 | 408,241 | (57,773) | 140,057 | 207,646 | 16,230 | (68,625) | 883,575 | 376,000 | 1,909,878 | 24,183 | 1,934,061 |
| Profit for the year | — | — | — | — | — | — | — | 324,729 | — | 324,729 | 10,305 | 335,034 |
| Other comprehensive income for the year: | | | | | | | | | | | | |
| Exchange differences on translation of foreign operations | — | — | — | — | — | — | (3,390) | — | — | (3,390) | (495) | (3,885) |
| Total comprehensive income for the year | — | — | — | — | — | — | (3,390) | 324,729 | — | 321,339 | 9,810 | 331,149 |
| Approved and paid final and special dividends in respect of the previous year | — | 1,043 | — | — | — | — | — | — | (376,000) | (374,957) | — | (374,957) |
| Shares purchased for share award scheme | — | — | (47,420) | — | — | — | — | — | — | (47,420) | — | (47,420) |
| Share-based compensation costs | — | — | — | — | 9,381 | — | — | — | — | 9,381 | 1,432 | 10,813 |
| Profit appropriations (note 34(a)) | — | — | — | 6,597 | — | — | — | (6,597) | | — | — | — |
| Exercise of share options | 150 | 123,931 | — | — | (60,153) | — | — | — | — | 63,928 | — | 63,928 |
| Vested awarded shares transferred to employees | — | — | 11,439 | — | (11,439) | — | — | — | — | — | — | — |
| Proposed final 2011 dividend (note 11) | — | (92,241) | — | — | — | — | — | — | 92,241 | — | — | — |
| Changes in the ownership interests in subsidiaries | — | — | — | — | — | 237,684 | — | — | — | 237,684 | 57,862 | 295,546 |
| **At 31 December 2011 and 1 January 2012** | **4,677** | **440,974** | **(93,754)** | **146,654** | **145,435** | **253,914** | **(72,015)** | **1,201,707** | **92,241** | **2,119,833** | **93,287** | **2,213,120** |
| Profit for the year | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **432,589** | **—** | **432,589** | **33,845** | **466,434** |
| Other comprehensive income for the year: | | | | | | | | | | | | |
| Exchange differences on translation of foreign operations | **—** | **—** | **—** | **—** | **—** | **—** | **(3,338)** | **—** | **—** | **(3,338)** | **(2,275)** | **(5,613)** |
| Total comprehensive income for the year | **—** | **—** | **—** | **—** | **—** | **—** | **(3,338)** | **432,589** | **—** | **429,251** | **31,570** | **460,821** |
| Approved and paid final dividends in respect of the previous year | **—** | **(830)** | **—** | **—** | **—** | **—** | **—** | **—** | **(92,241)** | **(93,071)** | **—** | **(93,071)** |
| Dividends paid to non-controlling interests | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **(12,958)** | **(12,958)** |
| Share-based compensation costs | **—** | **—** | **—** | **—** | **34,666** | **—** | **—** | **—** | **—** | **34,666** | **8,043** | **42,709** |
| Profit appropriations (note 34(a)) | **—** | **—** | **—** | **9,808** | **—** | **—** | **—** | **(9,808)** | **—** | **—** | **—** | **—** |
| Exercise of share options | **19** | **15,783** | **—** | **—** | **(7,641)** | **—** | **—** | **—** | **—** | **8,161** | **—** | **8,161** |
| Vested awarded shares transferred to employees | **—** | **—** | **11,627** | **—** | **(11,627)** | **—** | **—** | **—** | **—** | **—** | **—** | **—** |
| Repurchase and cancellation of shares | **(6)** | **(5,830)** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **(5,836)** | **—** | **(5,836)** |
| Capital contributions from non-controlling interests | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **11,195** | **11,195** |
| Proposed final 2012 dividend (note 11) | **—** | **(102,132)** | **—** | **—** | **—** | **—** | **—** | **—** | **102,132** | **—** | **—** | **—** |
| Changes in the ownership interests in subsidiaries | **—** | **—** | **—** | **—** | **—** | **21,825** | **—** | **—** | **—** | **21,825** | **28,966** | **50,791** |
| **At 31 December 2012** | **4,690** | **347,965** | **(82,127)** | **156,462** | **160,833** | **275,739** | **(75,353)** | **1,624,488** | **102,132** | **2,514,829** | **160,103** | **2,674,932** |

# CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2012

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Profit for the year | | **466,434** | 335,034 |
| Adjustments for: | | | |
| Loss on disposal of items of property, plant and equipment | 6 | **272** | 899 |
| Depreciation | 6 | **60,723** | 63,547 |
| Amortisation of lease prepayments | 6 | **941** | 941 |
| Amortisation of other intangible assets | 16 | **26,893** | 28,080 |
| Finance costs | 6 | **8,702** | 3,461 |
| Interest income | | **(64,532)** | (26,770) |
| Fair value loss/(gain) on a financial asset at fair value through profit or loss | 21 | **(16,010)** | 1,973 |
| Gain on disposal of a subsidiary | 6 | **—** | (828) |
| Gain on disposal of an available-for-sale investment | 6 | **—** | (1,440) |
| Gain on deemed disposal of an associate | 6 | **—** | (1,500) |
| Deferred income tax expense | 9 | **(6,065)** | (16,991) |
| Share-based compensation costs | | **48,279** | 10,813 |
| Write-down of inventories | 6 | **11,314** | 1,527 |
| Impairment of other intangible assets | 6 | **5,725** | — |
| Impairment of investments in jointly-controlled entities | 6 | **—** | 5,000 |
| Impairment of loans to other shareholders of jointly-controlled entities | 6 | **—** | 2,000 |
| Share of losses/(profits) of jointly-controlled entities | 18 | **(9,532)** | 1,945 |
| Share of losses of associates | 19 | **930** | 4,070 |
| | | **534,074** | 411,761 |
| Decrease/(increase) in trade receivables | | **(49,980)** | 18,573 |
| Increase in prepayments, deposits and other receivables | | **(29,712)** | (34,737) |
| Increase in loan receivables | | **(1,364)** | (958) |
| Increase in inventories | | **(25,009)** | (1,982) |
| Decrease in deferred cost | | **792** | 1,761 |
| Increase in trade payables | | **6,521** | 997 |
| Increase/(decrease) in deferred revenue | | **35,204** | (2,532) |
| Increase in other payables and accruals | | **91,373** | 45,429 |
| Increase/(decrease) in income tax payable | | **(5,953)** | 13,456 |
| Net cash flows from operating activities | | **555,946** | 451,768 |

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Interest received | | **63,240** | 20,354 |
| Proceeds from disposal of items of property, plant and equipment | | **916** | 192 |
| Purchases of items of property, plant and equipment | | **(59,244)** | (69,596) |
| Purchases of software | 16 | **(6,909)** | (6,170) |
| Addition of capitalised software costs | 16 | **(13,839)** | (7,532) |
| Addition of long-term prepayment | | **—** | (80,109) |
| Addition of lease prepayment | | **(1,763)** | — |
| Increase in time deposits with original maturity of over three months when acquired | 26 | **(1,016,982)** | (285,011) |
| Increase in pledged time deposit | 26 | **—** | (85,000) |
| Dividend from and proceeds from disposal of an associate | 19 | **—** | 39,500 |
| Acquisition of a business | 35 | **(3,000)** | (12,000) |
| Investment in an associate | 19 | **—** | (3,500) |
| Purchase of available-for-sale investments | 20 | **(2,192)** | (4,990) |
| Disposal of a subsidiary | | **—** | 870 |
| Disposal of an available-for-sale investment | 6 | **—** | 1,440 |
| Advance of loan to a related party | 38 | **(29,041)** | (122,801) |
| Receipt of loan to a related party | | **5,694** | — |
| Advance of loans to other shareholders of jointly-controlled entities | | **—** | (2,000) |
| Net cash flows used in investing activities | | **(1,063,120)** | (616,353) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Purchase of shares held for share award scheme | 7 | **—** | (47,420) |
| Purchase of shares for cancellation | | **(5,836)** | — |
| Contributions from non-controlling shareholders | 34(a) | **56,417** | 295,546 |
| Exercise of share options | | **8,160** | 63,928 |
| Dividends paid to owners of the parent | 11 | **(93,027)** | (374,957) |
| Dividends paid to non-controlling interests | | **(12,958)** | — |
| Repayment of bank loans | 29 | **(346,655)** | (102,108) |
| New bank loans | 29 | **413,559** | 346,655 |
| Interest paid | | **(9,717)** | (2,445) |
| Net cash flows from financing activities | | **9,943** | 179,199 |
| **NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | | **(497,231)** | 14,614 |
| Cash and cash equivalents at beginning of year | | **1,199,313** | 1,186,711 |
| Effect of foreign exchange rate changes, net | | **(5,583)** | (2,012) |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | | **696,499** | 1,199,313 |
| **ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS** | | | |
| Cash and bank balances | 26 | **377,990** | 296,853 |
| Time deposits with original maturity of three months or less when acquired | 26 | **241,829** | 902,460 |
| Cash and short term deposits attributable to a disposal group | 27 | **76,680** | — |
| | | **696,499** | 1,199,313 |

# STATEMENT OF FINANCIAL POSITION

31 December 2012

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| Property, plant and equipment | 13 | **—** | 1 |
| Investments in subsidiaries | 33 | **225,697** | 221,186 |
| Investment in a jointly-controlled entity | 18 | **20,122** | 10,622 |
| Total non-current assets | | **245,819** | 231,809 |
| **CURRENT ASSETS** | | | |
| Prepayments, deposits and other receivables | 25 | **1,294** | 494 |
| Due from related parties | 38 | **41,835** | 12,960 |
| Due from subsidiaries | 33 | **702,285** | 662,950 |
| Pledged deposit | | **19,000** | — |
| Cash and cash equivalents | 26 | **156,227** | 155,283 |
| Total current assets | | **920,641** | 831,687 |
| **CURRENT LIABILITIES** | | | |
| Interest-bearing bank loans | 29 | **413,559** | 346,655 |
| Other payables and accruals | 30 | **2,420** | 1,694 |
| Due to subsidiaries | 33 | **118,907** | 113,853 |
| Total current liabilities | | **534,886** | 462,202 |
| **NET CURRENT ASSETS** | | **385,755** | 369,485 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **631,574** | 601,294 |
| **Net assets** | | **631,574** | 601,294 |
| **EQUITY** | | | |
| Issued capital | 32 | **4,690** | 4,677 |
| Share premium account | 32 | **347,965** | 440,974 |
| Shares held for share award scheme | 32 | **(82,127)** | (93,754) |
| Employee share-based reserve | 34(b) | **142,524** | 142,851 |
| Foreign currency translation reserve | 34(b) | **(125,505)** | (125,053) |
| Retained earnings | 34(b) | **241,895** | 139,358 |
| Proposed final dividends | 11 | **102,132** | 92,241 |
| **Total equity** | | **631,574** | 601,294 |

**Hong Jiang Zhang**
*Director*

**Yuk Keung Ng**
*Director*

## 1. CORPORATE INFORMATION

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

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

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

- research and development of games, and provision of online games, mobile games and casual game services;
- research, development and operation of information security software and web browser, provision of information security service across devices, and provision of online advertising services; and
- research, development and distribution of office application software, provision of cloud storage, cloud computation and dictionary services across devices, and provision of online advertising services.

## 2.1 BASIS OF PREPARATION

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

These financial statements have been prepared under the historical cost convention, except for other financial asset, which has been measured at fair value. Disposal groups held for sale are stated at the lower of their carrying amounts and fair values less costs to sell as further explained in note 2.4. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

### Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2012. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated on consolidation in full.

Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if it results in a deficit balance.

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

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in other comprehensive income is reclassified to profit or loss or retained profits, as appropriate.

## 2.1 BASIS OF PREPARATION (continued)

### Basis of consolidation (continued)

The Company has set up a trust (the "Share Award Scheme Trust") for the purpose of purchasing, administering and holding the Company's shares for the share award scheme adopted on 31 March 2008 (the "Share Award Scheme", note 7(b)). The Group has the power to govern the financial and operating policies of the Share Award Scheme Trust and it can derive benefits from the services of the employees who have been awarded the awarded shares (the "Awarded Shares") through their continued employment with the Group. The assets and liabilities of the Share Award Scheme Trust are included in consolidated statement of financial position and the shares held by the Share Award Scheme Trust are presented as deduction in equity as shares held for Share Award Scheme.

Kingsoft Internet Security Software Holdings Limited ("KIS Holdings"), a subsidiary of the Company, has set up a trust (the "KIS Share Award Scheme Trust") for the purpose of administering and holding the KIS Holdings' shares for the share award scheme adopted on 26 May 2011 (the "KIS Share Award Scheme", note 7(c)). The Group has the power to govern the financial and operating policies of the KIS Share Award Scheme Trust and derives benefits from the services of the employees who have been awarded the awarded shares (the "KIS Awarded Shares") through their continued employment with the Group, the assets and liabilities of the KIS Share Award Scheme Trust are included in consolidated statement of financial position.

Kingsoft Office Software Holdings Limited ("KOS Holdings"), a subsidiary of the Company, has set up a trust (the "KOS Share Award Scheme Trust") for the purpose of administering and holding the KOS Holdings' shares for the share award scheme adopted on 3 December 2012 (the "KOS Share Award Scheme", note 7(d)). The Group has the power to govern the financial and operating policies of the KOS Share Award Scheme Trust and derive benefits from the services of the employees who have been awarded the awarded shares (the "KOS Awarded Shares") through their continued employment with the Group, the assets and liabilities of the KOS Share Award Scheme Trust are included in consolidated statement of financial position.

## 2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES

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

| | |
|---|---|
| IFRS 7 Amendments | Amendments to IFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets Requirements* |
| IAS 12 Amendments | Amendments to IAS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets* |

The adoption of the revised IFRSs has had no significant financial effect on these financial statements.

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

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

| | |
|---|---|
| IFRS 7 Amendments | Amendments to IFRS 7 *Financial Instruments:Disclosures – Offsetting Financial Assets and Financial Liabilities*[2] |
| IFRS 9 | *Financial Instrument*[4] |
| IFRS 10 | *Consolidated Financial Statements*[2] |
| IFRS 11 | *Joint Arrangement*[2] |
| IFRS 12 | *Disclosure of Interests in Other Entities*[2] |
| IFRS 10, IFRS 11 and IFRS 12 Amendments | Amendments to IFRS 10, IFRS 11 and IFRS 12 – *Transition Guidance*[2] |
| IFRS 10, IFRS 12 and IAS 27 (Revised) Amendments | Amendments to IFRS 10, IFRS 12 and IAS 27 (Revised) – *Investment Entities*[3] |
| IFRS 13 | *Fair Value Measurement*[2] |
| IAS 1 Amendments | Amendments to IAS 1 *Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income*[1] |
| IAS 19 (Amendments) | Amendments to IAS 19 – *Employee Benefits*[2] |
| IAS 27 (Revised) | *Separate Financial Statements*[2] |
| IAS 28 (Revised) | *Investments in Associates and Joint Ventures*[2] |
| IAS 32 Amendments | Amendments to IAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*[3] |
| Annual Improvements 2009-2011 Cycle | Amendments to a number of IFRSs issued in May 2012[2] |

1 Effective for annual periods beginning on or after 1 July 2012

2 Effective for annual periods beginning on or after 1 January 2013

3 Effective for annual periods beginning on or after 1 January 2014

4 Effective for annual periods beginning on or after 1 January 2015

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

Further information about those IFRSs that are expected to be applicable to the Group is as follows:

The IFRS 7 Amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. The Group expects to adopt the amendments from 1 January 2013.

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

In October 2010, the IASB issued additions to IFRS 9 to address financial liabilities (the "Additions") and incorporated in IFRS 9 the current derecognition principles of financial instruments of IAS 39. Most of the Additions were carried forward unchanged from IAS 39, while changes were made to the measurement of financial liabilities designated at fair value through profit or loss using the fair value option ("FVO"). For these FVO liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in other comprehensive income ("OCI"). The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. However, loan commitments and financial guarantee contracts which have been designated under the FVO are scoped out of the Additions.

IAS 39 is aimed to be replaced by IFRS 9 in its entirety. Before this entire replacement, the guidance in IAS 39 on hedge accounting and impairment of financial assets continues to apply. The Group expects to adopt IFRS 9 from 1 January 2015. The Group will quantify the effect in conjunction with other phases, when the final standard including all phases is issued.

IFRS 10 establishes a single control model that applies to all entities including special purpose entities or structured entities. It includes a new definition of control which is used to determine which entities are consolidated. The changes introduced by IFRS 10 require management of the Group to exercise significant judgement to determine which entities are controlled, compared with the requirements in IAS 27 and SIC 12 *Consolidation – Special Purpose Entities*. IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-Int 12. Based on the preliminary analyses performed, IFRS 10 is not expected to have any impact on the currently held investments of the Group.

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. It describes the accounting for joint arrangements with joint control. It addresses only two forms of joint arrangements, i.e., joint operations and joint ventures, and removes the option to account for joint ventures using proportionate consolidation.

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

IFRS 12 includes the disclosure requirements for subsidiaries, joint arrangements, associates and structured entities previously included in IAS 27 *Consolidated and Separate Financial Statements*, IAS 31 *Interests in Joint Ventures* and IAS 28 *Investments in Associates*. It also introduces a number of new disclosure requirements for these entities.

In June 2012, the IASB issued amendments to IFRS 10, IFRS 11 and IFRS 12 which clarify the transition guidance in IFRS 10 and provide further relief from full retrospective application of these standards, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. The amendments clarify that retrospective adjustments are only required if the consolidation conclusion as to which entities are controlled by the Group is different between IFRS 10 and IAS 27 or SIC 12 at the beginning of the annual period in which IFRS 10 is applied for the first time. Furthermore, for disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied.

The amendments to IFRS 10 issued in October 2012 include a definition of an investment entity and provide an exception to the consolidation requirement for entities that meet the definition of an investment entity. Investment entities are required to account for subsidiaries at fair value through profit or loss in accordance with IFRS 9 rather than consolidate them. Consequential amendments were made to IFRS 12 and IAS 27 (Revised). The amendments to IFRS 12 also set out the disclosure requirements for investment entities. The Group expects that these amendments will not have any impact on the Group as the Company is not an investment entity as defined in IFRS 10.

Consequential amendments were made to IAS 27 and IAS 28 as a result of the issuance of IFRS 10, IFRS 11 and IFRS 12. The Group expects to adopt IFRS 10, IFRS 11, IFRS 12, IAS 27 (Revised), IAS 28 (Revised), and the subsequent amendments to these standards issued in June and October 2012 from 1 January 2013.

IFRS 13 provides a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The standard does not change the circumstances in which the Group is required to use fair value, but provides guidance on how fair value should be applied where its use is already required or permitted under other IFRSs. The Group expects to adopt IFRS 13 prospectively from 1 January 2013.

The IAS 1 Amendments change the grouping of items presented in OCI. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net gain on hedge of a net investment, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) would be presented separately from items which will never be reclassified (for example, actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendments will affect presentation only and have no impact on the financial position or performance. The Group expects to adopt the amendments from 1 January 2013.

IAS 19 (Amendments) includes a number of amendments that range from fundamental changes to simple clarifications and re-wording. The amendments introduce significant changes in the accounting for defined benefit pension plans including removing the choice to defer the recognition of actuarial gains and losses. Other changes include modifications to the timing of recognition for termination benefits, the classification of short-term employee benefits and disclosures of defined benefit plans. The Group expects to adopt IAS 19 (Amendments) from 1 January 2013.

The IAS 32 Amendments clarify the meaning of "currently has a legally enforceable right to setoff" for offsetting financial assets and financial liabilities. The amendments also clarify the application of the offsetting criteria in IAS 32 to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments are not expected to have any impact on the financial position or performance of the Group upon adoption on 1 January 2014.

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

The *Annual Improvements to IFRSs 2009-2011* Cycle issued in May 2012 sets out amendments to a number of IFRSs. The Group expects to adopt the amendments from 1 January 2013. There are separate transitional provisions for each standard. While the adoption of some of the amendments may result in changes in accounting policies, none of these amendments are expected to have a significant financial impact on the Group. Those amendments that are expected to have a significant impact on the Group's policies are as follows:

(a) IAS *1 Presentation of Financial Statements:* Clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative period is the previous period. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the previous period. The additional comparative information does not need to contain a complete set of financial statements.

In addition, the amendment clarifies that the opening statement of financial position as at the beginning of the preceding period must be presented when an entity changes its accounting policies; makes retrospective restatements or makes reclassifications, and that change has a material effect on the statement of financial position. However, the related notes to the opening statement of financial position as at the beginning of the preceding period are not required to be presented.

(b) IAS 32 *Financial Instruments: Presentation:* Clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*. The amendment removes existing income tax requirements from IAS 32 and requires entities to apply the requirements in IAS 12 to any income tax arising from distributions to equity holders.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Subsidiaries

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

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

### Joint ventures

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

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

A joint venture is treated as:

(a) a subsidiary, if the Group/Company has unilateral control, directly or indirectly, over the joint venture;

(b) a jointly-controlled entity, if the Group/Company does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Joint ventures (continued)

(c) an associate, if the Group/Company does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or

(d) an equity investment accounted for in accordance with IAS 39, if the Group/Company holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

### Jointly-controlled operations

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

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

### Jointly-controlled entities

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

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

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

### Associates

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

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The consideration transferred is measured at the acquisition date fair value which is the sum of the acquisition date fair values of assets transferred by the Group, liabilities assumed by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of net assets in the event of liquidation either at fair value or at the proportionate share of the acquiree's identifiable net assets. All other components of non-controlling interests are measured at fair value. Acquisition-related costs are expensed as incurred.

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

If the business combination is achieved in stages, the previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognised in profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 is measured at fair value with changes in fair value either recognised in profit or loss or as a change to other comprehensive income. If the contingent consideration is not within the scope of IAS 39, it is measured in accordance with the appropriate IFRS. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted for within equity.

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

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

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

Where goodwill has been allocated to a cash-generating unit (or group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on the disposal. Goodwill disposed in these circumstances is measured based on the relative value of the disposed operation and the portion of the cash-generating unit retained.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Impairment of non-financial assets

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

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

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

### Related parties

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

(a) the party is a person or a close member of that person's family and that person

- (i) has control or joint control over the Group;
- (ii) has significant influence over the Group; or
- (iii) is a member of the key management personnel of the Group or of a parent of the Group;

or

(b) the party is an entity where any of the following conditions applies:

- (i) the entity and the Group are members of the same group;
- (ii) one entity is an associate or joint venture of the other entity (or of a parent, subsidiary or fellow subsidiary of the other entity);
- (iii) the entity and the Group are joint ventures of the same third party;
- (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- (v) the entity is controlled or jointly controlled by a person identified in (a); and
- (vi) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Property, plant and equipment and depreciation

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

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

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

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

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

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

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

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

### Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered principally through a sales transaction rather than through continuing use. For this to be the case, the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for the sale of such assets or disposal groups and its sale must be highly probable. All assets and liabilities of a subsidiary classified as a disposal group are reclassified as held for sale regardless of whether the Group retains a non-controlling interest in its former subsidiary after the sale.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Non-current assets and disposal groups held for sale (continued)

Non-current assets and disposal groups (other than investment properties and financial assets) classified as held for sale are measured at the lower of their carrying amounts and fair values less costs to sell. Property, plant and equipment and intangible assets classified as held for sale are not depreciated or amortised.

### Intangible assets (other than goodwill)

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

*Purchased software*

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

*Research and development costs*

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

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

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

*Website and internally used software development costs*

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

*Television program production costs*

Television program production costs include capitalisable production costs, production overhead and development costs and are stated at the cost, less accumulated amortisation. Marketing, distribution, and general and administrative costs are expensed as incurred.

Capitalised television program production costs are recognised to costs of revenue based on the percentage of the revenues recognised to the total revenue ("Ultimate Revenues") from all sources on an individual production basis. Ultimate Revenues for television program include revenues that will be earned within ten years from the date of the initial release. These estimates are reviewed on a periodic basis.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Leases

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

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

### Investments and other financial assets

*Initial recognition and measurement*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial investments, as appropriate. The Group determines the classification of its financial assets at initial recognition. When financial assets are recognised initially, they are measured at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

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

*Subsequent measurement*

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

*Financial assets at fair value through profit or loss*

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

Financial assets designated upon initial recognition at fair value through profit or loss are designated at the date of initial recognition and only the criteria under IAS 39 are satisfied.

*Loans and receivables*

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

*Available-for-sale financial investments*

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Investments and other financial assets (continued)

*Available-for-sale financial investments (continued)*

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

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

The Group evaluates whether the ability and intention to sell its available-for-sale financial assets in the near term are still appropriate. When, in rare circumstances, the Group is unable to trade these financial assets due to inactive markets and management's intent to do so significantly changes in the foreseeable future, the Group may elect to reclassify these financial assets. Reclassification to loans and receivables is permitted when the financial assets meet the definition of loans and receivables and the Group has the intent and ability to hold these assets for the foreseeable future or to maturity. Reclassification to the held-to-maturity category is permitted only when the Group has the ability and intent to hold until the maturity date of the financial asset.

For a financial asset reclassified from the available-for-sale category, the fair value carrying amount at the date of reclassification becomes its new amortised cost and any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost and the maturity amount is also amortised over the remaining life of the asset using the effective interest rate. If the asset is subsequently determined to be impaired, then the amount recorded in equity is reclassified to the income statement.

### Derecognition of financial assets

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

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

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

### 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Derecognition of financial assets (continued)

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

#### Impairment of financial assets

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

*Financial assets carried at amortised cost*

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

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

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

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

*Assets carried at cost*

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Impairment of financial assets (continued)

*Available-for-sale financial investments*

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

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

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

### Financial liabilities

*Initial recognition and measurement*

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

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

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

*Loans and borrowings*

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

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

### Derecognition of financial liabilities

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

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Fair value of financial instruments

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

### Shares held for share award scheme

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

### Inventories

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

### Cash and cash equivalents

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

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

### Provisions

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

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

A contingent liability recognised in a business combination is initially measured at its fair value. Subsequently, it is measured at the higher of (i) the amount that would be recognised in accordance with the general guidance for provisions above; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with the guidance for revenue recognition.

### Income tax

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Income tax (continued)

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

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

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

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

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

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

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

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

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

### Government grants

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) *Sale of application software*

Revenue from the sale of application software is recognised when significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold.

The Group also enters into multi-year licensing arrangements with certain original equipment manufacturer ("OEM") customers to allow them to install unlimited copies of the Group's application software over a period of one to three years in the their products for a fixed cash consideration. During the licensing period, the Group is required to provide when-and-if-available upgrades, technical support and training to the OEM customers. Revenue from multi-year licensing arrangements is recognised as revenue ratably over the licensing period upon the delivery of the software master copy.

(b) *Membership service of information security software*

The Group provides membership services, including a package of services such as restoration of data, remote technical support, computer maintenance and other privilege, to individual users of the Group's information security software. The individual user subscribes for membership services on a monthly basis or for a period of up to several years. Revenue is recognised ratably over the subscription period.

(c) *Online game services*

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

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

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

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

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

The sales of prepaid game cards to distributors include certain discounts from the face value of the cards. The Group recognises revenue net of the discounts provided to the distributors.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Revenue recognition (continued)

*(d) Online game licences*

The Group enters into licensing arrangements with the licensees to operate the Group's online games in defined regions and/or countries. The Group is entitled to the ongoing usage-based royalties which are determined based on the amount of money charged to the end users' accounts in a given country or region. The usage-based royalties are recognised when they are earned, provided that the collection is probable.

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

*(e) Online advertising services*

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

*(f) Television program revenues*

The Group recognises revenues from the sale or licensing arrangement of a television program when a copy of the television program has been delivered and the licensing period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale, provided that collection of the arrangement fee is reasonably assured and the Group has no control over the customer and expects to receive no further revenues.

*(g) Interest income*

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

*(h) Dividend income*

Dividend income is recognised when the shareholders' right to receive payment has been established.

### Cost of revenue

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

### Deferred revenue

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Share-based payments

The Group operates several share option schemes and share award schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including senior executives) of the Group receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using a binomial model. Further detail of the fair values of share options and awarded shares granted are given in note 7 to the financial statements.

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

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

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

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

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

### Defined contribution plan for PRC employees

Full-time employees of the Group's subsidiary which operates in Mainland China are required to participate in a defined contribution scheme operated by the local municipal government. These subsidiaries are required to contribute certain percentage of their payroll costs to the defined contribution scheme which includes pension, medical care, unemployment insurance, employee housing fund and other welfare. The contributions are charged to the income statement as they become payable in accordance with the rules of the defined contribution scheme. The Group has no legal obligation for the benefits beyond the contributions made.

### Dividends

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

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Foreign currencies

These financial statements are presented in RMB. The Company and its subsidiaries have determined their functional currencies to be their respective local currencies of Hong Kong Dollars ("HKD"), Japanese Yen ("JPY"), Malaysia Ringgit ("MYR"), United States Dollar ("USD") and RMB. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions recorded by the entities in the Group are initially recorded using their respective functional currency rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the end of the reporting period. Differences arising on settlement or translation of monetary items are recognised in the income statement.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. The gain or loss arising on retranslation of a non-monetary item measured at fair value is treated in line with the recognition of the gain or loss on change in fair value of the item (i.e., translation difference on the item whose fair value gain or loss is recognised in other comprehensive income or profit or loss is also recognised in other comprehensive income or profit or loss, respectively).

The functional currencies of the Company and certain overseas subsidiaries and jointly-controlled entities are currencies other than the RMB. As at the end of the reporting period, the assets and liabilities of these entities are translated into RMB at the exchange rates prevailing at the end of the reporting period and their income statements are translated into RMB at the weighted average exchange rates for the year.

The resulting exchange differences are recognised in other comprehensive income and accumulated in the foreign currency translation reserve. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the income statement.

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

## 3. SIGNIFICANT ESTIMATES

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

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

### (a) Fair value of other financial asset

The fair value of the option obtained from an online game operator in Vietnam is determined by the Black-Scholes valuation model (the "BS Model"). Significant judgement about factors, such as risk-free rate, dividend yield, expected volatility and expected life of option, is required to be made by the directors as the parameter for applying the BS Model. The Company engaged an independent valuer to assess the fair value of the option. The fair value of the option was approximately RMB27,822,000 as at 31 December 2012 (2011: RMB11,812,000). Further details are included in note 21 to the financial statements.

## 3. SIGNIFICANT ESTIMATES (continued)

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

The Company granted share options under 2011 share option scheme (the "2011 Scheme") to its employees. The fair value of the 2011 Scheme granted was valued by an external valuer using the binomial model. This valuation requires the Group to make estimates about the dividend yield, expected volatility, risk-free interest rate and expected life of options, and hence they are subject to uncertainty. The fair value of the share options granted during the year ended 31 December 2012 as determined by the binomial model was approximately RMB3,340,000 (2011: RMB11,483,000).

Some of the Group's subsidiaries adopted their own share award schemes, including KIS Share Award Scheme and KOS Share Award Scheme. Pursuant to these schemes, these subsidiaries granted their awarded shares to their respective employees. The fair values of the subsidiaries' award shares granted during the year ended 31 December 2012 is valued by an external valuer based on the expected cash flows discounted at a current rate applicable for items with similar terms and risk characteristics. This valuation requires the Group to make estimates about the expected future cash flows, credit risk, volatility and discount rates, and hence they are subject to uncertainty. The fair value of these awarded shares granted during the year ended 31 December 2012 was approximately RMB41,494,000 (2011: RMB15,375,000).

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

### (c) Software development costs

Software development costs are capitalised in accordance with the accounting policy for research and development costs. Determining the amounts to be capitalised requires management to make assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits. At 31 December 2012, the best estimate of the carrying amount of capitalised development costs was approximately RMB23,181,000 (2011: RMB18,461,000).

### (d) The useful life of Virtual Items in the Group's item-billing online games

Virtual Items include items consumed at a single point in time, at a series of times, or within a pre-determined period of time (collectively "Consumable Items"), and items used through the entire life of the game ("Permanent Items"). For Consumable Items, the Group uses historical usage pattern, player behaviour data and pre-specified usage period of virtual items to estimate the average useful life of these items. For Permanent Items, the useful life is equivalent to the estimated remaining game life, which is assessed based on historical and planned operation periods of the Group's online games.

### (e) Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2012 was approximately RMB14,559,000 (2011: RMB14,559,000). Further details are given in note 15 to the financial statements.

## 3. SIGNIFICANT ESTIMATES (continued)

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

The Group assesses whether there are any indicators of impairment for all non-financial assets at the end of each reporting period. Indefinite life intangible assets are tested for impairment annually and at other times when such an indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. Impairment exists when the carrying value of an asset or a cash-generating unit exceeds its recoverable amounts, which is the higher of its fair value less costs to sell and its value in use. The calculation of the fair value less costs to sell is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows. During the year ended 31 December 2012, impairment loss of RMB5,725,000 was recognised for other intangible assets, and RMB11,314,000 was recognised for inventory (2011: RMB5,000,000 was recognised for investments in jointly-controlled entities). Further details are contained in note 16 and note 18 to the financial statements.

## 4. OPERATING SEGMENT INFORMATION

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

(a) the entertainment software segment engages in research and development of games, and provision of online games, mobile games and casual game services;

(b) the information security software segment engages in the research, development and operation of information security software and web browser, provision of information security service across devices, and provision of online advertising services; and

(c) the other application software segment engages in the research, development and distribution of office application software, provision of cloud storage, cloud computation and dictionary services across devices, and provision of online advertising services.

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

## 4. OPERATING SEGMENT INFORMATION (continued)

| YEAR ENDED 31 DECEMBER 2012 | ENTERTAINMENT SOFTWARE RMB'000 | INFORMATION SECURITY SOFTWARE RMB'000 | OTHER APPLICATION SOFTWARE RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|
| **SEGMENT REVENUE:** | | | | |
| Sales to external customers | **860,651** | **336,741** | **213,769** | **1,411,161** |
| **SEGMENT RESULTS** | **436,451** | **70,670** | **97,577** | **604,698** |
| *Reconciliation:* | | | | |
| Administrative expenses | | | | **(147,954)** |
| Share-based compensation costs | | | | **(48,472)** |
| Other income and gains | | | | **28,609** |
| Other expenses | | | | **(22,971)** |
| Fair value gain on a financial asset at fair value through profit or loss | | | | **16,010** |
| Finance income | | | | **97,973** |
| Finance costs | | | | **(8,702)** |
| Share of profits and losses of: | | | | |
| Jointly-controlled entities | | | | **9,532** |
| Associates | | | | **(930)** |
| **PROFIT BEFORE TAX** | | | | **527,793** |
| **OTHER SEGMENT INFORMATION:** | | | | |
| Depreciation and amortisation | **38,724** | **11,206** | **27,030** | **76,960** |

## 4. OPERATING SEGMENT INFORMATION (continued)

| YEAR ENDED 31 DECEMBER 2011 | ENTERTAINMENT SOFTWARE RMB'000 | INFORMATION SECURITY SOFTWARE RMB'000 | OTHER APPLICATION SOFTWARE RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|
| **SEGMENT REVENUE:** | | | | |
| Sales to external customers | 694,410 | 194,548 | 131,550 | 1,020,508 |
| **SEGMENT RESULTS** | 352,798 | 15,976 | 74,201 | 442,975 |
| *Reconciliation:* | | | | |
| Administrative expenses | | | | (127,498) |
| Share-based compensation costs | | | | (17,266) |
| Other income and gains | | | | 44,051 |
| Other expenses | | | | (10,747) |
| Fair value loss on a financial asset at fair value through profit or loss | | | | (1,973) |
| Finance income | | | | 65,130 |
| Finance costs | | | | (3,461) |
| Share of losses of: | | | | |
| Jointly-controlled entities | | | | (1,945) |
| Associates | | | | (4,070) |
| **PROFIT BEFORE TAX** | | | | 385,196 |
| **OTHER SEGMENT INFORMATION:** | | | | |
| Depreciation and amortisation | 37,732 | 19,306 | 20,452 | 77,490 |

### Geographical information

(a) *Revenue from external customers:*

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Mainland China | **1,208,415** | 826,147 |
| Hong Kong | **52,811** | 54,229 |
| Japan | **105,809** | 83,294 |
| Other countries | **44,126** | 56,838 |
| Total | **1,411,161** | 1,020,508 |

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

## 4. OPERATING SEGMENT INFORMATION (continued)

### Geographical information (continued)

*(b) Non-current assets:*

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Mainland China | **479,988** | 601,228 |
| Japan | **2,009** | 1,540 |
| Other countries | **20,359** | 11,092 |
| Total | **502,356** | 613,860 |

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

### Information about a major customer

Revenue of approximately RMB83,880,000 (2011: RMB95,901,000) was derived by entertainment software segment from royalties from a single customer.

## 5. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, after allowances for returns and trade discounts; the value of services rendered; and the royalties derived from licensing agreements during the year.

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

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| *Revenue* | | |
| Sales of packaged software | **220,069** | 145,366 |
| Rendering of services | **1,061,842** | 741,567 |
| Royalties | **120,001** | 128,684 |
| Others | **9,249** | 4,891 |
| | **1,411,161** | 1,020,508 |

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| *Other income and gains* | | |
| Government grants | **23,318** | 35,497 |
| Gain on deemed disposal of an associate | **—** | 1,500 |
| Gain on disposal of an available-for-sale investment | **—** | 1,440 |
| Gain on disposal of a subsidiary | **—** | 828 |
| Others | **5,291** | 4,786 |
| | **28,609** | 44,051 |

## 6. PROFIT BEFORE TAX

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

| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| Employee benefit expenses (including directors' remuneration (note 8)): | | | |
| Wages and salaries | | **362,957** | 286,238 |
| Social insurance costs and staff welfare | | **73,074** | 57,047 |
| Share-based compensation costs | | **48,472** | 17,266 |
| Pension plan contributions | | **33,215** | 26,538 |
| | | **517,718** | 387,089 |
| Minimum lease payments under operating leases: | | | |
| Bandwidth and server | | **61,377** | 49,631 |
| Buildings | | **27,189** | 19,542 |
| | | **88,566** | 69,173 |
| Cost of inventory sold | | **15,419** | 11,272 |
| Depreciation | (a) | **60,723** | 63,547 |
| Amortisation of lease prepayments | (a) | **941** | 941 |
| Amortisation of other intangible assets | (a) | **26,700** | 27,940 |
| Write-down of inventories** | | **11,314** | 1,527 |
| Loss on disposal of items of property, plant and equipment** | | **272** | 899 |
| Foreign exchange differences, net** | | **591** | (2,807) |
| Impairment of other intangible assets** | | **5,725** | — |
| Impairment of investments in jointly-controlled entities** | 18 | **—** | 5,000 |
| Impairment of loans to other shareholders of jointly-controlled entities** | | **—** | 2,000 |
| Donation** | | **1,553** | 500 |
| Auditors' remuneration | | **9,248** | 9,268 |
| Interest on bank loans | | **8,702** | 3,461 |
| Government grants: | | | |
| — Recorded as a reduction to research and development costs* | | **(12,831)** | (21,781) |
| — Recorded in other income and gains | 5 | **(23,318)** | (35,497) |
| | | **(36,149)** | (57,278) |
| Gain on deemed disposal of an associate | | **—** | (1,500) |
| Gain on disposal of an available-for-sale investment | | **—** | (1,440) |
| Gain on disposal of a subsidiary | | **—** | (828) |
| Fair value loss/(gain) on a financial asset at fair value through profit or loss | 21 | **(16,010)** | 1,973 |
| Interest income from loans to related parties | | **(2,974)** | (2,040) |
| Bank interest income | | **(94,999)** | (63,090) |

## 6. PROFIT BEFORE TAX (continued)

* Government grants which were granted to support the development of software and online game technology are recorded as a reduction to "research and development costs" on the face of the consolidated income statement during the year. Government grants received/receivable for which the related expenditures have not yet been incurred are included in "deferred revenue" in the consolidated statement of financial position.

** They are included in "other expenses" on the face of the consolidated income statement.

Note:

(a) Depreciation of property, plant and equipment, amortisation of lease prepayments and other intangible assets

| | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|---|---|
| Included in: | | |
| Cost of revenue | **33,425** | 26,558 |
| Research and development costs | **40,239** | 46,979 |
| Selling and distribution expenses | **3,296** | 3,953 |
| Administrative expenses | **11,404** | 14,938 |
| | **88,364** | 92,428 |

## 7. SHARE-BASED COMPENSATION COSTS

### (a) Share option schemes

*2004 and 2007 Pre-IPO Share Option Schemes*

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

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

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

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

The 2004 Scheme and the 2007 Scheme were terminated on 3 September 2007. No share options have been granted under these two schemes since then. The following table illustrates the numbers and weighted average exercise prices ("WAEP") of, and movements in, the Company's share options under these two schemes for the years ended 31 December 2012 and 2011.

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

### (a) Share option schemes (continued)

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

| | GROUP AND COMPANY | | | |
|---|---|---|---|---|
| | 2012 NUMBER OF SHARE OPTIONS | 2012 WAEP USD PER SHARE | 2011 NUMBER OF SHARE OPTIONS | 2011 WAEP USD PER SHARE |
| 2004 Scheme | | | | |
| Outstanding at 1 January | **5,143,500** | **0.0945** | 12,480,500 | 0.0789 |
| Exercised during the year | **(2,200,500)** | **0.1767** | (7,337,000) | 0.0680 |
| Outstanding at 31 December | **2,943,000** | **0.0331** | 5,143,500 | 0.0945 |
| Exercisable at 31 December | **2,943,000** | **0.0331** | 5,143,500 | 0.0945 |
| 2007 Scheme | | | | |
| Outstanding at 1 January | **17,776,800** | **0.2432** | 57,017,100 | 0.2411 |
| Forfeited during the year | **—** | **—** | (104,000) | 0.2400 |
| Exercised during the year | **(3,693,000)** | **0.2412** | (39,136,300) | 0.2401 |
| Outstanding at 31 December | **14,083,800** | **0.2438** | 17,776,800 | 0.2432 |
| Exercisable at 31 December | **14,083,800** | **0.2438** | 17,776,800 | 0.2432 |
| Total outstanding at 31 December | **17,026,800** | **0.2074** | 22,920,300 | 0.2099 |
| Total exercisable at 31 December | **17,026,800** | **0.2074** | 22,920,300 | 0.2099 |

The weighted average share price at the date of exercise for the options exercised during the year was HKD3.70 (2011: HKD3.72).

The weighted average remaining contractual life for the Company's share options outstanding under the 2004 Scheme as at 31 December 2012 was 1.68 years (2011: 3.26 years), and the range of exercise prices for these outstanding options was USD0.0005 to USD0.2400 (2011: USD0.0005 to USD0.2400).

The weighted average remaining contractual life for the Company's share options outstanding under the 2007 Scheme as at 31 December 2012 was 4.10 years (2011: 5.10 years) and the range of exercise prices for these outstanding options was USD0.2400 to USD0.4616 (2011: USD0.2400 to USD0.4616).

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

### (a) Share option schemes (continued)

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

The following share options were outstanding under the 2004 Scheme and the 2007 Scheme during the years ended 31 December 2012 and 2011.

| | NUMBER OF SHARE OPTIONS | | | | |
|---|---|---|---|---|---|
| NAME OR CATEGORY OF PARTICIPANT | AT 1 JANUARY 2012 | EXERCISED DURING THE YEAR | AT 31 DECEMBER 2012 | DATE OF GRANT OF SHARE OPTIONS | EXERCISE PRICE OF SHARE OPTIONS USD PER SHARE |
| **OTHER EMPLOYEES** | | | | | |
| In aggregate | | | | | |
| | **1,700,500** | **(350,000)** | **1,350,500** | 1 January 2000**** | 0.0005 |
| | **1,517,500** | **(146,500)** | **1,371,000** | 1 August 2004 | 0.0353 |
| | **665,500** | **(494,000)** | **171,500** | 1 August 2005 | 0.2118 |
| | **410,000** | **(410,000)** | **—** | 1 August 2006 | 0.2118 |
| | **850,000** | **(800,000)** | **50,000** | 1 December 2006 | 0.2400 |
| | **16,966,800** | **(3,543,000)** | **13,423,800** | 1 February 2007*** | 0.2400 |
| | **444,000** | **(44,000)** | **400,000** | 1 April 2007*** | 0.2400 |
| | **106,000** | **(86,000)** | **20,000** | 8 May 2007*** | 0.2400 |
| | **260,000** | **(20,000)** | **240,000** | 1 August 2007*** | 0.4616 |
| | **22,920,300** | **(5,893,500)** | **17,026,800** | | |

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

### (a) Share option schemes (continued)

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

| NAME OR CATEGORY OF PARTICIPANT | NUMBER OF SHARE OPTIONS<br>AT 1 JANUARY 2011 | EXERCISED DURING THE YEAR | FORFEITED DURING THE YEAR | AT 31 DECEMBER 2011 | DATE OF GRANT OF SHARE OPTIONS | EXERCISE PRICE OF SHARE OPTIONS USD PER SHARE |
|---|---|---|---|---|---|---|
| **EXECUTIVE DIRECTORS** | | | | | | |
| Donghui Wang* | 100,000 | (100,000) | — | — | 1 December 2006 | 0.2400 |
| | 1,742,000 | (1,742,000) | — | — | 1 February 2007*** | 0.2400 |
| | 1,842,000 | (1,842,000) | — | — | | |
| Tao Zou | 400,000 | (400,000) | — | — | 1 December 2006 | 0.2400 |
| | 1,559,000 | (1,559,000) | — | — | 1 February 2007*** | 0.2400 |
| | 1,959,000 | (1,959,000) | — | — | | |
| **NON-EXECUTIVE DIRECTORS** | | | | | | |
| Jun Lei | 5,311,500 | (5,311,500) | — | — | 1 August 2004 | 0.0353 |
| | 22,451,800 | (22,451,800) | — | — | 1 February 2007*** | 0.2400 |
| | 27,763,300 | (27,763,300) | — | — | | |
| Shuen Lung Cheung** | 1,000,000 | — | — | 1,000,000 | 1 August 2004 | 0.0353 |
| **OTHER EMPLOYEES** | | | | | | |
| In aggregate | | | | | | |
| | 1,700,500 | — | — | 1,700,500 | 1 January 2000**** | 0.0005 |
| | 1,281,500 | (764,000) | — | 517,500 | 1 August 2004 | 0.0353 |
| | 975,000 | (309,500) | — | 665,500 | 1 August 2005 | 0.2118 |
| | 760,000 | (350,000) | — | 410,000 | 1 August 2006 | 0.2118 |
| | 952,000 | (102,000) | — | 850,000 | 1 December 2006 | 0.2400 |
| | 30,205,300 | (13,134,500) | (104,000) | 16,966,800 | 1 February 2007*** | 0.2400 |
| | 609,000 | (165,000) | — | 444,000 | 1 April 2007*** | 0.2400 |
| | 165,000 | (59,000) | — | 106,000 | 8 May 2007*** | 0.2400 |
| | 285,000 | (25,000) | — | 260,000 | 1 August 2007*** | 0.4616 |
| | 36,933,300 | (14,909,000) | (104,000) | 21,920,300 | | |
| | 69,497,600 | (46,473,300) | (104,000) | 22,920,300 | | |

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

### (a) Share option schemes (continued)

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

* Mr. Donghui Wang has resigned as an executive director of the Company on 1 October 2011.

** Mr. Shuen Lung Cheung was appointed as a non-executive director of the Company on 25 March 2010, and resigned on 28 July 2011.

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

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

*2011 Share Option Scheme*

The Company operates the 2011 Scheme for the purpose of providing incentives and rewards to eligible participants. Eligible participants of the 2011 Scheme include the Company's directors, including independent non-executive directors, and other employees of the Group. The 2011 Scheme became effective on 9 December 2011 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

The total number of shares which may be issued upon exercise of all share options to be granted under the 2011 Scheme and any other share option schemes of the Company shall not in aggregate exceed 10% of the total number of shares in issue on 9 December 2011. The maximum number of shares issuable under share options to each eligible participant in the 2011 Scheme within any 12-month period is limited to 1% of the shares of the Company at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their respective associates, are subject to approval in advance by the independent non-executive directors of the Company. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their respective associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the price of the Company's shares at the date of grant) in excess of HKD5,000,000, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

The offer of a grant of share options may be accepted within 28 days from the date of offer, upon payment of a nominal consideration of HKD1 in total by the grantee. The exercise period of the share options granted is determinable by the directors, and commences after a vesting period determined at the discretion of the board of directors and ends on a date which is no later than 10 years from the date of offer of the share options.

The exercise price of share options is determinable by the directors, but may not be less than the highest of (i) the Stock Exchange closing price of the Company's shares on the date of offer of the share options; (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of offer; and (iii) the nominal value of a share.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

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

### (a) Share option schemes (continued)

*2011 Share Option Scheme (continued)*

The following share options were outstanding under the 2011 Scheme during the years ended 31 December 2012 and 2011:

| | GROUP AND COMPANY | | | |
|---|---|---|---|---|
| | 2012 NUMBER OF SHARE OPTIONS | 2012 WAEP HKD PER SHARE | 2011 NUMBER OF SHARE OPTIONS | 2011 WAEP HKD PER SHARE |
| Outstanding at 1 January | **12,500,000** | 2.89 | **—** | — |
| Granted during the year | **3,000,000** | 3.28 | **12,500,000** | 2.89 |
| Forfeited during the year | **(5,000,000)** | 2.89 | **—** | — |
| Outstanding at 31 December | **10,500,000** | 3.00 | **12,500,000** | 2.89 |
| Exercisable at 31 December | **1,500,000** | — | **—** | — |

The weighted average remaining contractual life for the Company's share options outstanding under the 2011 Scheme as at 31 December 2012 was 9.08 years (2011: 9.97 years).

The following share options were outstanding under 2011 Scheme during the years ended 31 December 2012 and 2011.

| | NUMBER OF SHARE OPTIONS | | | | | |
|---|---|---|---|---|---|---|
| NAME OR CATEGORY OF PARTICIPANT | AT 1 JANUARY 2012 | GRANTED DURING THE YEAR | FORFEITED DURING THE YEAR | AT 31 DECEMBER 2012 | DATE OF GRANT OF SHARE OPTIONS | EXERCISE PRICE OF SHARE OPTIONS HKD PER SHARE |
| **EXECUTIVE DIRECTORS** | | | | | | |
| Hongjiang Zhang | **7,500,000** | **—** | **—** | **7,500,000** | 20 December 2011 | 2.89 |
| Shun Tak Wong* | **5,000,000** | **—** | **(5,000,000)** | **—** | 20 December 2011 | 2.89 |
| | **12,500,000** | **—** | **(5,000,000)** | **7,500,000** | | |
| **OTHER EMPLOYEES** | | | | | | |
| In aggregate | **—** | **3,000,000** | **—** | **3,000,000** | 20 July 2012 | 3.28 |
| | **12,500,000** | **3,000,000** | **(5,000,000)** | **10,500,000** | | |

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

### (a) Share option schemes (continued)

*2011 Share Option Scheme (continued)*

| NAME OR CATEGORY OF PARTICIPANT | NUMBER OF SHARE OPTIONS AT 1 JANUARY 2011 | GRANTED DURING THE YEAR | AT 31 DECEMBER 2011 | DATE OF GRANT OF SHARE OPTIONS | EXERCISE PRICE OF SHARE OPTIONS HKD PER SHARE |
|---|---|---|---|---|---|
| **EXECUTIVE DIRECTORS** | | | | | |
| Hongjiang Zhang | — | 7,500,000 | 7,500,000 | 20 December 2011 | 2.89 |
| Shun Tak Wong* | — | 5,000,000 | 5,000,000 | 20 December 2011 | 2.89 |
| | — | 12,500,000 | 12,500,000 | | |

* Mr. Shun Tak Wong resigned as an executive director of the Company on 15 July 2012.

The fair value of the share options granted during the years ended 31 December 2012 was RMB3,340,000 (2011: RMB11,483,000).

The fair value of the share options granted during the year was estimated as at the date of grant, using a binomial model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used:

| | |
|---|---|
| Dividend yield (%) | **3.30%** |
| Expected volatility (%) | **54.00%** |
| Risk-free interest rate (%) | **0.82%** |
| Expected forfeiture rate (%) | **0.00%** |
| Weighted average share price (HKD per share) | **3.28** |

The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

No other feature of the options granted was incorporated into the measurement of fair value.

At the end of the reporting period, the Company had 27,526,800 share options outstanding under the 2004 Scheme, 2007 Scheme and 2011 Scheme. The exercise in full of the outstanding share options would, under the present capital structure of the Company, result in the issue of 27,526,800 additional ordinary shares of the Company and additional share capital of RMB87,000 and share premium of RMB47,661,000 (before issue expenses).

At the date of approval of these financial statements, the Company had 27,526,800 share options outstanding under the above three schemes, which represented approximately 2.35% of the Company's shares in issue as at that date.

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

### (a) Share option schemes (continued)

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

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

(a) Pursuant to a directors' resolution on 4 January 2007, 410 options were granted to certain employees which vest over a period of three years, with one third of options to be vested on the first anniversary of the grant date, and an additional one twelfth to be vested after each three months and exercisable upon the Condition. 210 options out of such 410 options have already been forfeited.

(b) Pursuant to a directors' resolution on 30 March 2007, 90 options, which are exercisable upon the Condition above, were granted to employees and a consultant.

(c) Pursuant to a directors' resolution on 31 July 2007, the authorisation to issue the remaining 500 options under the November Resolution was revoked, and another 710 options were granted to the employees. Among the 710 options, 520 options are vested over a period of two years, with half of the options to be vested on the first anniversary of the grant date or the date when the employee joined the company, whichever is earlier, and an additional one eighth to be vested each three months thereafter; and the remaining 190 options are vested over a period of three years, with one third of the options to be vested on the first anniversary of the grant date or the date when the employee joined the company, whichever is earlier, and an additional one twelfth to be vested after each three months. The exercise of the above options is conditional upon a successful initial public offering of Kingsoft Japan.

No share options were granted or exercised in 2012 and 2011, and no share options were forfeited in 2012 and 2011.

*Kingsoft Cloud Holdings Limited ("KC Holdings") Share Option Scheme*

On 27 February 2013 (the "KC Share Option Adoption Date"), the shareholders of the Company and KC Holdings, a subsidiary of the Company, approved and adopted the KC Share Option Scheme for the purpose of providing incentives and rewards to eligible participants, in which selected employees of KC Holdings and its subsidiaries are entitled to participate. The maximum number of KC Share Option Scheme which may be issued upon exercise of all share options to be granted may not in aggregate exceed 49,550,000 shares (representing 5.37% of the shares in issue) which is lower than 10% of the shares in issue at the KC Share Option Adoption Date. The KC Share Option Scheme shall be valid and effective for a term of ten years commencing on the KC Adoption Date. The exercise price of share options is determinable by the board of KC Holdings.

During the year ended 31 December 2012, 37,700,000 share options were granted, through grant intention letters, subject to the approval of the Company's shareholders and KC Holdings' shareholders, to a number of employees with a vesting period of five years and the employees began to provide services from the grant intention letter date.

The fair value of the KC share options granted during the year ended 31 December 2012 was estimated based on the grant intention letter date fair value of the share options and would be adjusted ultimately based on the formal grant date fair value. The total expense in respect of the KC Share Option Scheme for the year ended 31 December 2012 was insignificant.

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

### (b) Share Award Scheme

On 31 March 2008, the directors of the Company approved and adopted the Share Award Scheme in which selected employees of the Group are entitled to participate. Unless early terminated by the directors of the Company, the Share Award Scheme is valid and effective for a term of five years commencing from 31 March 2008. On 25 November 2010, the directors of the Company resolved to extend the termination date of the Share Awarded Scheme from 30 March 2013 to 30 March 2017. The directors will not grant any awarded shares which would result in the total number of shares, which are the subject of awards granted by the directors of the Company under the Share Award Scheme (but not counting any which have lapsed or have been forfeited), in aggregate over 10% of the issued capital of the Company as at the date of such grant.

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

During the year ended 31 December 2012, 8,092,000 shares (2011: 11,870,000 shares) were granted to a number of employees with vesting period of five years, out of which, no (2011: 170,000 shares) Awarded Shares were subject to certain performance conditions.

During the year ended 31 December 2012, the Share Award Scheme Trust did not acquire shares (2011: 20,000,000 shares, at a total cost of approximately RMB47,420,000) of the Company through purchases on the open market.

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

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

The following table illustrates the numbers of and movements in the Company's Awarded Shares for the years ended 31 December 2012 and 2011.

| | 2012 NUMBER OF AWARDED SHARES | 2011 NUMBER OF AWARDED SHARES |
|---|---|---|
| Outstanding as at 1 January | **16,207,004** | 16,596,801 |
| Granted during the year | **8,092,000** | 11,870,000 |
| Forfeited during the year | **(3,224,334)** | (4,214,202) |
| Cancelled during the year | **—** | (1,440,600) |
| Exercised and transferred during the year | **(3,430,000)** | (6,604,995) |
| Outstanding as at 31 December | **17,644,670** | 16,207,004 |
| Exercisable as at 31 December | **2,046,000** | 1,024,000 |

The total expense recognised in respect of the Awarded Shares for the year ended 31 December 2012 was RMB18,267,000 (2011: RMB11,974,000).

The fair value of the Awarded Shares was determined based on the market value of the Company's shares at the grant date. The weighted average fair value of the Awarded Shares granted during the year ended 31 December 2012 was RMB3.62 each (2011: RMB2.71 each).

As at 31 December 2012, 9,014,337 (2011: 13,882,002) forfeited or unawarded shares were held by the Share Award Scheme Trust and would be granted in future.

At the date of approval of these financial statements, the Company had 17,644,670 Awarded Shares outstanding under the Share Award Scheme, which represented approximately 1.51% of the Company's shares in issue as at that date.

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

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

The following Awarded Shares were outstanding under the Share Award Scheme during the years ended 31 December 2012 and 2011.

| | NUMBER OF AWARDED SHARES | | | | | |
|---|---|---|---|---|---|---|
| NAME OR CATEGORY OF PARTICIPANT | AT 1 JANUARY 2012 | GRANTED DURING THE YEAR | FORFEITED DURING THE YEAR | EXERCISED AND TRANSFERRED DURING THE YEAR | AT 31 DECEMBER 2012 | GRANT DATE |
| **EXECUTIVE DIRECTORS** | | | | | | |
| Hongjiang Zhang | 7,000,000 | — | — | — | 7,000,000 | 29 NOVEMBER 2011 |
| Shun Tak Wong* | 2,500,000 | — | (2,500,000) | — | — | 29 NOVEMBER 2011 |
| Tao Zou | 216,000 | — | — | (216,000) | — | 13 OCTOBER 2008 |
| | — | 500,000 | — | — | 500,000 | 1 JUNE 2012 |
| | 216,000 | 500,000 | — | (216,000) | 500,000 | |
| **NON-EXECUTIVE DIRECTOR** | | | | | | |
| Pak Kwan Kau | 500,000 | — | — | (500,000) | — | 13 JULY 2009 |
| **OTHER EMPLOYEES** | | | | | | |
| In aggregate | | | | | | |
| | 100,000 | — | — | (41,000) | 59,000 | 26 JUNE 2008 |
| | 147,000 | — | — | (132,000) | 15,000 | 13 OCTOBER 2008 |
| | 50,000 | — | — | (50,000) | — | 1 DECEMBER 2008 |
| | 160,000 | — | — | (160,000) | — | 8 JUNE 2009 |
| | 26,667 | — | — | (26,667) | — | 27 NOVEMBER 2009 |
| | 648,000 | — | — | (476,000) | 172,000 | 1 DECEMBER 2009 |
| | 1,396,667 | — | (263,334) | (698,333) | 435,000 | 26 MARCH 2010 |
| | 1,066,669 | — | (113,333) | (490,000) | 463,336 | 26 MAY 2010 |
| | 40,001 | — | (16,667) | (20,000) | 3,334 | 23 JUNE 2010 |
| | 86,000 | — | (56,000) | (30,000) | — | 12 JULY 2010 |
| | 150,000 | — | — | (50,000) | 100,000 | 12 JANUARY 2011 |
| | 120,000 | — | (80,000) | (40,000) | — | 18 APRIL 2011 |
| | 2,000,000 | — | — | (500,000) | 1,500,000 | 8 JUNE 2011 |
| | — | 782,000 | (195,000) | — | 587,000 | 4 APRIL 2012 |
| | — | 5,880,000 | — | — | 5,880,000 | 1 JUNE 2012 |
| | — | 80,000 | — | — | 80,000 | 19 JUNE 2012 |
| | — | 250,000 | — | — | 250,000 | 3 DECEMBER 2012 |
| | — | 600,000 | — | — | 600,000 | 17 DECEMBER 2012 |
| | 5,991,004 | 7,592,000 | (724,334) | (2,714,000) | 10,144,670 | |
| | 16,207,004 | 8,092,000 | (3,224,334) | (3,430,000) | 17,644,670 | |

* Mr. Shun Tak Wong resigned as an executive director of the Company on 15 July 2012.

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

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

| NAME OR CATEGORY OF PARTICIPANT | AT 1 JANUARY 2011 | GRANTED DURING THE YEAR | FORFEITED DURING THE YEAR | CANCELLED DURING THE YEAR | EXERCISED AND TRANSFERRED DURING THE YEAR | AT 31 DECEMBER 2011 | GRANT DATE |
|---|---|---|---|---|---|---|---|
| | NUMBER OF AWARDED SHARES | | | | | | |
| **EXECUTIVE DIRECTORS** | | | | | | | |
| Hongjiang Zhang | — | 7,000,000 | — | — | — | 7,000,000 | 29 November 2011 |
| Shun Tak Wong | — | 2,500,000 | — | — | — | 2,500,000 | 29 November 2011 |
| Pak Kwan Kau | 1,000,000 | — | — | — | (500,000) | 500,000 | 13 July 2009 |
| Donghui Wang | 127,000 | — | (127,000) | — | — | — | 13 October 2008 |
| | 1,000,000 | — | (500,000) | — | (500,000) | — | 13 July 2009 |
| | 57,000 | — | — | (57,000)# | — | — | 26 March 2010 |
| | 1,184,000 | — | (627,000) | (57,000) | (500,000) | — | |
| Tao Zou | 324,000 | — | — | — | (108,000) | 216,000 | 13 October 2008 |
| | 78,000 | — | — | (78,000)# | — | — | 26 March 2010 |
| | 402,000 | — | — | (78,000) | (108,000) | 216,000 | |
| **OTHER EMPLOYEES** | | | | | | | |
| In aggregate | | | | | | | |
| | 1,382,000 | — | (333,000) | — | (949,000) | 100,000 | 26 June 2008 |
| | 2,239,000 | — | (428,000) | — | (1,664,000) | 147,000 | 13 October 2008 |
| | 200,000 | — | — | — | (200,000) | — | 27 November 2008 |
| | 50,000 | — | — | — | — | 50,000 | 1 December 2008 |
| | 1,066,667 | — | (533,334) | — | (533,333) | — | 1 January 2009 |
| | 320,000 | — | — | — | (160,000) | 160,000 | 8 June 2009 |
| | 53,334 | — | — | — | (26,667) | 26,667 | 27 November 2009 |
| | 951,000 | — | (258,000) | — | (45,000) | 648,000 | 1 December 2009 |
| | 350,000 | — | (240,000) | — | (110,000) | — | 12 January 2010 |
| | 4,626,800 | — | (862,867) | (1,305,600)# | (1,061,666) | 1,396,667 | 26 March 2010 |
| | 2,460,000 | — | (740,000) | — | (653,331) | 1,066,669 | 26 May 2010 |
| | 73,000 | — | (8,667) | — | (24,332) | 40,001 | 23 June 2010 |
| | 209,000 | — | (53,334) | — | (69,666) | 86,000 | 12 July 2010 |
| | 30,000 | — | (30,000) | — | — | — | 26 November 2010 |
| | — | 250,000 | (100,000) | — | — | 150,000 | 12 January 2011 |
| | — | 120,000 | — | — | — | 120,000 | 18 April 2011 |
| | — | 2,000,000 | — | — | — | 2,000,000 | 8 June 2011 |
| | 14,010,801 | 2,370,000 | (3,587,202) | (1,305,600) | (5,496,995) | 5,991,004 | |
| | 16,596,801 | 11,870,000 | (4,214,202) | (1,440,600) | (6,604,995) | 16,207,004 | |

# During the year ended 31 December 2011, 1,440,600 Awarded Shares granted to certain directors and employees on 26 March 2010 were cancelled with cash compensation of RMB7,520,000.

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

### (c) Share Award Scheme adopted by KIS Holdings

On 26 May 2011 (the "KIS Adoption Date"), the directors of KIS Holdings, a subsidiary of the Company, approved and adopted the KIS Share Award Scheme, in which selected employees of KIS Holdings and its subsidiaries ("KIS Group") are entitled to participate. Unless early terminated by the directors of KIS Holdings, the KIS Share Award Scheme shall be valid and effective for a term of ten years commencing on the KIS Adoption Date. The directors of KIS Holdings will not grant any award of shares which would result in the total number of shares (but not counting any which have lapsed or have been forfeited) being greater than 100,000,000 shares, as at the date of such grant.

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

During the year ended 31 December 2012, 29,270,000 shares (2011: 51,550,000 shares) were awarded to a number of employees with a vesting period from 0.45 years to four years.

The following table illustrates the numbers of and movements in the KIS Awarded Shares for the years ended 31 December 2012 and 2011.

| | 2012 NUMBER OF AWARDED SHARES | 2011 NUMBER OF AWARDED SHARES |
|---|---|---|
| Outstanding as at 1 January | **49,870,000** | — |
| Granted during the year | **29,270,000** | 51,550,000 |
| Forfeited during the year | **(4,212,500)** | (1,680,000) |
| Outstanding as at 31 December | **74,927,500** | 49,870,000 |
| Exercisable as at 31 December | **14,092,500** | 49,870,000 |

The total expense recognised in respect of the KIS Awarded Shares for the year ended 31 December 2012 was RMB18,590,000 (2011: RMB4,751,000).

The fair value of the KIS Awarded Shares was determined by reference to the fair value of KIS Holdings' ordinary shares at the grant date, which was valued by an external valuer using a discounted cash flow method. The weighted average fair value of the KIS Awarded Shares granted during the year ended 31 December 2012 was RMB1.13 (2011: RMB0.30) each.

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

### (d) Share Award Scheme adopted by KOS Holdings

On 3 December 2012 (the "KOS Adoption Date"), the directors of KOS Holdings, a subsidiary of the Company, approved and adopted the KOS Share Award Scheme, in which selected employees of KOS Holdings and its subsidiaries ("KOS Group") are entitled to participate. Unless early terminated by the directors of KOS Holdings, the KOS Share Award Scheme shall be valid and effective for a term of ten years commencing on the KOS Adoption Date. The directors of KOS Holdings will not grant any award of shares which would result in the total number of shares (but not counting any which have lapsed or have been forfeited) being greater than 50,000,000 shares, as at the date of such grant.

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

During the year ended 31 December 2012, 30,000,000 shares were awarded to a number of employees, of which 6,000,000 shares were vested at the grant date immediately, and the remain shares will be vested by several tranches over a vesting period not less than four years. No shares were forfeited during the year 31 December 2012.

The total expense recognised in respect of the KOS Awarded Shares for the year ended 31 December 2012 was RMB1,755,000.

The fair value of the KOS Awarded Shares was determined by reference to the fair value of KOS Holdings' ordinary shares at the grant date, which was valued by an external valuer using a discounted cash flow method. The weighted average fair value of the KOS Awarded Shares granted during the year ended 31 December 2012 was RMB0.2837 each.

### (e) Share Award Scheme adopted by KC Holdings

On 22 February 2013, the directors of KC Holdings approved and adopted the KC Share Award Scheme, in which selected employees of KC Holdings and its subsidiaries are entitled to participate. Unless early terminated by the directors of KC Holdings, the KC Share Award Scheme shall be valid and effective for a term of ten years commencing on 22 February 2013. The directors of KC Holdings will not grant any award of shares which would result in the total number of shares (but not counting any which have lapsed or have been forfeited) being greater than 48,000,000 shares, as at the date of such grant.

During the year ended 31 December 2012, 25,000,000 awarded shares under KC Share Award Scheme were granted, through grant intention letters, subject to the approval of the KC Holdings' board of directors, to a number of employees and the employees began to provide services from the grant intention letter date.

The total expense in respect of the KC Awarded Shares for the year ended 31 December 2012 was insignificant.

## 8. DIRECTORS' AND CHIEF EXECUTIVE'S REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS

### (a) Directors' and chief executive's remuneration

Directors' and chief executive's remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on the Stock Exchange and Section 161 of the Hong Kong Companies Ordinance, is as follows:

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Fees | **443** | 579 |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | **5,781** | 4,747 |
| Discretionary bonuses | **329** | 768 |
| Pension plan contributions | **51** | 22 |
| Share-based compensation | **12,260** | 4,022 |
| | **18,864** | 10,138 |

*Year ended 31 December 2012*

| | FEES RMB'000 | SALARIES, ALLOWANCES AND BENEFITS IN KIND RMB'000 | DISCRETIONARY BONUSES RMB'000 | PENSION PLAN CONTRIBUTIONS RMB'000 | SHARE-BASED COMPENSATION RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|---|
| Executive directors: | | | | | | |
| Hongjiang Zhang[1] | — | 3,503 | 329 | 25 | 11,534 | 15,391 |
| Shun Tak Wong[2] | — | 1,077 | — | — | — | 1,077 |
| Tao Zou | — | 810 | — | 13 | 330 | 1,153 |
| Non-executive directors: | | | | | | |
| Pak Kwan Kau | — | 189 | — | — | 396 | 585 |
| Jun Lei | — | 202 | — | 13 | — | 215 |
| Chi Ping Lau[3] | — | — | — | — | — | — |
| Independent non-executive directors: | | | | | | |
| Tat Joel Chang[4] | 101 | — | — | — | — | 101 |
| Guangming George Lu | 190 | — | — | — | — | 190 |
| Chuan Wang[3] | — | — | — | — | — | — |
| To Thomas Hui[5] | 152 | — | — | — | — | 152 |
| | 443 | 5,781 | 329 | 51 | 12,260 | 18,864 |

1 Mr. Hongjiang Zhang was the chief executive officer of the Company during the year.

2 Mr. Shun Tak Wong resigned as an executive director of the Company on 15 July 2012.

3 Mr. Chi Ping Lau and Mr. Chuan Wang agreed to waive their remuneration during the year.

4 Mr. Tat Joel Chang resigned as an independent non-executive director of the Company on 25 May 2012.

5 Mr. To Thomas Hui has been appointed as a non-executive director of the Company on 25 May 2012.

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

### (a) Directors' and chief executive's remuneration (continued)

*Year ended 31 December 2011*

| | FEES RMB'000 | SALARIES, ALLOWANCES AND BENEFITS IN KIND RMB'000 | DISCRETIONARY BONUSES RMB'000 | PENSION PLAN CONTRIBUTIONS RMB'000 | SHARE-BASED COMPENSATION RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|---|
| Executive directors: | | | | | | |
| Hongjiang Zhang[1] | — | 718 | 108 | — | 853 | 1,679 |
| Shun Tak Wong[2] | — | 889 | 660 | — | 313 | 1,862 |
| Pak Kwan Kau[3] | — | 1,218 | — | — | 1,366 | 2,584 |
| Donghui Wang[4] | — | 682 | — | — | 940 | 1,622 |
| Tao Zou | — | 875 | — | 11 | 488 | 1,374 |
| Non-executive directors: | | | | | | |
| Pak Kwan Kau[3] | — | 36 | — | — | — | 36 |
| Jun Lei | — | 201 | — | 11 | 62 | 274 |
| Shuen Lung Cheung[5] | — | 128 | — | — | — | 128 |
| Chi Ping Lau[6] | — | — | — | — | — | — |
| Independent non-executive directors: | | | | | | |
| Tat Joel Chang[7] | 63 | — | — | — | — | 63 |
| Guangming George Lu | 194 | — | — | — | — | 194 |
| Shun Tak Wong[2] | 194 | — | — | — | — | 194 |
| Mingming Huang[8] | 128 | — | — | — | — | 128 |
| Chuan Wang[9] | — | — | — | — | — | — |
| | 579 | 4,747 | 768 | 22 | 4,022 | 10,138 |

1 Mr. Hongjiang Zhang has been appointed as an executive director of the Company with effect from 14 December 2011.

2 Mr. Shun Tak Wong resigned as an independent non-executive director of the Company on 1 October 2011, and has been appointed as an executive director of the Company with effect from 14 December 2011.

3 Mr. Pak Kwan Kau re-designated as a non-executive director of the Company on 24 October 2011.

4 Mr. Donghui Wang resigned as an executive director of the Company on 1 October 2011.

5 Mr. Shuen Lung Cheung resigned as a non-executive director of the Company on 28 July 2011.

6 Mr. Chi Ping Lau has been appointed as a non-executive director of the Company with effect from 28 July 2011, and he agreed to waive his remuneration during the year.

7 Mr. Tat Joel Chang has been appointed as an independent non-executive director of the Company with effect from 1 October 2011.

8 Mr. Mingming Huang retired as an independent non-executive director of the Company on 28 July 2011.

9 Mr. Chuan Wang has been appointed as an independent non-executive director of the Company with effect from 28 July 2011, and he agreed to waive his remuneration during the year.

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

### (b) Five highest paid individuals

The five highest paid individuals for the year ended 31 December 2011 were all directors, details of whose remuneration are set above. The five highest paid individuals for the year ended 31 December 2012 included one director, details of whose remuneration are set out above, and details of the remuneration of the remaining non-director, highest paid employees are as follows:

| | GROUP 2012 RMB'000 |
|---|---|
| Salaries, allowances and benefits in kind | **2,958** |
| Discretionary bonuses | **657** |
| Pension plan contributions | **91** |
| Share-based compensation | **1,933** |
| | **5,639** |

For the year ended 31 December 2012, the number of non-director, highest paid individuals whose remuneration fell within the following bands is as follows:

| | NUMBER OF EMPLOYEE 2012 |
|---|---|
| RMB1,000,001 to RMB1,500,000 | 3 |
| RMB1,500,001 to RMB2,000,000 | 1 |

During the year, certain non-director, highest paid employees were granted Awarded Shares and share options in respect of their services to the Group under the Share Award Scheme and the 2011 Scheme of the Company, further details of which are set out in note 7 to the financial statements. The fair value of such Awarded Shares and share options, which has been recognised in the income statement over the vesting period, was determined as at the date of the grant and the amount included in the financial statements for the current year is included in the above directors' remuneration disclosures.

## 9. INCOME TAX

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

Hong Kong profits tax has been provided at the rate of 16.5% (2011: 16.5%) on estimated assessable profits arising in Hong Kong during the year ended 31 December 2012.

In accordance with Japanese tax laws, the income tax rate applicable to the Group's subsidiary in Japan was 41% for the year ended 31 December 2012 (2011: 41%).

The Group's subsidiary in Malaysia was granted the Multimedia Super Corridor Malaysia Status ("MSC Malaysia Status"). Therefore, the online game related activities of the subsidiary were exempted from corporate income tax for the period from April 2010 to December 2014.

## 9. INCOME TAX (continued)

The major components of income tax expense for the years ended 31 December 2012 and 2011 are:

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Current — Mainland China | **55,059** | 52,689 |
| Current — Hong Kong | **6,711** | 4,907 |
| Current — Elsewhere | **5,655** | 9,557 |
| Deferred | **(6,066)** | (16,991) |
| Total tax charge for the year | **61,359** | 50,162 |

A reconciliation of the tax expense applicable to profit before tax at the statutory rates for the jurisdictions in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

| | GROUP | | | |
|---|---|---|---|---|
| | 2012 RMB'000 | % | 2011 RMB'000 | % |
| Profit before tax | **527,793** | | 385,196 | |
| Tax at the respective statutory income tax rate | **131,948** | **25.0** | 96,391 | 25.0 |
| Lower tax rates for entities entitled to tax holiday or a preferential tax rate | **(90,990)** | **(17.2)** | (51,203) | (13.3) |
| Expenses not deductible for tax | **6,481** | **1.2** | 1,920 | 0.5 |
| Income not subject to tax | **(22,924)** | **(4.3)** | (11,633) | (3.0) |
| Profits and losses attributable to associates and jointly-controlled entities | **750** | **0.1** | 611 | 0.2 |
| Tax losses and temporary differences not recognised | **35,867** | **6.8** | 8,791 | 2.2 |
| Tax losses and other deductible temporary differences utilised from previous periods | **(8,872)** | **(1.7)** | (715) | (0.2) |
| Effect of withholding tax on the distributable profits of the Group's PRC subsidiaries | **9,099** | **1.8** | 6,000 | 1.6 |
| Tax charge at the Group's effective income tax rate | **61,359** | **11.7** | 50,162 | 13.0 |

## 9. INCOME TAX (continued)

Deferred income tax relates to the following:

| | CONSOLIDATED STATEMENT OF FINANCIAL POSITION | | CONSOLIDATED INCOME STATEMENT | |
|---|---|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 | 2012 RMB'000 | 2011 RMB'000 |
| *Deferred income tax liabilities* | | | | |
| Deferred cost | **(17)** | (25) | **(8)** | (1,138) |
| Fair value adjustment arising from acquisition of a subsidiary | **(1,555)** | (1,905) | **(350)** | (438) |
| Gain on disposal of an associate | **—** | — | **—** | (5,825) |
| Withholding taxes on the distributable profits of the Group's PRC subsidiaries | **(15,699)** | (14,100) | **1,599** | (4,000) |
| Capitalised software costs | **(760)** | (3,148) | **(2,388)** | (758) |
| Others | **(1,342)** | (846) | **496** | (2,955) |
| | **(19,373)** | (20,024) | **(651)** | (15,114) |
| *Deferred income tax assets* | | | | |
| Property, plant and equipment | **266** | 703 | **437** | (250) |
| Deferred revenue | **22,297** | 18,553 | **(3,744)** | 1,515 |
| Accruals | **2,102** | 2,432 | **330** | 1,609 |
| Government grants | **—** | 359 | **359** | 749 |
| Others | **8,297** | 5,500 | **(2,797)** | (5,500) |
| | **32,962** | 27,547 | **(5,415)** | (1,877) |
| Deferred income tax expense | | | **(6,066)** | (16,991) |

The share of tax attributable to associates and jointly-controlled entities amounting to nil (2011: nil) and RMB517,000 (tax credit) (2011: tax credit of RMB517,000), respectively, is included in "Share of profits and losses of associates and jointly-controlled entities" in the consolidated income statement.

The Group has tax losses arising in Mainland China of RMB221,004,000 as at 31 December 2012 (2011: RMB170,463,000) that will expire in one to five years for offsetting against future taxable profits.

The amounts and expiration dates of the tax losses carried forward at 31 December 2012 and 2011 are listed below:

| EXPIRATION DATE | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| 31 December 2013 | **13,071** | 20,517 |
| 31 December 2014 | **8,176** | 20,714 |
| 31 December 2015 | **28,755** | 29,757 |
| 31 December 2016 | **92,678** | 99,475 |
| 31 December 2017 | **78.324** | — |

## 9. INCOME TAX (continued)

The Group also has tax losses arising in Hong Kong of RMB2,513,000 (2011: RMB408,000) that are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose.

Deferred tax assets have not been recognised in respect of those losses as they have arisen in subsidiaries that have been loss-making for some time and it is not considered probable that taxable profits will be available against which the tax losses can be utilised.

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

| | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|---|---|
| Tax losses | **281,927** | 170,463 |
| Deductible temporary differences | **34,134** | 21,021 |
| | **316,061** | 191,484 |

Pursuant to the PRC Corporate Income Tax Law, a 10% withholding tax is levied on dividends declared to foreign investors from the foreign investment enterprises established in Mainland China. The requirement is effective from 1 January 2008 and applies to earnings after 31 December 2007. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign investors. For the Group, the applicable rate is 5% or 10%. The Group is therefore liable for withholding taxes on dividends distributed by those subsidiaries established in Mainland China in respect of earnings generated from 1 January 2008.

Deferred tax liability is recognised for the estimated withholding taxes to the extent that it is probable that those subsidiaries will distribute earnings in the foreseeable future. This requires an estimation of the likely timing and level of dividends to be distributed, and a judgement as to whether the dividends are associated to earnings generated from 1 January 2008 or not. The aggregate amount of temporary differences associated with investments in subsidiaries in Mainland China, for which deferred tax liabilities have not been recognised for withholding taxes that would be payable on the unremitted earnings of these subsidiaries, totalled approximately RMB1,416 million at 31 December 2012 (2011: RMB965 million). In the opinion of the directors, it is not probable that these subsidiaries will distribute such earnings in the foreseeable future.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

## 10. PROFIT ATTRIBUTABLE TO OWNERS OF THE PARENT

The consolidated profit attributable to owners of the parent for the year ended 31 December 2012 includes a profit of RMB102,537,000 (2011: RMB39,933,000) which has been dealt with in the financial statements of the Company.

## 11. DIVIDENDS

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Final dividend proposed (notes (a) and (b)): | | |
| HKD0.11 (2011: HKD0.10) per share based on issued share capital as at year end | **104,510** | 94,680 |
| Less: Dividend for shares held for share award scheme as at year end | **(2,378)** | (2,439) |
| | **102,132** | 92,241 |

Notes:

(a) The actual amount of final 2011 dividends paid was RMB93,071,000, after eliminating RMB157,000 paid for shares held by the Share Award Scheme Trust.

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

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

The calculation of basic earnings per share amount is based on the profit for the year attributable to ordinary equity holders of the parent, and the weighted average number of ordinary shares of 1,142,829,305 (2011: 1,125,104,224) in issue during the year.

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

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

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| **EARNINGS** | | |
| Profit attributable to ordinary equity holders of the parent | **432,589** | 324,729 |

| | NUMBER OF SHARES 2012 | 2011 |
|---|---|---|
| **SHARES** | | |
| Weighted average number of ordinary shares in issue less shares held for the Share Award Scheme | **1,142,829,305** | 1,125,104,224 |
| Effect of dilution — weighted average number of ordinary shares: | | |
| Share options | **11,509,686** | 29,717,895 |
| Awarded Shares | **10,050,424** | 8,934,331 |
| | **1,164,389,415** | 1,163,756,450 |

## 13. PROPERTY, PLANT AND EQUIPMENT

| GROUP | LEASEHOLD LAND AND BUILDINGS RMB'000 | ELECTRONIC EQUIPMENT RMB'000 | OFFICE EQUIPMENT AND FIXTURES RMB'000 | MOTOR VEHICLES RMB'000 | LEASEHOLD IMPROVEMENTS RMB'000 | CONSTRUCTION IN PROGRESS RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|---|---|
| **31 DECEMBER 2012** | | | | | | | |
| At 31 December 2011 and 1 January 2012: | | | | | | | |
| Cost | **256,539** | **178,319** | **116,999** | **4,417** | **8,437** | **34,653** | **599,364** |
| Accumulated depreciation | **(10,996)** | **(123,032)** | **(62,958)** | **(1,782)** | **(5,268)** | **—** | **(204,036)** |
| Net carrying amount | **245,543** | **55,287** | **54,041** | **2,635** | **3,169** | **34,653** | **395,328** |
| At 1 January 2012, net of accumulated depreciation | **245,543** | **55,287** | **54,041** | **2,635** | **3,169** | **34,653** | **395,328** |
| Additions | **—** | **43,183** | **2,148** | **946** | **1,990** | **3,633** | **51,900** |
| Government grants received | **—** | **(13,981)** | **—** | **—** | **—** | **—** | **(13,981)** |
| Disposals | **—** | **(945)** | **(20)** | **(335)** | **(11)** | **—** | **(1,311)** |
| Depreciation provided during the year | **(4,129)** | **(31,574)** | **(23,111)** | **(554)** | **(1,355)** | **—** | **(60,723)** |
| At 31 December 2012, net of accumulated depreciation | **241,414** | **51,970** | **33,058** | **2,692** | **3,793** | **38,286** | **371,213** |
| At 31 December 2012: | | | | | | | |
| Cost | **256,539** | **201,295** | **118,850** | **4,422** | **8,978** | **38,286** | **628,370** |
| Accumulated depreciation | **(15,125)** | **(149,325)** | **(85,792)** | **(1,730)** | **(5,185)** | **—** | **(257,157)** |
| Net carrying amount | **241,414** | **51,970** | **33,058** | **2,692** | **3,793** | **38,286** | **371,213** |
| **31 DECEMBER 2011** | | | | | | | |
| At 31 December 2010 and 1 January 2011: | | | | | | | |
| Cost | 252,151 | 157,373 | 116,068 | 3,072 | 5,061 | 11,423 | 545,148 |
| Accumulated depreciation | (6,876) | (100,457) | (39,944) | (1,359) | (3,745) | — | (152,381) |
| Net carrying amount | 245,275 | 56,916 | 76,124 | 1,713 | 1,316 | 11,423 | 392,767 |
| At 1 January 2011, net of accumulated depreciation | 245,275 | 56,916 | 76,124 | 1,713 | 1,316 | 11,423 | 392,767 |
| Additions | 4,388 | 38,136 | 1,581 | 1,345 | 3,416 | 23,230 | 72,096 |
| Acquisition of a business (note 35) | — | 105 | — | — | — | — | 105 |
| Government grants received | — | (5,002) | — | — | — | — | (5,002) |
| Disposals | — | (1,043) | (48) | — | — | — | (1,091) |
| Depreciation provided during the year | (4,120) | (33,825) | (23,616) | (423) | (1,563) | — | (63,547) |
| At 31 December 2011, net of accumulated depreciation | 245,543 | 55,287 | 54,041 | 2,635 | 3,169 | 34,653 | 395,328 |
| At 31 December 2011: | | | | | | | |
| Cost | 256,539 | 178,319 | 116,999 | 4,417 | 8,437 | 34,653 | 599,364 |
| Accumulated depreciation | (10,996) | (123,032) | (62,958) | (1,782) | (5,268) | — | (204,036) |
| Net carrying amount | 245,543 | 55,287 | 54,041 | 2,635 | 3,169 | 34,653 | 395,328 |

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

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

During the year ended 31 December 2012, the Company did not acquire property, plant and equipment, and depreciation charge of RMB990 was provided during the year. As at 31 December 2012, the cost, accumulated depreciation and net carrying amount of the electronic equipment of the Company amounted to RMB3,239, RMB3,239 and nil, respectively.

## 14. LEASE PREPAYMENTS

| | GROUP | |
|---|---|---|
| | **2012 RMB'000** | **2011 RMB'000** |
| Carrying amount at 1 January | **44,142** | 45,083 |
| Addition | **—** | — |
| Amortisation during the year | **(941)** | (941) |
| Carrying amount at 31 December | **43,201** | 44,142 |
| At 31 December: | | |
| Cost | **46,206** | 46,206 |
| Accumulated amortisation | **(3,005)** | (2,064) |
| Net carrying amount | **43,201** | 44,142 |

The Group's lease prepayments represent prepaid land lease payments. The leasehold land is situated in Mainland China and is held under a medium term lease.

## 15. GOODWILL

| GROUP | RMB'000 |
|---|---|
| At 1 January 2011: | |
| Cost | 14,087 |
| Accumulated impairment | (2,377) |
| Net carrying amount | 11,710 |
| Cost at 1 January 2011, net of accumulated impairment | 11,710 |
| Acquisition of a subsidiary | 2,849 |
| Cost and net carrying amount at 31 December 2011 | 14,559 |
| At 31 December 2011: | |
| Cost | 14,559 |
| Accumulated impairment | — |
| Net carrying amount | 14,559 |
| Cost, net of accumulated impairment at 1 January 2012 and 31 December 2012 | **14,559** |
| At 31 December 2012: | |
| Cost | **14,559** |
| Accumulated impairment | **—** |
| Net carrying amount | **14,559** |

## 15. GOODWILL (continued)

### Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to the information security software cash-generating unit for impairment testing:

The recoverable amount of the information security software cash-generating unit has been determined based on a value in use calculation using cash flow projections based on financial budgets covering a five-year period approved by management. The discount rate applied to the cash flow projections is 20%. The growth rate used to extrapolate the cash flows of the industrial products unit beyond the five-year period is 3% by reference to long-term average growth rate.

The carrying amount of goodwill allocated to the cash-generating unit is as follows:

| | INFORMATION SECURITY SOFTWARE | |
|---|---|---|
| | **2012 RMB'000** | **2011 RMB'000** |
| Carrying amount of goodwill | **14,559** | 14,559 |

Assumptions were used in the value in use calculation of the information security software cash-generating unit for 31 December 2012. The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill:

*Budgeted revenue* – The basis used to determine the value assigned to the budgeted revenue is the revenue achieved in the year immediately before the budget year, increased for expected market development.

*Discount rate* – The discount rate used is before tax and reflects specific risks relating to the relevant unit.

The values assigned to the key assumptions are consistent with external information sources.

## 16. OTHER INTANGIBLE ASSETS

| GROUP | PURCHASED SOFTWARE RMB'000 | CAPITALISED SOFTWARE COSTS RMB'000 | CAPITALISED TELEVISION PROGRAM PRODUCTION COSTS RMB'000 | OTHERS RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|
| **31 DECEMBER 2012** | | | | | |
| Cost at 1 January 2012, net of accumulated amortisation | **30,548** | **18,461** | **14,974** | **4,187** | **68,170** |
| Addition | **6,909** | **13,839** | **—** | **—** | **20,748** |
| Government grants received | **(3,039)** | **—** | **—** | **—** | **(3,039)** |
| Amortisation provided during the year | **(8,098)** | **(9,119)** | **(9,249)** | **(427)** | **(26,893)** |
| Impairment | **—** | **—** | **(5,725)** | **—** | **(5,725)** |
| At 31 December 2012 | **26,320** | **23,181** | **—** | **3,760** | **53,261** |
| At 31 December 2012: | | | | | |
| Cost | **65,750** | **91,544** | **19,865** | **4,721** | **181,880** |
| Accumulated amortisation and impairment | **(39,430)** | **(68,363)** | **(19,865)** | **(961)** | **(128,619)** |
| Net carrying amount | **26,320** | **23,181** | **—** | **3,760** | **53,261** |
| **31 DECEMBER 2011** | | | | | |
| At 1 January 2011: | | | | | |
| Cost | **47,798** | **70,174** | **19,865** | **7,640** | **145,477** |
| Accumulated amortisation | **(26,539)** | **(44,706)** | **—** | **(5,187)** | **(76,432)** |
| Net carrying amount | **21,259** | **25,468** | **19,865** | **2,453** | **69,045** |
| Cost at 1 January 2011, net of accumulated amortisation | 21,259 | 25,468 | 19,865 | 2,453 | 69,045 |
| Addition | 6,170 | 7,532 | — | — | 13,702 |
| Acquisition of a subsidiary | 12,885 | — | — | 2,161 | 15,046 |
| Government grants received | (1,543) | — | — | — | (1,543) |
| Amortisation provided during the year | (8,223) | (14,539) | (4,891) | (427) | (28,080) |
| At 31 December 2011 | 30,548 | 18,461 | 14,974 | 4,187 | 68,170 |
| At 31 December 2011 and at 1 January 2012: | | | | | |
| Cost | 61,878 | 77,706 | 19,865 | 4,721 | 164,170 |
| Accumulated amortisation | (31,330) | (59,245) | (4,891) | (534) | (96,000) |
| Net carrying amount | 30,548 | 18,461 | 14,974 | 4,187 | 68,170 |

During the years ended 31 December 2012 and 2011, capitalised software costs were related to development expenditure on application software products.

## 17. LONG-TERM PREPAYMENT

The Group's long-term prepayment as at 31 December 2011 represented deposit for acquisition of the land use right of a piece of land in Chengdu, Mainland China, which is unsecured and interest-free. During the year ended 31 December 2012, the Group decided to dispose of this land use right and other related assets. As a result, the entire blance of long-term prepayment was classified as part of assets of a disposal group classified as held for sale as at 31 December 2012.

## 18. INVESTMENTS IN JOINTLY-CONTROLLED ENTITIES

| | GROUP | | COMPANY | |
|---|---|---|---|---|
| | **2012 RMB'000** | **2011 RMB'000** | **2012 RMB'000** | **2011 RMB'000** |
| Unlisted investment, at cost | | | **32,574** | 32,566 |
| Share of net assets | **16,226** | 6,730 | **—** | — |
| Goodwill on acquisition | **19,232** | 19,228 | **—** | — |
| Impairment | **(15,336)** | (15,336) | **(12,452)** | (21,944) |
| | **20,122** | 10,622 | **20,122** | 10,622 |

Particulars of the jointly-controlled entities are as follows:

| NAME | PLACE OF REGISTRATION/ INCORPORATION | NOMINAL VALUE OF REGISTERED CAPITAL/ISSUED ORDINARY SHARE CAPITAL | PERCENTAGE OF EQUITY ATTRIBUTABLE TO THE GROUP | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|
| Beijing Kingsoft Lianking Technology Corporation Limited ("Kingsoft Lianking") | PRC | RMB8,000,600 | 40 | Research and development of games |
| Sky Profit Limited ("Sky Profit")* | Cayman Islands | USD50,000 | 26.42# | Research and development of computer software and hardware, system integration, technical training and services |

* Not audited by Ernst & Young, Hong Kong or another member firm of the Ernst & Young global network.

\# The Company directly held 3,410,594 preferred shares and 796,026 ordinary shares of USD0.001 each of Sky Profit.

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

Pursuant to the cooperative agreement dated 23 May 2009, the Group is required to transfer up to 15% of its equity interest in Kingsoft Lianking at no consideration to the other shareholders of Kingsoft Lianking should the revenue of the first online game developed by Kingsoft Lianking achieve certain predetermined revenue targets in the coming years, or upon the happening of specified events. Another 10% of the Group's equity interest in Kingsoft Lianking will be required to transfer to the other shareholders should the revenue of online games developed by Kingsoft Lianking achieve certain predetermined revenue targets during the first five years. On the contrary, if the revenue of the first online game developed by Kingsoft Lianking is below certain predetermined revenue targets and the first online game of Kingsoft Lianking is not ready for commercialisation during the first 24 months of its operation, the Group is entitled to acquire up to 19% of equity interest in Kingsoft Lianking from the other shareholders at no consideration. As at 31 December 2012, Kingsoft Lianking has not launched its first online game yet.

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

| | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|---|---|
| **SHARE OF THE JOINTLY-CONTROLLED ENTITIES' ASSETS AND LIABILITIES:** | | |
| Current assets | **14,684** | 2,369 |
| Non-current assets | **7,353** | 9,136 |
| Current liabilities | **(2,611)** | (1,575) |
| Non-current liabilities | **(3,200)** | (3,200) |
| Net assets | **16,226** | 6,730 |
| **SHARE OF THE JOINTLY-CONTROLLED ENTITIES' RESULTS:** | | |
| Revenue | **22,098** | 6,574 |
| Other income | **32** | 8 |
| | **22,130** | 6,582 |
| Total expenses | **(11,084)** | (9,044) |
| Tax | **(1,514)** | 517 |
| Profit/(loss) after tax | **9,532** | (1,945) |

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

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

(a) Investment in Kingsoft Lianking: The carrying amount of investment in Kingsoft Lianking was nil after making an impairment of RMB1,936,000 as at 31 December 2010. As at 31 December 2012, the Group performed an assessment and determined that there is no indication that the previously recognised impairment losses may no longer exist or may have decreased.

(b) Investment in Sky Profit: The Group performed the impairment assessment as at 31 December 2012. The recoverable amount of the investment has been determined based on a value in use calculation using cash flow projections from financial budgets approved by management covering a five-year period. As a result of this analysis, no further impairment was recognised (2011: RMB5,000,000) against the investment in Sky Profit and no indication that the previously recognised impairment losses may no longer exist or may have decreased was found.

## 19. INVESTMENTS IN ASSOCIATES

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Share of net assets | — | 930 |

Particulars of the associates are as follows:

| NAME | PLACE OF REGISTRATION | NOMINAL VALUE OF REGISTERED CAPITAL | PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE GROUP | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|
| Guangzhou Tuotu Computer Technology Co., Ltd. | PRC | RMB100,000 | 19.9 | Research and development of computer and network related technology; provision of network service; design and publishing of advertisements |
| Zhuhai Kingsoft Kuaikuai Technology Co., Ltd. ("Zhuhai Kuaikuai")* | PRC | RMB5,600,000 | 62.5 | Research and development of computer and network related technology; provision of network service; design and publishing of advertisements |

* Zhuhai Kuaikuai is accounted for as an associate as the Group has no control over the financial and operating policies of Zhuhai Kuaikuai.

## 19. INVESTMENTS IN ASSOCIATES (continued)

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

The following table illustrates the summarised financial information of the Group's associates from their financial statements:

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Assets | **805** | 3,716 |
| Liabilities | **(1,058)** | (2,228) |
| Revenue | **2,223** | 3,715 |
| Loss | **(1,183)** | (6,512) |

## 20. AVAILABLE-FOR-SALE INVESTMENTS

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Unlisted equity investments, at cost | **7,182** | 4,990 |

As at 31 December 2012, the unlisted equity investments with a carrying amount of RMB7,182,000 were stated at cost less impairment. The directors are of the opinion that the investees' fair value cannot be reliably measured. The Group has no intention to dispose of the investees in the near future.

## 21. OTHER FINANCIAL ASSET

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Ordinary shares subscription option | **27,822** | 11,812 |

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

## 22. LOAN RECEIVABLES

The loan receivables are interest-free housing loans granted to employees, which were carried at amortised cost with effective interest rates of 6.40% and 6.90% per annum during the years ended 31 December 2012 and 2011, respectively. The general terms of the loan receivables are three to five years and they are repaid monthly by employees.

## 23. INVENTORIES

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| Packaging materials | **888** | 589 |
| Trading stocks | **16,118** | 2,722 |
| | **17,006** | 3,311 |

## 24. TRADE RECEIVABLES

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| Trade receivables | **133,301** | 82,154 |
| Impairment | **(2,955)** | (1,788) |
| | **130,346** | 80,366 |

The Group's trading terms with its customers are mainly on credit, except for online sales, where payment in advance is normally required. The credit period is generally one month, extending up to three months for major customers. Each customer has a maximum credit limit. The Group seeks to maintain strict control over its outstanding receivables and has a credit control department to minimise credit risk. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. The Group does not hold any collateral or other credit enhancements over its trade receivable balances. Trade receivables are non-interest-bearing.

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

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| 0 to 30 days | **71,842** | 39,090 |
| 31 to 60 days | **30,206** | 15,742 |
| 61 to 90 days | **9,018** | 13,339 |
| 91 to 365 days | **14,900** | 8,380 |
| Over one year | **4,380** | 3,815 |
| | **130,346** | 80,366 |

## 24. TRADE RECEIVABLES (continued)

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

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| At 1 January | **1,788** | 1,567 |
| Impairment losses recognised | **1,515** | 455 |
| Amount written off as uncollectible | **(348)** | (234) |
| | **2,955** | 1,788 |

Included in the above provision for impairment of trade receivables is a provision for individual impaired trade receivables of RMB2,955,000 (2011: RMB1,788,000) with a carrying amount before provision of RMB2,955,000 (2011: RMB1,788,000).

The individually impaired trade receivables relate to customers that were in financial difficulties or were in default in principal payments and only a portion of the receivables is expected to be recovered.

The aged analysis of the trade receivables that are not individually nor collectively considered to be impaired is as follows:

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Neither past due nor impaired | **62,382** | 44,202 |
| 0 to 30 days past due | **18,571** | 14,453 |
| 31 to 60 days past due | **28,893** | 6,505 |
| 61 to 90 days past due | **6,629** | 5,151 |
| 91 to 365 days past due | **9,905** | 6,396 |
| Over one year past due | **3,966** | 3,659 |
| | **130,346** | 80,366 |

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, the directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable.

Included in the Group's trade receivables is amount due from a company whose parent has a significant influence on the Company of RMB12,746,000 (2011: RMB2,140,000), which are repayable on similar credit terms to those offered to the major customers of the Group.

## 25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Prepayments | **65,805** | 59,057 |
| Value-added tax receivable | **22,560** | 11,485 |
| Deposits | **9,080** | 5,376 |
| Other receivables | **23,031** | 15,038 |
| | **120,476** | 90,956 |

| | COMPANY | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Prepayments | **214** | 494 |
| Other receivables | **1,080** | — |
| Total | **1,294** | 494 |

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

## 26. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSIT

| | | GROUP | |
|---|---|---|---|
| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
| Cash and bank balances | (a) | **377,990** | 296,853 |
| Time deposits with original maturity of three months or less when acquired | (a) | **241,829** | 902,460 |
| | | **619,819** | 1,199,313 |
| Time deposits with original maturity of over three months when acquired | (a) | **1,815,440** | 839,457 |
| Less: Pledged time deposit for a bank loan (note 29(b)) | (a) | **(19,000)** | (85,000) |
| Cash and cash equivalents | | **2,416,259** | 1,953,770 |
| Denominated in RMB | (b) | **2,275,166** | 1,789,950 |
| Denominated in USD | | **100,818** | 33,949 |
| Denominated in HKD | | **22,115** | 47,049 |
| Denominated in JPY | | **17,975** | 49,241 |
| Denominated in MYR | | **185** | 33,581 |
| | | **2,416,259** | 1,953,770 |

## 26. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSIT (continued)

| | NOTES | COMPANY 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|---|
| Cash and bank balances | | **41,775** | 12,847 |
| Time deposits with original maturity of three months or less when acquired | | **37,902** | 142,436 |
| | | **79,677** | 155,283 |
| Time deposits with original maturity of over three months when acquired | | **95,550** | — |
| Less: Pledged time deposit for a bank loan (note 29(b)) | | **(19,000)** | — |
| Cash and cash equivalents | (a) | **156,227** | 155,283 |

(a) Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and a year depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. The bank balances and pledged deposits are deposited with creditworthy banks with no recent history of default. The carrying amounts of the cash and cash equivalents as at 31 December 2012 and 2011 approximated to their fair values.

(b) The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

## 27. A DISPOSAL GROUP CLASSIFIED AS HELD FOR SALE

On 5 February 2013, the Company announced the decision of its board of directors to dispose of Chengdu Baiming Real Estate Company Limited ("Chengdu Baiming"). The Group decided to cease the land development and focus on its main business. Chengdu Baiming engages in real estate related business and acquired a piece of land in Chengdu during the year ended 31 December 2011. Chengdu Baiming has not developed this piece of land and Chengdu Baiming is not a cash-generating unit. This transaction is treated as disposal of a group of assets, with some directly associated liabilities together in a single transaction. As at 31 December 2012, Chengdu Baiming was classified as a disposal group held for sale.

The major classes of assets and liabilities of Chengdu Baiming classified as held for sale as at 31 December are as follows:

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| *Assets* | | |
| Lease prepayment | **81,872** | — |
| Prepayments, deposits and other receivables | **1,069** | — |
| Cash and short term deposits | **76,680** | — |
| Time deposits over three months | **41,000** | — |
| Assets of a disposal group classified as held for sale | **200,621** | — |
| *Liabilities* | | |
| Other payables and accruals | **(753)** | — |
| Liabilities directly associated with the assets classified as held for sale | **(753)** | — |
| Net assets directly associated with the disposal group | **199,868** | — |

## 28. TRADE PAYABLES

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

| | GROUP | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| 0 to 30 days | **7,929** | 5,557 |
| 31 to 60 days | **5,065** | 1,794 |
| 61 to 90 days | **2,420** | 2,022 |
| 91 to 365 days | **5,194** | 4,976 |
| Over one year | **2,481** | 2,219 |
| | **23,089** | 16,568 |

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

## 29. INTEREST-BEARING BANK LOANS

| | NOTES | EFFECTIVE INTEREST RATE | MATURITY | PRINCIPAL AMOUNT RMB'000 |
|---|---|---|---|---|
| **GROUP AND COMPANY** | | | | |
| At 31 December 2012 | | | | |
| Current | | | | |
| Bank loan — unsecured | (a) | HIBOR plus 1.18%–2.35% per annum/LIBOR plus 1.12% per annum | 2013 | 397,341 |
| Bank loan — secured | (b) | HIBOR plus 0.75% per annum | 2013 | 16,218 |
| | | | | 413,559 |
| **GROUP AND COMPANY** | | | | |
| At 31 December 2011 | | | | |
| Current | | | | |
| Bank loan — unsecured | | LIBOR plus 1.12% per annum | 2012 | 265,585 |
| Bank loan — secured | | HIBOR plus 1.18% per annum | 2012 | 81,070 |
| | | | | 346,655 |

(a) The interest-bearing bank loan represented a drawdown of HKD490,000,000 (equivalent to RMB397,341,000) from the Group's banking facility of HKD670,000,000 in 2012. As an undertaking of such banking facility, the Group provided a RMB deposit of an amount of 50%–100% of the bank loan outstanding from time to time.

(b) The interest-bearing bank loan represented a drawdown of HKD20,000,000 (equivalent to RMB16,218,000) (2011: HKD100,000,000, equivalent to RMB81,070,000) from the Group's banking facilities of HKD100,000,000 (2011: HKD200,000,000) in September 2012. The bank loan was secured by the Group's time deposit of RMB19,000,000 (2011: RMB85,000,000).

## 30. OTHER PAYABLES AND ACCRUALS

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| Deposits received from customers | **13,639** | 15,091 |
| Other payables | **208,358** | 143,473 |
| Other taxes payable | **36,679** | 19,298 |
| Contingent consideration for acquiring a business | **3,000** | 6,000 |
| Accruals | **37,151** | 35,538 |
| | **298,827** | 219,400 |

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

Other payables are non-interest-bearing.

## 31. DEFERRED REVENUE

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| Entertainment software | **146,340** | 121,869 |
| Information security software | **24,243** | 32,980 |
| Other application software | **7,282** | 6,123 |
| Government grants | **21,849** | 20,559 |
| | **199,714** | 181,531 |
| Less: Current portion | **(185,462)** | (161,210) |
| Non-current portion | **14,252** | 20,321 |

## 32. SHARE CAPITAL

| SHARES | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Authorised: | | |
| 2,400,000,000 (2011: 2,400,000,000) ordinary shares of USD0.0005 each | **9,260** | 9,260 |
| Issued and fully paid: | | |
| 1,171,791,433 (2011: 1,167,880,933) ordinary shares of USD0.0005 each | **4,690** | 4,677 |

## 32. SHARE CAPITAL (continued)

During the years ended 31 December 2011 and 2012, the movements in the Company's issued share capital were as follows:

| COMPANY | NOTES | NUMBER OF SHARES IN ISSUE | ISSUED SHARE CAPITAL RMB'000 | SHARE PREMIUM ACCOUNT RMB'000 | SHARES HELD FOR SHARE AWARD SCHEME RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|---|
| At 1 January 2011 | | 1,104,713,632 | 4,527 | 408,241 | (57,773) | 354,995 |
| Difference between the proposed and paid dividend in respect of the previous year | | — | — | 1,043 | — | 1,043 |
| Shares purchased for a share award scheme | | (20,000,000) | — | — | (47,420) | (47,420) |
| Exercise of share options | | 46,473,300 | 150 | 123,931 | — | 124,081 |
| Vested awarded shares transferred to employees | | 6,604,995 | — | — | 11,439 | 11,439 |
| Proposed final 2011 dividend | | — | — | (92,241) | — | (92,241) |
| At 31 December 2011 and 1 January 2012 | | **1,137,791,927*** | **4,677** | **440,974** | **(93,754)** | **351,897** |
| Difference between the proposed and paid dividend in respect of the previous year | | **—** | **—** | **(830)** | **—** | **(830)** |
| Exercise of share options | 7(a) | **5,893,500** | **19** | **15,783** | **—** | **15,802** |
| Vested awarded shares transferred to employees | 7(b) | **3,429,999** | **—** | **—** | **11,627** | **11,627** |
| Repurchase and cancellation of shares | | **(1,983,000)** | **(6)** | **(5,830)** | **—** | **(5,836)** |
| Proposed final 2012 dividend | | **—** | **—** | **(102,132)** | **—** | **(102,132)** |
| At 31 December 2012 | | **1,145,132,426*** | **4,690** | **347,965** | **(82,127)** | **270,528** |

* Excluding 26,659,007 (2011: 30,089,006) shares held by the Share Award Scheme Trust as at 31 December 2012

During the year ended 31 December 2012, the Company repurchased a total of 1,983,000 of its own ordinary shares at a total cost of approximately RMB5,836,000, inclusive of transaction cost.

### Share options

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

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

| | COMPANY | |
|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 |
| Unlisted shares, at cost | **26,049** | 29,855 |
| Capital contribution in respect of employee share-based compensation | **199,648** | 191,331 |
| | **225,697** | 221,186 |

The amounts due from and to subsidiaries included in the Company's current assets and current liabilities of RMB702,285,000 (2011: RMB662,950,000) and RMB118,907,000 (2011: RMB113,853,000), respectively, are unsecured, interest-free and are repayable on demand.

Particulars of the subsidiaries are as follows:

| NAME | PLACE OF INCORPORATION/ REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/ REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY ATTRIBUTABLE TO THE COMPANY AS AT 31 DECEMBER 2012 | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|
| Kingsoft Entertainment Software Holdings Limited ("KES Holdings") | Cayman Islands | USD1 | **100** | Investment holding |
| Kingsoft Application Software Holdings Limited ("KAS Holdings") | Cayman Islands | HKD1 | **100** | Investment holding |
| KIS Holdings | Cayman Islands | USD25,000 | **64.86** | Investment holding |
| KOS Holdings | Cayman Islands | USD1,950,000 | **78.95** | Investment holding |
| KC Holdings* | Cayman Islands | USD2,351,000 | **72.56** | Investment holding |
| Westhouse Holdings Limited ("Westhouse Holdings") | Cayman Islands | USD4,000,000 | **80** | Investment holding |
| Kingsoft Jingcai Online Game Holdings Limited ("Jingcai Holdings") | Cayman Islands | USD750,000 | **80.4** | Investment holding |
| Conew.com Corporation ("Conew") | British Virgin Islands | USD8,250 | **64.86** | Investment holding |
| KS Mobile Inc.* | United States | USD1 | **64.86** | Investment holding |
| Kingsoft Entertainment Software Corporation Limited | Hong Kong | HKD1 | **100** | Investment holding, operation and distribution of games |
| Kingsoft Application Software Corporation Limited | Hong Kong | HKD1 | **100** | Investment holding |

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

Particulars of the subsidiaries are as follows: (continued)

| NAME | NOTES | PLACE OF INCORPORATION/ REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/ REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY ATTRIBUTABLE TO THE COMPANY AS AT 31 DECEMBER 2012 | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|---|
| Cheetah Technology Corporation Limited | | Hong Kong | HKD1 | **64.86** | Investment holding |
| Kingsoft Office Software Corporation Limited | | Hong Kong | HKD1 | **78.95** | Investment holding |
| Westhouse Corporation Limited | | Hong Kong | HKD18,600,000 | **80** | Investment holding |
| Kingsoft Jingcai Online Game Corporation Limited | | Hong Kong | HKD850,000 | **80.4** | Investment holding |
| Kingsoft Cloud Corporation Limited | | Hong Kong | HKD2,000,000 | **72.56** | Investment holding |
| Kingsoft (M) SDN.BHD ("Kingsoft Malaysia") | | Malaysia | MYR1,000,000 | **100** | Import and export of software and hardware and related business |
| Kingsoft Japan | | Japan | JPY447,875,000 | **51** | Development and sale of the security software and office application software |
| Mobile in Style, Inc.*~ | | Japan | JYP53,000,000 | **43.35** | Development and sale of tablet PCs |
| Beijing Kingsoft Software Co., Ltd.# | | PRC/Mainland China | RMB10,000,000 | **100** | Marketing and distribution of application software |
| Beijing Digital Entertainment# | (a) | PRC/Mainland China | RMB10,000,000 | **100** | Marketing and operation of SMS and wireless service of online games and application software, holding of ICP licencer |
| Beijing Kingsoft Internet Security Software Co., Ltd. ("Beijing Security Software")# | | PRC/Mainland China | RMB8,000,000 | **64.86** | Sale and operation of internet security software |
| Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian")# | (a) | PRC/Mainland China | RMB1,500,000 | **100** | Investment holding |
| Beijing Kingsoft Office Software Co., Ltd.("Beijing Kingsoft Office")#^ | | PRC/Mainland China | RMB10,000,000 | **78.95** | Sale and operation of office application software |
| Beijing Kingsoft Cloud Network Technology Co., Ltd. ("Beijing Cloud Network")# | | PRC/Mainland China | RMB1,000,000 | **72.56** | Sale and operation of office application software |
| Shell Internet (Beijing) Security Technology Co., Ltd. ("Shell Internet")# | (e) | PRC/Mainland China | RMB3,500,000 | **64.86** | Provision of internet security service |

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

Particulars of the subsidiaries are as follows: (continued)

| NAME | NOTES | PLACE OF INCORPORATION/ REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/ REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY ATTRIBUTABLE TO THE COMPANY AS AT 31 DECEMBER 2012 | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|---|
| Conew Network Technology (Beijing) Co., Ltd. ("Conew Network")# | | PRC/Mainland China | USD1,243,813 | **64.86** | Research and development for application software and sales operations of related business |
| Beijing Conew Technology Development Co., Ltd. ("Conew Technology")# | (d) | PRC/Mainland China | RMB300,000 | **64.86** | ICP license holder |
| Beijing Kingsoft Network Technology Co., Ltd. ("Beijing Network Technology")*# | (h) | PRC/Mainland China | RMB10,000,000 | **64.86** | Marketing and operation of Duba products |
| Beijing Kingsoft Cloud Technology Co., Ltd. ("Beijing Cloud Technology")*# | (i) | PRC/Mainland China | RMB5,000,000 | **72.56** | Investment holding, research, development and distribution of application software |
| Dalian Kingsoft Interactive Entertainment Co., Ltd. ("Kingsoft Dalian")# | | PRC/Mainland China | RMB30,000,000 | **80.4** | Research, development and distribution of games |
| Jingcai Online Technology (Dalian) Co., Ltd.# | | PRC/Mainland China | RMB1,000,000 | **80.4** | Research and development of games |
| Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment")# | | PRC/Mainland China | RMB100,000,000 | **100** | Research and development of games |
| Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment")# | (b) | PRC/Mainland China | RMB10,000,000 | **100** | Marketing and operation of entertainment software products, ICP license holder |
| Chengdu Westhouse Interactive Entertainment Co., Ltd. ("Chengdu Westhouse")# | | PRC/Mainland China | RMB15,000,000 | **80** | Research and development of games |
| Chengdu Westhouse Shiyou Technology Co., Ltd. ("Chengdu Westhouse Shiyou ")*# | (g) | PRC/Mainland China | RMB10,000,000 | **80** | Research, development and distribution of games |
| Zhuhai Kingsoft Digital Technology Co., Ltd.# | | PRC/Mainland China | RMB198,048,000 | **100** | Investment holding |
| Zhuhai Juntian Electronic Technology Co., Ltd.# | | PRC/Mainland China | RMB18,952,000 | **64.86** | Investment holding, research, development and distribution of security software |

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

Particulars of the subsidiaries are as follows: (continued)

| NAME | NOTES | PLACE OF INCORPORATION/ REGISTRATION AND OPERATIONS | NOMINAL VALUE OF ISSUED ORDINARY/ REGISTERED SHARE CAPITAL | PERCENTAGE OF EQUITY ATTRIBUTABLE TO THE COMPANY AS AT 31 DECEMBER 2012 | PRINCIPAL ACTIVITIES |
|---|---|---|---|---|---|
| Zhuhai Kingsoft Software Co., Ltd. ("Zhuhai Software")# | | PRC/Mainland China | RMB215,500,000 | **100** | Research, development and distribution of consumer application software |
| Zhuhai Xishanju Software Co., Ltd.# | | PRC/Mainland China | RMB2,200,000 | **100** | Investment holding |
| Zhuhai Kingsoft Online Game Technology Co., Ltd. ("Zhuhai Online Game")# | (f) | PRC/Mainland China | RMB10,000,000 | **80** | Research and development for online games |
| Zhuhai Qiwen Application Software Co., Ltd. ("Zhuhai Qiwen")# | (c) | PRC/Mainland China | RMB68,000,000 | **78.95** | Investment holding |
| Zhuhai Kingsoft Application Software Co., Ltd. ("Zhuhai Kingsoft Application")# | (c) | PRC/Mainland China | RMB68,000,000 | **100** | Sale and operation of office application software |
| Zhuhai Westhouse Shiyou Technology Co., Ltd. ("Zhuhai Westhouse Shiyou ")*# | (g) | PRC/Mainland China | RMB10,000,000 | **80** | Research, development and distribution of games |
| Zhuhai Westhouse Xiangyou Technology Co., Ltd. *#~ | | PRC/Mainland China | RMB3,000,000 | **40.8** | Research and development of games |
| Zhuhai Kingsoft Cloud Technology Co., Ltd. ("Zhuhai Cloud Technology")# | (i) | PRC/Mainland China | RMB11,080,000 | **72.56** | Research, development and distribution of application software |

* Companies established during the year ended 31 December 2012.

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

^ Companies registered as a wholly-foreign-owned enterprise under PRC law.

~ Companies are subsidiary of a non-wholly-owned subsidiary of the Company and, accordingly, are accounted for as a subsidiary by virtue of the Company's control over it.

All the above companies are with limited liability. They are indirectly held by the Company, except for KES Holdings, KAS Holdings, KIS Holdings, KOS Holdings, KC Holdings, Kingsoft Malaysia and Kingsoft Japan, which are directly held by the Company.

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

Notes:

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

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

(b) As at 31 December 2012, Chengdu Digital Entertainment is 99% owned by Beijing Digital Entertainment. The non-controlling equity holder of Chengdu Digital Entertainment borrowed a interest-free loan of RMB100,000 from Chengdu Interactive Entertainment for its investment in Chengdu Digital Entertainment and the loan is secured by its equity interest in Chengdu Digital Entertainment. Chengdu Interactive Entertainment is granted an exclusive call option to buy at its sole discretion at any time part or all of the equity interest held by the non-controlling equity holder in Chengdu Digital Entertainment. During the pledge period, the non-controlling equity holder forfeits the right to receive dividends from Chengdu Digital Entertainment and Chengdu Interactive Entertainment is entitled to this portion of dividends from Chengdu Digital Entertainment. Chengdu Digital Entertainment (as the licensee) entered into a licensing agreement with Chengdu Interactive Entertainment (as the licensor) and the Group, via Chengdu Interactive Entertainment, has rights to obtain the majority of the benefits from Chengdu Digital Entertainment's operations, but also exposes to risks incidental to the activities of Chengdu Digital Entertainment. Accordingly, Chengdu Digital Entertainment is accounted for as a subsidiary by virtue of the Group's control over it.

(c) In February and August 2010, the two individual equity holders of Zhuhai Qiwen ("Zhuhai Qiwen's equity holders") entered into loan agreements with Zhuhai Software, pursuant to which Zhuhai Software provided interest-free loans of RMB8,000,000 and RMB60,000,000 respectively to Zhuhai Qiwen's equity holders. The loans are secured by the respective equity interests held by Zhuhai Qiwen's equity holders. Zhuhai Software has been granted an exclusive irrevocable option to purchase part or all of the equity interests in Zhuhai Qiwen held by Zhuhai Qiwen's equity holders. Zhuhai Qiwen's equity holders entrust all of their respective shareholder rights in Zhuhai Qiwen to Zhuhai Software. Zhuhai Qiwen's equity holders give up the dividends in Zhuhai Qiwen and Zhuhai Software is entitled to dividends if Zhuhai Qiwen declares dividend. During the year ended 31 December 2011, one of Zhuhai Qiwen's equity holders transferred part of her equity interests in Zhuhai Qiwen to 26 natural persons (together with the original two individual equity holders referred to as the "New Equity Holders") for a consideration of discharging the corresponding portion of her liability under the aforesaid loan agreement, which were assumed by these 26 natural persons. Consequently, Zhuhai Software transferred the loan in the amount of RMB68,000,000 receivable from the New Equity Holders to Beijing Kingsoft Office, a wholly owned subsidiary of the Group, for a cash consideration of RMB68,000,000, and hence the New Equity Holders were liable to Beijing Kingsoft Office a loan in total of RMB68,000,000. The loan was secured by the respective equity interests held by the New Equity Holders in Zhuhai Qiwen. Meanwhile, Beijing Kingsoft Office was granted an irrevocable exclusive option to purchase part or all of the New Equity Holders' equity interests in Zhuhai Qiwen. The New Equity Holders also entrusted all of their respective shareholder rights in Zhuhai Qiwen to a person designated by Beijing Kingsoft Office and pledged all of their respective equity interests in Zhuhai Qiwen in favour of Beijing Kingsoft Office. The New Equity Holders give up the dividends in Zhuhai Qiwen and Beijing Kingsoft Office is entitled to receive dividends if Zhuhai Qiwen declares dividend. The Group, via Beijing Kingsoft Office (and via Zhuhai Software before Beijing Kingsoft Office), has rights to obtain the majority of the benefits from Zhuhai Qiwen's operations, but also exposes to risks incidental to the activities of Zhuhai Qiwen. Accordingly, Zhuhai Qiwen and its wholly-owned subsidiary, Zhuhai Kingsoft Application, are accounted for as subsidiaries by virtue of the Group's control over it.

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

(d) In August 2010, the two individual equity holders of Conew Technology ("Conew Technology's equity holders") entrusted all of their respective shareholder rights in Conew Technology to Conew Network. Conew Network was granted an exclusive irrevocable option to purchase part or all of the equity interests in Conew Technology held by Conew Technology's equity holders. Conew Technology's equity holders give up the dividends in Conew Technology to Conew Network and Conew Network is entitled to receive dividends if Conew Technology declares dividend. The Group, via Conew Network, has rights to obtain the majority of the benefits from Conew Technology's operations, but also exposes to risks incidental to the activities of Conew Technology. Accordingly, Conew Technology is accounted for as a subsidiary by virtue of the Group's control over it.

(e) In January 2011 and October 2012, the two individual equity holders of Shell Internet ("Shell Internet's equity holders") entered into loan agreements with Beijing Security Software, pursuant to which Beijing Security Software provided an interest-free loans of RMB7,200,000 to Shell Internet's equity holders. The loans were secured by the respective equity interests held by Shell Internet's equity holders. Beijing Security Software has been granted an irrevocable exclusive option to purchase part or all of the equity interests in Shell Internet held by Shell Internet's equity holders. Shell Internet's equity holders entrusted all of their respective shareholder rights in Shell Internet to a person designated by Beijing Security Software. Shell Internet's equity holders give up the dividends in Shell Internet and Beijing Security Software is entitled to receive dividends if Shell Internet declares dividend. The Group, via Beijing Security Software, has rights to obtain the majority of the benefits from Shell Internet's operations, but also exposes to risks incidental to the activities of Shell Internet. Accordingly, Shell Internet is accounted for as a subsidiary by virtue of the Group's control over it.

(f) As at 31 December 2012, Zhuhai Online Game is 81.3% owned by Chengdu Westhouse. The non-controlling equity holders of Zhuhai Online Game borrowed an interest-free loans of RMB3,487,550 from Chengdu Westhouse to repay the liabilities incurred by them due to the acquisition of the 18.7% registered capital in Zhuhai Online Game and the loans are secured by the non-controlling equity holders' respective equity interests in Zhuhai Online Game. Chengdu Westhouse is granted an irrevocable exclusive option to purchase at its sole discretion at any time part or all of the equity interests held by the non-controlling equity holders in Zhuhai Online Game. The non-controlling equity holders entrusted all of their respective shareholder rights in Zhuhai Online Game to a person designated by Chengdu Westhouse. During the pledge period, the non-controlling equity holders forfeit the right to receive dividends from Zhuhai Online Game and Chengdu Westhouse is entitled to this portion of dividends from Zhuhai Online Game. The Group, via Chengdu Westhouse, has rights to obtain the majority of the benefits from Zhuhai Online Game's operations, but also exposes to risks incidental to the activities of Zhuhai Online Game. Accordingly, Zhuhai Online Game is accounted for as a subsidiary by virtue of the Group's control over it.

(g) In September 2012, the two individual equity holders of Zhuhai Westhouse Shiyou ("Zhuhai Westhouse Shiyou's equity holders") entered into loan agreements with Chengdu Westhouse, pursuant to which Chengdu Westhouse provided interest-free loans of RMB8,000,000 and RMB2,000,000 respectively to Zhuhai Westhouse Shiyou's equity holders. The loans were secured by the respective equity interests held by Zhuhai Westhouse Shiyou's equity holders. Chengdu Westhouse has been granted an irrevocable exclusive option to purchase part or all of the equity interests in Zhuhai Westhouse Shiyou held by Zhuhai Westhouse Shiyou's equity holders. Zhuhai Westhouse Shiyou's equity holders entrusted all of their respective shareholder rights in Zhuhai Westhouse Shiyou to a person designated by Chengdu Westhouse. Zhuhai Westhouse Shiyou's equity holders give up the dividends in Zhuhai Westhouse Shiyou and Chengdu Westhouse is entitled to receive dividends if Zhuhai Westhouse Shiyou declares dividend. The Group, via Chengdu Westhouse, has rights to obtain the majority of the benefits from Zhuhai Westhouse Shiyou's operations, but also exposes to risks incidental to the activities of Zhuhai Westhouse Shiyou. Accordingly, Zhuhai Westhouse Shiyou is accounted for as a subsidiary by virtue of the Group's control over it.

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

Zhuhai Westhouse Shiyou wholly owns Chengdu Westhouse Shiyou. Accordingly, Chengdu Westhouse Shiyou is accounted for as a subsidiary by virtue of the Group's control, through Zhuhai Westhouse Shiyou, over it.

(h) In June 2012, the two individual equity holders of Beijing Network Technology ("Beijing Network Technology's equity holders") entered into loan agreements with Conew Network, pursuant to which Conew Network provided interest-free loans of RMB5,000,000 and RMB5,000,000 respectively to Beijing Network Technology's equity holders. The loans are secured by the respective equity interests held by Beijing Network Technology's equity holders. Conew Network has been granted an irrevocable exclusive option to purchase part or all of the equity interests in Beijing Network Technology held by Beijing Network Technology's equity holders. Beijing Network Technology's equity holders entrusted all of their respective shareholder rights in Beijing Network Technology to person designated by Conew Network. Beijing Network Technology's equity holders give up the dividends in Beijing Network Technology and Conew Network is entitled to receive dividends if Beijing Network Technology declares dividend. The Group, via Conew Network, has rights to obtain the majority of the benefits from Beijing Network Technology's operations, but also exposes to risks incidental to the activities of Beijing Network Technology. Accordingly, Beijing Network Technology is accounted for as a subsidiary by virtue of the Group's control over it.

(i) In May 2012, the two individual shareholders (the "Zhuhai Cloud Technology's original shareholders") of Zhuhai Cloud Technology and Beijing Digital Entertainment entered into a loan agreement, pursuant to which Beijing Digital Entertainment provided interest-free loans of RMB99,000 and RMB1,000, respectively to Zhuhai Cloud Technology's original shareholders. The loans were secured by the respective equity interests held by Zhuhai Cloud Technology's original shareholders. Beijing Digital Entertainment has been granted an irrevocable exclusive option to purchase part or all of the equity interests in Zhuhai Cloud Technology held by Zhuhai Cloud Technology's original shareholders. Zhuhai Cloud Technology's original shareholders entrusted all of their respective shareholder rights in Zhuhai Cloud Technology to a person designated by Beijing Digital Entertainment and pledged all of their respective equity interests in Zhuhai Cloud Technology in favour of Beijing Digital Entertainment. Zhuhai Cloud Technology's original shareholders give up the dividends in Zhuhai Cloud Technology and Beijing Digital Entertainment is entitled to receive dividends if Zhuhai Cloud Technology declares dividend. The Group, via Beijing Digital Entertainment, has rights to obtain the majority of the benefits from Zhuhai Cloud Technology's operations, but also exposes to risks incidental to the activities of Zhuhai Cloud Technology. Accordingly, Zhuhai Cloud Technology is accounted for as a subsidiary by virtue of the Group's control over it.

In June 2012, certain of the Group's employees involving in cloud business and Beijing Digital Entertainment (together with Zhuhai Cloud Technology's original shareholders referred to as Zhuhai Cloud Technology's equity holders) acquired additional share capitals in Zhuhai Cloud Technology.

In November 2012, all above structure contracts entered into in May 2012 were terminated, and a new set of structure contracts with same term as above were entered into among Zhuhai Cloud Technology's equity holders, Beijing Digital Entertainment and Beijing Cloud Technology, whereby the control over Zhuhai Cloud Technology of Beijing Digital Entertainment was transferred to Beijing Cloud Technology. Zhuhai Cloud Technology is still accounted for as a subsidiary by virtue of the Group's control over it.

Zhuhai Cloud Technology wholly owns Beijing Cloud Network. Accordingly, Beijing Cloud Network is accounted for as a subsidiary by virtue of the Group's control, through Zhuhai Cloud Technology, over it.

## 34. RESERVES

### (a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity of the financial statements on page 7 to 8.

In accordance with the regulations in the PRC and the respective articles of association, the PRC subsidiaries of the Group are required to make an appropriation of retained earnings equal to at least 10% of their respective after-tax profits, calculated in accordance with the PRC accounting standards and regulations. Such appropriations are classified in the consolidated financial position as statutory reserves and start from the first period in which after-tax profits exceed all prior year accumulated losses. Appropriations to these reserves are not required after these reserves have reached 50% of the registered capital of the respective companies. In addition, the PRC subsidiaries may, subject to a shareholders' resolution, draw a discretionary reserve from their after-tax profits. The reserves shall be used to offset accumulated losses, or to increase registered capital of the companies. Where the statutory reserve is converted into capital, the remaining statutory reserve balance shall be no less than 25 % of the registered capital prior to the conversion.

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

During the year ended 31 December 2012, the Group's major equity transactions are as follows:

(i) On 21 May 2012, KOS Holdings issued 200,000,000 new ordinary shares (representing 21.05% of the enlarged equity interest of KOS Holdings) to a company owned by some founding employees including a director of some subsidiaries of the Company at a consideration of RMB38,347,000, resulting in an increase in capital reserve of RMB15,980,000.

(ii) On 30 November 2012, KC Holdings issued 91,000,000 new ordinary shares (representing 9.87% of the enlarged equity interest of KC Holdings) to a company owned by a director and a main shareholder of the Company at a consideration of RMB11,512,000, resulting in an increase in capital reserve of RMB8,272,000.

## 34. RESERVES (continued)

### (b) Company

| | NOTE | SHARE PREMIUM ACCOUNT RMB'000 | SHARES HELD FOR SHARE AWARD SCHEME RMB'000 | EMPLOYEE SHARE-BASED RESERVE RMB'000 | FOREIGN CURRENCY TRANSLATION RESERVE RMB'000 | RETAINED EARNINGS RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|---|---|---|
| **AT 1 JANUARY 2011** | | 408,241 | (57,773) | 208,062 | (88,428) | 99,425 | 569,527 |
| Total comprehensive income for the year | | — | — | — | (36,625) | 39,933 | 3,308 |
| Difference between the proposed and paid dividend in respect of the previous year | | 1,043 | — | — | — | — | 1,043 |
| Shares purchased for share award scheme | | — | (47,420) | — | — | — | (47,420) |
| Exercise of share options | | 123,931 | — | (60,153) | — | — | 63,778 |
| Share-based compensation costs | | — | — | 6,381 | — | — | 6,381 |
| Vested awarded shares transferred to employees | | — | 11,439 | (11,439) | — | — | — |
| Proposed final 2011 dividends | 11 | (92,241) | — | — | — | — | (92,241) |
| **AT 31 DECEMBER 2011 AND 1 JANUARY 2012** | | **440,974** | **(93,754)** | **142,851** | **(125,053)** | **139,358** | **504,376** |
| Total comprehensive income for the year | | **—** | **—** | **—** | **(452)** | **102,537** | **102,085** |
| Difference between the proposed and paid dividend in respect of the previous year | | **(830)** | **—** | **—** | **—** | **—** | **(830)** |
| Exercise of share options | | **15,783** | **—** | **(7,641)** | **—** | **—** | **8,142** |
| Share-based compensation costs | | **—** | **—** | **18,941** | **—** | **—** | **18,941** |
| Vested awarded shares transferred to employees | | **—** | **11,627** | **(11,627)** | **—** | **—** | **—** |
| Repurchase and cancellation of shares | | **(5,830)** | **—** | **—** | **—** | **—** | **(5,830)** |
| Proposed final 2012 dividend | 11 | **(102,132)** | **—** | **—** | **—** | **—** | **(102,132)** |
| At 31 December 2012 | | **347,965** | **(82,127)** | **142,524** | **(125,505)** | **241,895** | **524,752** |

The Company operates three share option schemes and a share award scheme as part of the benefits to its employees. The employee share-based reserve comprises the fair value of share options and awarded shares granted which are yet to be exercised, as further explained in the accounting policy for share-based payment transactions in note 2.4 to the financial statements. The amount will be either transferred to the share premium account when the related share options are exercised, or be transferred to shares held for share award scheme when the related awarded shares are vested and transferred.

## 35. BUSINESS COMBINATION

On 4 January 2011, the Group, through its subsidiary, Shell Internet, entered into an agreement (the "Acquisition Agreement") with 7 parties (the "Selling Parties") who owned drivergenius software which can be downloaded from its official website drivergenius.com and also owned a few websites including mydrivers.com, drivers.com.cn, myfiles.com.cn and 9724.com (the "Target Business"). Pursuant to the Acquisition Agreement, the Group paid the Selling Parties a cash consideration of RMB12,000,000, and will pay another consideration of RMB6,000,000 conditional upon the achievements by the Target Business of certain operating results within the first 12-month period and the second 12-month period after the completion of the acquisition. In return, the Selling Parties transferred all of the intellectual properties, user database, material contracts, fixed assets and key employees engaged in the Target Business to the Group. The transaction was closed on 24 January 2011.

The fair values of the identifiable assets of the Target Business as at the date of acquisition were:

| | NOTES | FAIR VALUE RECOGNISED ON ACQUISITION RMB'000 |
|---|---|---|
| Property, plant and equipment | 13 | 105 |
| Trademarks and websites | 16 | 2,161 |
| Software | 16 | 12,885 |
| **TOTAL IDENTIFIABLE NET ASSETS AT FAIR VALUE** | | 15,151 |
| Goodwill on acquisition | 15 | 2,849 |
| **SATISFIED BY CASH AND OTHER PAYABLES** | | 18,000 |

An analysis of the cash flows in respect of the acquisition of the Target Business is as follows:

| | |
|---|---|
| Cash paid in 2011 | (12,000) |
| Cash paid in 2012 | (3,000) |
| Net outflow of cash and cash equivalents included in cash flows used in investing activities | (15,000) |

The Group did not incur transaction costs for this acquisition. The transaction costs were borne by the Selling Parties.

Since the acquisition, the Target Business contributed RMB6,904,000 to the Group's revenue and RMB4,500,000 to the consolidated profit for the year ended 31 December 2011.

Had the combination taken place at the beginning of the period, the revenue of the Group and the profit of the Group for the year ended 31 December 2011 would have been RMB1,020,804,000 and RMB335,090,000, respectively.

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

### Supplemental cash flow information

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Cash received from interest | **90,001** | 55,496 |
| Cash paid for income tax related to operating activities | **(48,125)** | (49,307) |

## 37. COMMITMENTS

### Operating lease commitments — Group as lessee

The Group leases certain of its office premises and electronic equipment under operating lease arrangements. These non-cancellable leases have remaining terms ranging one to five years.

At 31 December 2012, the Group and the Company had total future minimum lease payments under non-cancelled operating leases falling due as follows:

| | GROUP | | COMPANY | |
|---|---|---|---|---|
| | 2012 RMB'000 | 2011 RMB'000 | 2012 RMB'000 | 2011 RMB'000 |
| Within one year | **21,620** | 21,544 | **6** | 85 |
| After one year but not more than five years | **9,469** | 1,622 | **—** | — |
| | **31,089** | 23,166 | **6** | 85 |

As at 31 December 2012, the calculation of lease payment of some electronic equipment was based on the actual number of users of the relevant servers. The rental expense under these operating leases was RMB10,213,000 for the year ended 31 December 2012 (2011: RMB15,413,000). As future lease payments for these arrangements are based on the actual number of users and thus cannot be reasonably estimated, they are not included in the minimum lease payments shown above.

### Capital commitments

| | | GROUP | |
|---|---|---|---|
| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
| Contracted, but not provided for: | | | |
| Purchase of electronic equipment | | **415** | 6,333 |
| Development of land and buildings | (a) | **922,975** | 1,646,500 |
| Acquisition of intangible assets | | **34** | 430 |
| | | **923,424** | 1,653,263 |

(a) The capital commitment for the development of land and buildings at 31 December 2012 represented the commitment to invest in an aggregate amount of RMB922,975,000 before 2014 in the development of a piece of land in Zhuhai (2011: RMB926,609,000 for a piece of land in Zhuhai and RMB719,891,000 for a piece of land in Chengdu).

## 38. RELATED PARTY TRANSACTIONS

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

| | | GROUP | |
|---|---|---|---|
| | NOTES | 2012 RMB'000 | 2011 RMB'000 |
| Equity contribution from non-controlling shareholders of subsidiaries | (i) | **50,670** | 175,496 |
| Loans to non-controlling shareholders of subsidiaries | (i) | **28,472** | 122,801 |
| Interest income from non-controlling shareholder of subsidiaries | (i) | **2,974** | 1,741 |
| Provision of services to a company whose parent has a significant influence on the Company | (ii) | **70,493** | 7,523 |
| Purchases of products from a company controlled by a director of the Company | (iii) | **10,430** | — |

(i) On 21 May 2012, KOS Holdings issued 200,000,000 new ordinary shares (representing 21.05% of the enlarged equity interest of KOS Holdings) to a company owned by some founding employees including a director of some subsidiaries of the Company, at a subscription price of USD0.03 per share for an aggregate consideration of approximately USD6,000,000 (equivalent to RMB38,132,000). Part of the consideration amounting to USD4,500,000 (equivalent to RMB28,285,000) is funded by a loan advanced from the Company, the parent of KOS Holdings, which bears interest at a rate of Hong Kong Interbank Offered Rate plus 1.3%, and is secured by 200,000,000 shares of KOS Holdings held by the company owned by some founding employees. The term of the above loan is one year and can be automatically extended for the succeeding one year upon expiration if certain conditions have been satisfied.

On 11 November 2012, KC Holdings issued 162,000,000 new ordinary shares (representing 19.49% of the enlarged equity interest of KC Holdings) to a company owned by some founding employees, at a subscription price of USD0.001 per shares for an aggregate consideration of approximately USD162,000 (equivalent to RMB1,027,000). On 30 November 2012, KC Holdings issued 91,000,000 new ordinary shares (representing 9.87% of the enlarged equity interest of KCS Holdings) to a company owned by a director of the Group, at a subscription price of USD0.02 per share for an aggregate consideration of approximately USD1,820,000 (equivalent to RMB11,511,000).

On 8 April 2011, Westhouse Holdings issued 160,000,000 new ordinary shares (representing 20% of enlarged equity interest of Westhouse Holdings) to a company owned by some founding employees including a director of the Company, at a subscription price of HKD1.1834 per share for an aggregate consideration of approximately HKD189,344,000 (equivalent to RMB159,078,000). Part of the consideration amounting to HKD151,475,000 (equivalent to RMB123,513,000) is funded by a loan advanced from KES Holdings, the parent of Westhouse Holdings, which bears interest at a rate of Hong Kong Interbank Offered Rate plus 1.3% for initial term and Hong Kong Bank Offered Loan Rate for the succeeding terms, and is secured by 128,000,000 shares of Westhouse Holdings held by the company owned by some founding employees. The term of the above loan is one year and can be automatically extended for the succeeding one year upon expiration if certain conditions have been satisfied.

## 38. RELATED PARTY TRANSACTIONS (continued)

(a) (continued)

(i) (continued)

Pursuant to a share subscription agreement dated 8 March 2011, KIS Holdings issued 100,000,000 ordinary shares (representing 11% of the enlarged equity interest of KIS Holdings) to a company controlled by a non-controlling shareholder of a subsidiary, for an aggregate consideration of USD2,499,000 (equivalent to RMB16,418,000) on 31 March 2011. Moreover, KIS Holdings was granted options from the above company to repurchase the above 100,000,000 ordinary shares (the "Repurchase Option") if certain conditions have been fulfilled. The option relating to the repurchase of the 20% of the above shares has been expired as at 30 September 2011, and the option relating to the repurchase of the remaining 80% of the above shares will be expired upon the earlier of: (i) the IPO of KIS Holdings, and (ii) the fourth anniversary from the date of 31 March 2011.

(ii) The directors of the Company consider that the provision of services was made according to the published prices and conditions offered to the major customers of the Group.

(iii) The directors of the Company consider that the purchases were made according to the published prices and conditions offered to the major customers of the supplier.

### (b) Outstanding balances with related parties:

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

| | | GROUP | |
|---|---|---|---|
| | NOTE | 2012 RMB'000 | 2011 RMB'000 |
| Due from related parties: | | | |
| Loans to non-controlling shareholders of subsidiaries | (i) | **161,262** | 137,502 |
| Due from related parties included in trade receivables | | | |
| Receivables from a company whose parent has a significant influence on the Company | | **12,746** | 2,140 |
| | | **174,008** | 139,642 |

(i) Loans of HKD182,778,000 (equivalent to RMB148,214,000) were due from non-controlling shareholder of subsidiaries. Details are included in note 38(a) (i) above.

A loan of RMB13,048,000 was due from non-controlling shareholders of a subsidiary. This loan bears interest at a rate of HIBOR plus 1.5% per annum and will be repaid in four years since June 2009. The loan is secured by certain equity interest of the subsidiary held by the non-controlling shareholders.

## 38. RELATED PARTY TRANSACTIONS (continued)

### (c) Compensation of key management personnel of the Group

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

| | GROUP 2012 RMB'000 | GROUP 2011 RMB'000 |
|---|---|---|
| Salaries, allowances and benefits in kind | **2,648** | 7,680 |
| Pension plan contributions | **115** | 168 |
| Share-based compensation costs | **593** | 2,645 |
| Total compensation paid to key management personnel | **3,356** | 10,493 |

## 39. FINANCIAL INSTRUMENTS BY CATEGORY

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

| | GROUP | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | | | 2011 | | | |
| FINANCIAL ASSETS | LOANS AND RECEIVABLES RMB'000 | AVAILABLE-FOR-SALE INVESTMENTS RMB'000 | DESIGNATED AS FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION RMB'000 | TOTAL RMB'000 | LOANS AND RECEIVABLES RMB'000 | AVAILABLE-FOR-SALE INVESTMENT RMB'000 | DESIGNATED AS FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION RMB'000 | TOTAL RMB'000 |
| Other financial asset | **—** | **—** | **27,822** | **27,822** | — | — | 11,812 | 11,812 |
| Available-for-sale investments | **—** | **7,182** | **—** | **7,182** | — | 4,990 | — | 4,990 |
| Loan receivables | **5,864** | **—** | **—** | **5,864** | 4,500 | — | — | 4,500 |
| Trade receivables | **130,346** | **—** | **—** | **130,346** | 80,366 | — | — | 80,366 |
| Due from related parties | **161,262** | **—** | **—** | **161,262** | 137,502 | — | — | 137,502 |
| Financial assets included in prepayments, deposits and other receivables | **41,239** | **—** | **—** | **41,239** | 20,414 | — | — | 20,414 |
| Pledged deposit | **19,000** | **—** | **—** | **19,000** | 85,000 | — | — | 85,000 |
| Cash and cash equivalents | **2,416,259** | **—** | **—** | **2,416,259** | 1,953,770 | — | — | 1,953,770 |
| Total | **2,773,970** | **7,182** | **27,822** | **2,808,974** | 2,281,552 | 4,990 | 11,812 | 2,298,354 |

## 39. FINANCIAL INSTRUMENTS BY CATEGORY (continued)

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

| | GROUP | |
|---|---|---|
| **FINANCIAL LIABILITIES** | **2012 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000** | **2011 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000** |
| Trade payables | **23,089** | 16,568 |
| Financial liabilities included in other payables and accruals | **213,926** | 149,473 |
| Interest-bearing bank loans | **413,559** | 346,655 |
| Total | **650,574** | 512,696 |

| | COMPANY | |
|---|---|---|
| **FINANCIAL ASSETS** | **2012 LOANS AND RECEIVABLES RMB'000** | **2011 LOANS AND RECEIVABLES RMB'000** |
| Due from related parties | **41,835** | 12,960 |
| Due from subsidiaries | **702,285** | 662,950 |
| Pledged deposit | **19,000** | — |
| Cash and cash equivalents | **156,227** | 155,283 |
| Total | **919,347** | 831,193 |

| | COMPANY | |
|---|---|---|
| **FINANCIAL LIABILITIES** | **2012 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000** | **2011 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000** |
| Financial liabilities included in other payables and accruals | **1,245** | 425 |
| Due to subsidiaries | **118,907** | 113,853 |
| Interest-bearing bank loans | **413,559** | 346,655 |
| Total | **533,711** | 460,933 |

## 40. FAIR VALUE AND FAIR VALUE HIERARCHY

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

**Group**

| | CARRYING AMOUNTS | | FAIR VALUES | |
|---|---|---|---|---|
| | **2012 RMB'000** | **2011 RMB'000** | **2012 RMB'000** | **2011 RMB'000** |
| **FINANCIAL ASSETS** | | | | |
| Cash and cash equivalents | **2,416,259** | 1,953,770 | **2,416,259** | 1,953,770 |
| Pledged deposit | **19,000** | 85,000 | **19,000** | 85,000 |
| Loan receivables | **5,864** | 4,500 | **5,864** | 4,500 |
| Trade receivables | **130,346** | 80,366 | **130,346** | 80,366 |
| Due from related parties | **161,262** | 137,502 | **161,262** | 137,502 |
| Financial assets included in prepayments, deposits and other receivables | **41,239** | 20,414 | **41,239** | 20,414 |
| Available-for-sale investments | **7,182** | 4,990 | **7,182** | 4,990 |
| Other financial asset | **27,822** | 11,812 | **27,822** | 11,812 |
| | **2,808,974** | 2,298,354 | **2,808,974** | 2,298,354 |
| **FINANCIAL LIABILITIES** | | | | |
| Trade payables | **23,089** | 16,568 | **23,089** | 16,568 |
| Financial liabilities included in other payables and accruals | **213,926** | 149,473 | **213,926** | 149,473 |
| Interest-bearing bank loans | **413,559** | 346,655 | **413,559** | 346,655 |
| | **650,574** | 512,696 | **650,574** | 512,696 |

**Company**

| | CARRYING AMOUNTS | | FAIR VALUES | |
|---|---|---|---|---|
| | **2012 RMB'000** | **2011 RMB'000** | **2012 RMB'000** | **2011 RMB'000** |
| **FINANCIAL ASSETS** | | | | |
| Cash and cash equivalents | **156,227** | 155,283 | **156,227** | 155,283 |
| Pledged deposit | **19,000** | — | **19,000** | — |
| Due from related parties | **41,835** | 12,960 | **41,835** | 12,960 |
| Due from subsidiaries | **702,285** | 662,950 | **702,285** | 662,950 |
| | **919,347** | 831,193 | **919,347** | 831,193 |
| **FINANCIAL LIABILITIES** | | | | |
| Due to subsidiaries | **118,907** | 113,853 | **118,907** | 113,853 |
| Financial liabilities included in other payables and accruals | **1,245** | 425 | **1,245** | 425 |
| Interest-bearing bank loans | **413,559** | 346,655 | **413,559** | 346,655 |
| | **533,711** | 460,933 | **533,711** | 460,933 |

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

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

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

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

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

### Fair value hierarchy

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

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

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

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

*Assets measured at fair value:*

Group

As at 31 December 2012

| | LEVEL 1 RMB'000 | LEVEL 2 RMB'000 | LEVEL 3 RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|
| Other financial asset at fair value through profit or loss | — | — | 27,822 | 27,822 |
| | — | — | 27,822 | 27,822 |

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

**Fair value hierarchy (continued)**

*Assets measured at fair value: (continued)*

As at 31 December 2011

| | LEVEL 1 RMB'000 | LEVEL 2 RMB'000 | LEVEL 3 RMB'000 | TOTAL RMB'000 |
|---|---|---|---|---|
| Other financial asset at fair value through profit or loss | — | — | 11,812 | 11,812 |
| | — | — | 11,812 | 11,812 |

The movement in fair value measurements in Level 3 during the year is as follows:

| | 2012 RMB'000 | 2011 RMB'000 |
|---|---|---|
| Other financial asset at fair value through profit or loss: | | |
| At 1 January | **11,812** | 13,785 |
| Total gain/(loss) recognised in the income statement | **16,010** | (1,973) |
| At 31 December | **27,822** | 11,812 |

During the year, there were no transfers of fair value measurements between Level 1 and Level 2 and no transfers into or out of Level 3 (2011: Nil).

## 41. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise interest-bearing bank loans, cash and cash equivalents and pledged deposits. The main purpose of these financial instruments is to raise finance for the Group's operations and payment of dividends. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The board of directors reviews and agrees policies for managing each of these risks and they are summarised below.

### Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's bank loans with floating interest rates and loans to related parties bearing a floating interest rates.

The Group's policy is to reduce the interest expenses through a combination of bank loans denominated in USD or HKD and equivalent deposits in RMB. As at 31 December 2012, approximately RMB413,559,000 of the Group's bank loans denominated in USD or HKD bore interest at floating rates. The Group believes that the exposure to the risk of changes in market interest rates is minimal because simultaneously the Group has an equivalent RMB deposit earning at a higher interest rate.

For the year ended 31 December 2012, if the average interest rate on the loan to related parties and bank loans had been 5% (2011: 5%) higher/lower with all other variables held constant, the profit of the Group for the year would have been approximately RMB12,615,000 (2011: RMB10,458,000) lower/higher as a result of higher/lower finance costs.

For the year ended 31 December 2012, if the average interest rate on the loan to related parties and bank loans had been 5% (2011: 5%) higher/lower with all other variables held constant, the profit of the Company for the year would have been approximately RMB18,586,000 (2011: RMB16,685,000) lower/higher as a result of higher/lower finance costs.

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

### Foreign currency risk

The Group has transactional currency exposures. Such exposures arise from royalties and licensing revenue derived from overseas markets by operating units in currencies other than the units' functional currencies. Approximately 8% (2011: 12%) of the Group's royalties and licencing revenue were denominated in currencies other than the functional currency of the operating units authorising the licence.

The following table demonstrates the sensitivity at the end of the reporting period to a reasonably possible change in the USD and HKD exchange rates, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) for the year:

| | INCREASE/ (DECREASE) IN PROFIT BEFORE TAX RMB'000 |
|---|---|
| **2012** | |
| If RMB strengthens 5% against HKD | **(268)** |
| If RMB weakens 5% against HKD | **268** |
| If RMB strengthens 5% against USD | **(224)** |
| If RMB weakens 5% against USD | **224** |
| **2011** | |
| If RMB strengthens 5% against HKD | (44) |
| If RMB weakens 5% against HKD | 44 |
| If RMB strengthens 5% against USD | (263) |
| If RMB weakens 5% against USD | 263 |

### Credit risk

The Group trades only with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

The credit risk of the Group's other financial assets, which comprise cash and cash equivalents, pledged deposit, loan receivables, loans to related parties and other receivables, arises from default of the counterparty, with a maximum exposure equal to the carrying amounts of these instruments.

At the end of the reporting period, the Group had certain concentrations of credit risk as 4% (2011: 14%) of the Group's trade receivables were due from the Group's largest customer, within the entertainment software segment.

Further quantitative data in respect of the Group's exposure to credit risk arising from trade receivables are disclosed in note 24 to the financial statements.

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

### Liquidity risk

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

The contractual maturity of trade payables and interest-bearing bank loans are disclosed in notes 28 and 29 respectively. For trade payables, they are generally on credit terms of two to three months after the invoice date. For other payables and accruals, there are generally no specified contractual maturities for these liabilities, and they are paid on a regular basis or upon counterparty's formal notification.

The Group has been continuously generating cash inflows from its operating activities and recording an increase of cash and cash equivalents. As at 31 December 2012, the Group's cash and cash equivalents balance was approximately RMB2,416,259,000, accounting for 78.8% of the Group's current assets and 66.4% of the Group's total assets. The Group believes that the exposure to liquidity risks is minimal.

### Capital management

The primary objectives of the Group's capital management are to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholders' value.

The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. The Group is not subject to any externally imposed capital requirements. No changes were made in the objectives, policies or processes for managing capital during the years ended 31 December 2012 and 31 December 2011.

The Group monitors capital using the net cash over debt position, which is cash and cash equivalents less trade payables, other payables and accruals, and interest-bearing bank loans.

| | **GROUP** | |
|---|---|---|
| | **2012** | **2011** |
| | **RMB'000** | **RMB'000** |
| Cash and cash equivalents | **2,416,259** | 1,953,770 |
| Trade payables | **(23,089)** | (16,568) |
| Other payables and accruals | **(298,827)** | (219,400) |
| Interest-bearing bank loans | **(413,559)** | (346,655) |
| Net cash over debt position | **1,680,784** | 1,371,147 |

## 42. CONTINGENT LIABILITIES

At the end of the reporting period, neither the Group nor the Company had any significant contingent liabilities.

## 43. EVENTS AFTER THE REPORTING PERIOD

(a) On 5 February 2013, Zhuhai Software entered into a sale and purchase agreement with a third party company (the "Purchaser"), whereby the Purchaser agreed to purchase 80% equity interest in Chengdu Baiming, a wholly-owned subsidiary of Zhuhai Software, at a consideration of RMB200,000,000. The Purchaser and Chengdu Baiming agreed that the benefit accrued to the Zhuhai Software's remaining 20% interest in Chengdu Baiming shall not be less than RMB88,000,000 (inclusive of equity investment cost of RMB40,000,000), such interest shall take priority over other shareholders' interests and that such interest shall be realised not later than 30 June 2016.

(b) On 27 February 2013, the share option scheme of Kingsoft Cloud and Kingsoft Jingcai was approved at the Extraordinary General Meeting of the Company.

## 44. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 19 March 2013.