



Kingsoft Internet Security 互联网安全组合装

金山毒霸
2009



Kingsoft Corporation Limited
2008 Annual Report

 **KINGSOFT**

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

Beijing Zhuhai Chengdu Dalian Shenzhen Japan Vietnam Malaysia



Kingsoft Corporation Limited

Annual Report 2008 | KINGSOFT CORPORATION LIMITED

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MISSION

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

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

CORPORATE INFORMATION

Legal Name of the Company

Kingsoft Corporation Limited

Stock Code

3888

Date of Listing

October 9, 2007

Head Office and Principal Place of Business

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

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Tsuen Wan, N.T.

Hong Kong

Registered Office

Clifton House

75 Fort Street

P.O. Box 1350 GT

George Town

Grand Cayman

Cayman Islands

Executive Directors

Mr. Pak Kwan Kau (Chairman)

Mr. Donghui Wang

Non-executive Directors

Mr. Jun Lei

Mr. Choon Choong Tay

Mr. Wai Ming Wong

Mr. Wing Chung Anders Cheung

Independent Non-executive Directors

Mr. Shun Tak Wong

Mr. Guangming George Lu

Mr. Mingming Huang

Audit Committee

Mr. Shun Tak Wong (Chairman)

Mr. Guangming George Lu

Mr. Wing Chung Anders Cheung

Remuneration Committee

Mr. Wing Chung Anders Cheung (Chairman)

Mr. Shun Tak Wong

Mr. Mingming Huang

Nomination Committee

Mr. Guangming George Lu (Chairman)

Mr. Wing Chung Anders Cheung

Mr. Mingming Huang

Company Secretary and Board Secretary

Ms. Michelle Feng Harnett (ACCA)

Compliance Adviser

Evolution Watterson Securities Limited

5th Floor, 8 Queen's Road, Central

Hong Kong

CORPORATE INFORMATION (continued)

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

Cayman Islands

Hong Kong Branch Share Registrar and Transfer Office

Computershare Hong Kong Investor Services Limited

Shops 1712–1716, 17/F.

Hopewell Centre

183 Queen's Road East

Hong Kong

Auditors

Ernst & Young

Certified Public Accountants

18th Floor, Two International Finance Centre

8 Finance Street

Central

Hong Kong

Legal Advisers on Hong Kong law

Woo Kwan Lee & Lo

26th Floor, Jardine House

1 Connaught Place

Central

Hong Kong

Principal Bankers

Industrial and Commercial Bank of China (Asia) Limited

Standard Chartered Bank (Hong Kong) Limited

Standard Chartered Bank (China) Limited

Bank of Beijing — Zhongguancun Branch

China Merchants Bank Beijing — Beijing Dayuncun
sub-branch

Bank of Communications — Zhuhai Jida Branch

Investor and Media Relations

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FINANCIAL HIGHLIGHTS

Consolidated Income Statements

	YEAR ENDED DECEMBER 31,			
	2005 RMB'000	2006 RMB'000	2007 RMB'000	2008 RMB'000
Revenue:				
Entertainment software	133,903	215,356	396,440	553,723
Applications software	80,322	98,432	156,521	261,150
Others	976	2,643	3,653	6,071
	215,201	316,431	556,614	820,944
Cost of revenue	(33,271)	(44,671)	(95,484)	(110,935)
Gross profit	181,930	271,760	461,130	710,009
Research and development costs, net of government grants	(42,367)	(58,914)	(68,450)	(124,926)
Selling and distribution costs	(67,017)	(59,504)	(108,723)	(148,565)
Administrative expenses	(28,879)	(43,766)	(65,785)	(93,772)
Share-based compensation costs	(15,576)	(6,852)	(103,764)	(49,909)
Other operating costs	(2,115)	(13,296)	(2,249)	(4,822)
Impairment of an available-for-sale investment/ an associate	(1,000)	(6,000)	—	—
Other income and gains	3,715	28,316	11,531	18,898
Operating Profit	28,691	111,744	123,690	306,913
Finance income	1,312	3,753	22,775	31,022
Finance costs	(494)	(6,271)	(1,211)	—
Share of profit/(loss) of an associate	—	(527)	(2,460)	27,263
Share of loss of a jointly-controlled entity	—	—	—	(1,278)
Profit before tax	29,509	108,699	142,794	363,920
Income tax credit/(expense)	4,923	(9,589)	12,658	(59,885)
Profit for the period	34,432	99,110	155,452	304,035
Attributable to:				
Equity holders of the Company	35,667	99,525	164,678	307,501
Minority interests	(1,235)	(415)	(9,226)	(3,466)
	34,432	99,110	155,452	304,035
Proposed final dividend	—	—	95,710	139,723
	RMB	RMB	RMB	RMB
Earnings per share attributable to ordinary equity holders of the Company				
Basic	0.0486	0.1245	0.1815	0.2895
Diluted	0.0446	0.1185	0.1725	0.2774

FINANCIAL HIGHLIGHTS (continued)

Consolidated Balance Sheets (Selected Items)

	AS AT DECEMBER 31,			
	2005 RMB'000	2006 RMB'000	2007 RMB'000	2008 RMB'000
Cash and cash equivalents	137,568	333,508	1,246,077	1,007,115
Credit-linked deposit	—	—	—	111,708
Total assets	270,933	520,709	1,499,921	1,739,223
Total equity	41,753	267,827	1,133,657	1,328,365

Consolidated Cash Flow Statements (Selected Items)

	YEAR ENDED DECEMBER 31,			
	2005 RMB'000	2006 RMB'000	2007 RMB'000	2008 RMB'000
Net cash inflow from operating activities	58,362	139,701	345,474	381,472
Net cash outflow in investing activities	(29,561)	(49,265)	(395,659)	(520,533)
Net cash inflow/(outflow) from financing activities	6,353	91,464	647,412	(97,073)
Net increase/(decrease) in cash and cash equivalents	35,154	181,900	597,227	(236,134)

MILESTONES OF THE GROUP IN 2008

February:

- Partnered with Baidu, the largest Chinese language internet search provider, to launch a free internet security service that would benefit as many as 200 million users in China

April:

- Kingsoft Internet Security 2008 was awarded the VB100 certificate in April and October by Virus Bulletin, the international authority in anti-virus software testing

May:

- Kingsoft entered into a framework agreement with Lianking (煉金), an online game R&D studio in China, to form a joint venture (“JV”) that will develop online games, Kingsoft invested RMB10 million in the JV for an initial shareholding of 40%
- Partnered with Google to launch “Google-Kingsoft PowerWord”, the partnership is the start of a new chapter for Kingsoft PowerWord as it transforms into a web-based service
- Entered into a commodity houses pre-sale contract and a supplemental agreement with Beijing Yinbei, Kingsoft agreed to purchase a property, which is a seven-storey composite building located at the north of Xiaoying Road West, Haidian District, Beijing as the Company’s new headquarter, at a total cash consideration of RMB175.0 million (equivalent to approximately HK\$195.3 million)
- Launched open beta testing for The First Myth II, the highly anticipated massively multi-player online role-playing game (“MMORPG”)

June:

- Acquired China Merchants InfoGate Ltd. (“InfoGate”), an Internet security products and services provider in Shenzhen, at a cash consideration of RMB14.52 million

July:

- Kingsoft entered into a purchase agreement with the State Grid Corporation of China (“SGCC”) with value over RMB10 million. Each unit in SGCC, including 31 regional grid companies, electric power companies located in each province, autonomous region and municipal as well as 21 directly subordinated units will fully adopted the Kingsoft WPS Office

September:

- Kingsoft formally adopted ERP software, which will help to improve the internal processes of resource utilization and management efficiency

October:

- “JX Online World” conducted open beta testing on October 16, and it recorded the peak concurrent users of over 280,000 during its close beta testing period, set concurrent users during close beta testing period to a new high amongst China-made online games
- Entered Malaysia market and formed a subsidiary, Kingsoft (M) Sdn. Bhd, this is the first time that Kingsoft expands overseas markets through a wholly-owned subsidiary

November:

- Reached a strategic cooperation agreement with Microsoft MSN to jointly launch the free “MSN Protection Shield v1.0” and “MSN Security Center”, the reliable anti-virus software for all users of Windows Live Messenger and Internet
- Kingsoft celebrated its 20th anniversary and announced the launch of four new products, including “WPS Office 2009”, “Kingsoft PowerWord 2009 Oxford Edition”, “Kingsoft Internet Security 2009” and “JX Online III (“JX III”)”
- “JX III” kicked off its close alpha testing

December:

- With a total consideration of US\$8.0 million, Kingsoft entered into an agreement to acquire approximately 30.03% interest in aggregate in the share capital of Sky Profit, a holding company that has full control in its PRC subsidiary companies developing computer and online game software products

CHAIRMAN'S STATEMENT

In the year of 2008, we progressed significantly in strengthening Kingsoft's position as a leading developer, distributor and service provider of online games and applications software in China.

We have successfully executed our dual-engine growth strategy. Total revenue for 2008 increased by 47% to RMB820.9 million year-over-year. The Group's total profit attributable to equity holders for 2008 was RMB307.5 million, an increase of 87% year-over-year.

Our dual-engine growth model has been fundamentally driven by the growth of internet. China Internet Network Information Center recent report shows that total number of Internet users in China reached 298 million at the end of 2008, representing a year-on-year growth of 42% as a combined result of increased broadband penetration, increased online activities and applications, particularly in the usages of interactive communities and entertainment contents.

Kingsoft has built successes upon a strong research and development culture, which fosters innovative teams; enables us to scale to simultaneously execute several large-scale development projects to maintain a diversified pipeline of quality products; have a significant cost advantage over competitors that license third-party technology or contents.

Our online game business has been pursuing best content strategy. In the fourth quarter of 2008, our MMORPGs had an aggregate of over 1 million daily average peak concurrent users ("PCU"), and over 1.5 million monthly average paid users. JX series made a combined PCU of 0.80 million, about 80 percent of our daily online game traffic. Today, JX developed by our Zhuhai studio has become one of the most influential martial-arts online games in China and Southeast Asia. Kingsoft is also an early investor in innovative teams and diversification. Our other game studios in Beijing, Chengdu and Dalian are also expanding their own online game sequels, such as First Myth and CQ. Following Kingsoft Guangzhou, we continued to invest in and partner with top game studios in China, such as Lianking and recently Zhixiong.

We believe quality premium of our games is the key for long-term success. JX III is currently ranked by 17173.com as one of the most anticipated new online games. It has been under development for over six years and equipped with our proprietary state-of-arts three-dimension game engine.

Kingsoft was awarded "China Top-ten Online Game Developer and Operator" during the 2008 China Online Game Industry Annual Conference.

Our total revenue of application software grew by 67% year-over-year in 2008. Being the origin of Kingsoft, our application software is in constant transition to a web-based software-as-a-service model. Our software portfolio including Kingsoft Internet Security, Kingsoft PowerWord and Kingsoft WPS has continued to increase market position in China and Japan in 2008.

Kingsoft Internet Security has adopted the new three-dimension Internet defense system and the fourth time passed the Virus Bulletin 100 Test in December 2008, the international authority in anti-virus software testing. Our total number of online daily average paying users for Kingsoft Internet Security was 8.4 million in the fourth quarter of 2008.

CHAIRMAN'S STATEMENT (continued)

www.iciba.com of Kingsoft PowerWord has been a leading virtual English learning site in China. Kingsoft WPS Office has been widely used by Chinese governments and continued expansion into local enterprises in 2008, which was marked by a milestone sale contract of WPS Office with State Grid Corporation of China ("SGCC") at a total value over RMB10 million in July 2008.

Kingsoft was named as one of "Top 10 China Copyright Holders in 2008" by Copyright Protection Center of China (CPCC) in 2008.

To highlight all these achievements, I'm very pleased to present our 2008 annual report. I would like to thank the management and staff for their hard work, and thank all our shareholders and investors for their support and confidence in Kingsoft.

Pak Kwan Kau

Chairman

PRC, March 31, 2009

MANAGEMENT DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2008

The following table sets forth the comparative numbers for the years ended December 31, 2008 and December 31, 2007, respectively.

	2008 RMB'000	2007 RMB'000
Revenue:		
Entertainment software	553,723	396,440
Applications software	261,150	156,521
Others	6,071	3,653
	820,944	556,614
Cost of revenue	(110,935)	(95,484)
Gross profit	710,009	461,130
Research and development costs, net of government grants	(124,926)	(68,450)
Selling and distribution costs	(148,565)	(108,723)
Administrative expenses	(93,772)	(65,785)
Share-based compensation costs	(49,909)	(103,764)
Other operating costs	(4,822)	(2,249)
Other income and gains	18,898	11,531
Operating profit	306,913	123,690
Finance income	31,022	22,775
Finance costs	—	(1,211)
Share of profit/(loss) of an associate	27,263	(2,460)
Share of loss of a jointly-controlled entity	(1,278)	—
Profit before tax	363,920	142,794
Income tax credit/(expense)	(59,885)	12,658
Profit for the year	304,035	155,452
Attributable to:		
Equity holders of the Company	307,501	164,678
Minority interests	(3,466)	(9,226)
	304,035	155,452
Proposed final dividend	139,723	95,710
	RMB	RMB
Earnings per share attributable to ordinary equity holders of the Company		
Basic	0.2895	0.1815
Diluted	0.2774	0.1725

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Revenue

Revenue increased by 47% year-over-year to RMB820.9 million. Approximately 67% was generated from the entertainment software business segment and 32% was generated from the applications software business segment.

— Entertainment Software

Revenue from the entertainment software increased by 40% to RMB553.7 million. This strong revenue growth was mainly attributable to the increasing popularity of the Group's MMOPRGs, especially the success of JX franchise. The Group's daily average peak concurrent users increased by 70% to 1.0 million year-over-year for the three month period ended December 31, 2008.

The monthly ARPU for our MMOPRGs increased by 3% year-over-year to RMB38 year-over-year for the three month period ended December 31, 2008.

— Applications Software

Revenue from the applications software business increased by 67% year-over-year to RMB261.2 million primarily due to a significant increase in the number of subscribers for online services of Kingsoft Internet Security software and a rapid growth of software revenue from Kingsoft Japan.

During the year, the revenue contributed from Kingsoft Internet Security was RMB201.4 million, represented 77%

The following table sets forth a breakdown of R&D costs for the year ended December 31, 2008 and December 31, 2007, respectively:

	For the year ended	
	December 31,	
	2008	2007
	RMB'000	RMB'000
Staff cost	114,641	75,795
Depreciation & Amortisation	6,869	4,468
Others	16,455	7,910
	137,965	88,173
Less: Capitalised software costs (except share-based compensation costs)	(9,560)	(1,817)
Add: Amortisation of capitalised software costs	4,110	882
Less: Government Grants for research and development activities	(7,589)	(18,788)
Total	124,926	68,450

of the total revenue of our applications software and an 81% increase from last year.

Gross Profit and Cost of Revenue

Gross profit increased by 54% year-over-year to RMB710.0 million. The Group's gross profit margin increased by three percentage points year-over-year to 86%. This increase was primarily due to a combination of the improved utilisation of servers and bandwidth, reduced proportion of royalty fees for ShuiHu Q Zhuan, and increased proportion of revenue from online service of Kingsoft Internet Security.

Cost of revenue increased by 16% year-over-year to RMB110.9 million primarily due to the increased revenue from MMORPGs and online services of Kingsoft Internet Security compared to the previous year.

Research and Development ("R&D") Costs

R&D costs, before government grants, increased by 52% year-over-year to RMB132.5 million primarily due to the increase in salaries, benefits, bonuses paid to our R&D personnel and an overall increase in R&D headcount.

Government grants for 2008 and 2007 were research-project based for the Group's development of software and online game technologies and amounted to RMB7.6 million and RMB18.8 million, respectively.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Selling and Distribution Costs

Selling and distribution expenses increased by 37% year-over-year to RMB148.6 million primarily due to an increase in online advertisement expenses related to promoting our MMORPGs and online services of Kingsoft Internet Security.

Administrative Expenses

Administrative expenses increased by 43% year-over-year to RMB93.8 million primarily due to growth in headcount for supporting the business expansion, the salary benefits and bonuses increases implemented in 2008, and the increased professional fee for enhancement of the Group's management.

Share-based Compensation Costs

Share-based compensation costs decreased substantially by 52% year-over-year to RMB49.9 million primarily due to the graded vesting of the granted share options.

Other Operating Costs

Other operating costs increased by 114% year-over-year to RMB4.8 million primarily due to the increased donation for Sichuan earthquake in 2008 and the write back of bad-debt impaired receivables in 2007 with amount of RMB2.5 million.

Other Income and Gains

Other income and gains increased by 64% year-over-year to RMB18.9 million primarily due to the increased non-research-project based government grants.

Operating Profit Excluding Share-based Compensation Costs

Operating profit excluding share-based compensation costs increased by 57% year-over-year to RMB356.8 million as a result of the combination of above reasons. The margin of operating profit excluding share-based compensation costs improved by two percentage points year-over-year to 43% which reflected the enhanced profitability as a combined result of larger scale of the Group's entertainment software, greater portion of revenue from online service of Kingsoft Internet Security and initial success of new business model of Kingsoft Internet Security in oversea markets.

Finance Income

Finance income increased by 36% year-over-year to RMB31.0 million due to the higher average cash deposit balances in 2008.

Finance Costs

Finance costs were nil in 2008 versus RMB1.2 million in 2007, which resulted from that the Group did not have any borrowings for the year ended December 31, 2008.

Share of Profit/Loss of an associate

Share of gain of an associate was RMB27.3 million in 2008, while the Group recorded a loss of RMB2.5 million in 2007. For the year of 2008, Meng Xiang Shi Jie, the first game launched by Kingsoft Guangzhou, remained a strong and rising operational performance.

Income Tax Expense/Credit

Income tax expenses was RMB59.9 million in 2008 versus an income tax credit of RMB12.7 million in 2007.

This income tax expense of RMB59.9 million was a result of a combination of the current income tax charges of RMB43.3 million and deferred tax expense of RMB16.6 million. The deferred tax expense mainly constituted of a deferred tax asset reversal of RMB16.1 million due to the preferential applicable rates for calculating deferred tax assets as at December 31, 2008.

Profit Attributable to Equity Holders of the Company

Profit attributable to equity holders of the Company increased by 87% year-over-year to RMB307.5 million.

Profit Attributable to Equity Holders of the Company before Share-based Compensation Costs

Profit attributable to equity holders of the Company before share-based compensation costs increased by 33% year-over-year to RMB357.3 million.

The profit margin excluding the effect of share-based compensation costs was lowered to 44% for the year ended December 31, 2008 versus 48% for the year ended

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

December 31, 2007 for the reasons for increased income tax expense described above.

Liquidity and Financial Resource

The Group had a strong cash position towards the end of the reporting year. As at December 31, 2008, the Group had major financial resources in the forms of cash and cash equivalent, time deposits with initial term of over three months and credit-linked deposits amounting to RMB617.0 million, RMB390.2 million, RMB111.7 million, respectively, which totally represented 64% of the Group's total assets. The Group received the principle and interests of the credit-linked deposits in full amounts of HK\$126.7 million, when it was due on January 10, 2009.

As at December 31, 2008, our gearing ratio, which represents total liabilities divided by total assets, was 24%, which remained unchanged as at December 31, 2007. We did not have any borrowings from banks or other institutions as at December 31, 2008.

As at December 31, 2008, RMB308.9 million of the Group's financial assets were held in deposits and investments denominated in non-RMB currencies. Since 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 fluctuations in connection with our deposits and investments.

Deferred Revenue

Deferred revenue (including current and non-current portion) increased by 12% year-over-year to RMB214.6 million as at December 31, 2008. The increases in deferred revenue were consistent with the increased sales of prepaying games cards and online points for the Group's online games and prepayments for online subscription for the Group's application software products.

Net Cash Generated from Operating Activities

Cash generated by our operating activities reflects our profit for reporting year, as the case may be, as adjusted for non-cash items, such as depreciation, amortisation of capitalised software costs, and share-based compensation costs, as well as the effect of changes in certain balance sheet items, such as deferred revenue and accrued expenses and other payables. Our net cash generated by operating activities increase by 10% to RMB381.5 million for the year ended December 31, 2008.

Capital Expenditures

Capital expenditures represent cash payments for acquisition of property, fixed assets and intangible assets such as software. Cash used for capital expenditures increased by 545% year-over-year to RMB329.6 million for the year ended December 31, 2008. During the reporting year, we incurred larger capital expenditures due to the purchase and decoration of the new office property in Beijing, the construction and decoration of the Zhuhai Research Center, and the purchase of additional server for First Myth II and JX Online World.

Business Review and Prospects

2008 was another successful year for Kingsoft following the IPO in 2007. We made robust financial and operational performance in entertainment software and application software. Our online games' traffic, ADPCU reached to a record of in over 1 million for the fourth quarter of 2008; in a constant transit to a web-based software as a service model, our application software also recorded a year-over-year growth of 67% as we increased the proportion of subscription revenue and advertising revenue.

Our 2008 annual results showed the resilience of our dual-engine growth model to the global economy recession. This dual-engine growth model has been fundamentally driven by the growth of internet. China Internet Network Information Center recent report shows that total number of Internet users in China reached 298 million at the end of 2008, representing a year-on-year growth of 42% as a combined result of increased broadband penetration, increased online activities and applications, particularly in the usages of interactive communities and entertainment contents.

— MMORPGs

Since the launch of our first game in 2003, Kingsoft has expanded the game portfolio into eight games, six self-developed and two licensed.

JX Online World was launched in July 2008, which continued the successful story of JX brand name and recorded PCU of over 0.37 million in the fourth quarter of 2008. Our flagship game series, JX has become one of the most influential martial-arts genre game series in China and Southeast Asia with ADPCU of over 0.80 million for the fourth quarter. JX III has possessed top ranking on the game wish-list by 17173.com.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

The limited close-beta testing of JX III running on our proprietary state-of-the-art 3D engine commenced in November, 2008 and received overwhelmingly strong support from the fans. We expect JX III will be in full commercialisation in the second half of 2009. In addition to JX III, we plan to launch four new games in 2009.

Kingsoft was an early believer in game diversification. We have multiple studios specialised in different game genres of martial-arts, Chinese mythology, cartoon and FPS in four major locations, Zhuhai, Beijing, Chengdu and Dalian. The total number of research and development staff of online games is over 760. To further diversify and leverage our operating and user platforms, in addition to Kingsoft Guangzhou, we made investment into two other domestic game studios, "Lianking" studio in Beijing in 2008, and "Zhixiong" studio in Shanghai in 2009.

To broaden Kingsoft's access to gamers, in December 2008, we entered an agreement to acquire in aggregate approximately 30.03% interest of Sky Profit, a leading gamer voice-chat platform in China.

Kingsoft games' overseas expansion continued in 2008 as we launched a number of new games into Southeast Asia, such as JX Online II and First Myth II in Vietnam and MAT in Thailand and Taiwan. JX series have been leading the local market in Vietnam through the game operator Vinagame since 2005.

Applications Software

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

— Internet Security Software

Our principal Internet security software product is Kingsoft Internet Security, which is the one of the leading domestically produced Internet security software products in China.

During the reporting period, its total number of online daily average paying users reached to over 8.4 million. Kingsoft Internet Security teamed up with Baidu, the largest Chinese language internet search provider and launched a free internet security service that will benefit as many as 200 million users in China in January 2008.

In December 2008, Kingsoft Internet Security 2008 was the

fourth time awarded the VB100 certificate by Virus Bulletin, the international authority in anti-virus software testing.

Kingsoft Internet Security reached a strategic cooperation agreement with Microsoft MSN to jointly launch the free "MSN Protection Shield v1.0" and "MSN Security Center" in November 2008.

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

— Dictionary Software

Our key dictionary software, Kingsoft PowerWord, is China's number one multilingual dictionary software. The website www.iciba.com provides an all-round environment for foreign language learning and is dedicated to becoming a comprehensive community for foreign language learners. It has the highest traffic among its Chinese peers issued by Alexa.

In May 2008, Kingsoft PowerWord partnered with Google to launch "Google-Kingsoft PowerWord". The partnership is the start of a new chapter for Kingsoft PowerWord as it transforms into a web-based service. As the first co-branded and free version of the Kingsoft PowerWord series with local dictionary, "Google-Kingsoft PowerWord" leverages on the firm foundation of the PowerWord product, offering quality translation services.

— Office Application Software

Our office application software, WPS Office, is the leading domestically developed office applications software in China.

In August 2008, PRC government departments implemented mandatory application of Uniform Office Format standard ("UOF"), which is expected to accelerate development of PRC-made software. As one of the setters of the UOF standard, Kingsoft's key new product WPS Office 2007 is in full compliance with UOF.

DIRECTORS AND SENIOR MANAGEMENT

Executive Directors

Pak Kwan KAU, aged 44, is an executive Director and the chairman of the Board of our company. Mr. Kau has been employed by us since 1988. He graduated from National Defense University of Science and Technology in China in 1984 with a bachelor degree in Information Management Systems. Between 1984 and 1987, Mr. Kau worked at various Chinese companies as a software developer.

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

Mr. Kau is also a director of Chengdu Kingsoft Interactive Entertainment Co., Ltd., Zhuhai Kingsoft Software Co., Ltd., Zhuhai Xishanju Software Co., Ltd., Zhuhai Juntian Electronic Technology Co., Ltd., Zhuhai Kingsoft Digital Technology Co., Ltd., Zhuhai Kingsoft Online Game Co., Ltd. and Dalian Kingsoft Interactive Entertainment Co., Ltd.

Donghui WANG, aged 38, is currently our chief financial officer. Mr. Wang received a bachelor's degree in engineering from Tianjin Polytechnic University in 1992 and a MBA degree from Victoria University of Technology, Australia in 1997. Mr. Wang worked at Ernst & Young Beijing from 1997 to 1999 as a senior accountant. From 1999 to 2005, Mr. Wang served as a consultant in the PricewaterhouseCoopers Sydney office and a senior manager in their Beijing office. Mr. Wang joined us at the beginning of 2005 as a vice president and was appointed as our chief financial officer in December 2005. Mr. Wang became Senior Vice President of the company in December, 2007. And he has been an executive director of our company since May, 2008.

Mr. Wang is also a director of Zhuhai Xishanju Software Co., Ltd. and Dalian Kingsoft Interactive Entertainment Co., Ltd.

Non-executive Directors

Jun LEI, aged 39, is a non-executive Director, and vice chairman of the Board of our company. Mr. Lei has been employed by us since 1992. Mr. Lei graduated from Wuhan University in 1991 with a bachelor degree in Computer Science. He has been a member of the board of Wuhan University since 2003. He was co-founder of Joyo.com, which was founded in April 2000 and sold to Amazon.com in 2004. Mr. Lei has played a key role in developing the operation of our Group and expanding our business operations. He has been our chief executive officer since 1998, and under his leadership, we further expanded applications software businesses into utilities software, Internet security software and online games. He also played a major role in transforming our Group from a traditional software company into an on-demand software company which extensively utilises the Internet.

Mr. Lei was named as one of the Beijing Top Ten Young Entrepreneurs in 2002, as one of the ten most influential leaders in China's games industry at the inaugural China Game Industry Annual Conference in January 2008. In December, 2007, Mr. Lei relinquished his position as chief executive officer, chief technology officer and president of the Company, but remained as an executive director and vice Chairman of the Board of the Company. In August 2008, Mr. Lei was re-designated from an executive director to a non-executive director. Mr. Lei has held directorship in 2020 CHINACAP ACQUIRCO, INC. — an AMEX listed company since January, 2007. 2020 CHINACAP ACQUIRCO, INC. is listed on AMEX since November 8, 2007.

Mr. Lei is also a director of Beijing Kingsoft Qijian Digital Technology Co., Ltd., Beijing Kingsoft Software Co., Ltd., Beijing Kingsoft Digital Entertainment Co., Ltd., Chengdu Kingsoft Digital Entertainment Co., Ltd. and Zhuhai Kingsoft Software Co., Ltd.

TAY Choon Chong, aged 39, has been a non-executive director of our company since Jan 2008. He is also the Managing Director and China Chief Representative for Vertex Management. Mr. Tay previously served as the Senior Vice President for GIC Special Investments Corporation, Head of Strategic Relations for Singapore Technologies Engineering, the President of Fortune Venture Management, and the Senior Vice President of SAS Component A/S and ST Aerospace Supplies respectively. Mr. Tay has held a non-executive directorship of Ntegrator International Ltd from March 2003 to September 2007, which is a listed company in Stock Exchange of Singapore.

DIRECTORS AND SENIOR MANAGEMENT (continued)

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

Wai Ming WONG, aged 51, has been a non-executive Director of our Company since April 2007. Mr. Wong graduated from the Victoria University of Manchester in the United Kingdom with a bachelor's degree (with honours) in Management Sciences. Mr. Wong is a member of both the Hong Kong Institute of Certified Public Accountants and the Institute of Chartered Accountants in England and Wales. Mr. Wong serves as senior Vice President and the Chief Financial Officer of Lenovo Group Limited, a non-executive director of Linmark Group Limited, and an independent non-executive director of both China Unicom Limited and I.T. Limited, all of these companies are Hong Kong listed companies.

Wing Chung Anders CHEUNG, aged 45, has been a non-executive Director of our Company since September 2004. He is the Chief Executive Office of Aedac Group Limited which develops information technology businesses including networking products, telecommunication software solution as well as software outsourcing for multinational companies.

Before founding Aedac Group, Mr. Cheung was a Vice President of Lenovo Group Limited and was responsible for the corporate development of Lenovo Group, including strategic investment, acquisitions, joint ventures and investment portfolio investment. Mr. Cheung resigned as a non-executive director from Nasdaq listed company Asiainfo Holdings Inc. at the end of October 2008. Mr. Cheung received an MBA degree from a joint program between Northwestern University in the United States and The Hong Kong University of Science and Technology in 2002.

Mr. Cheung is a director of Zhuhai Kingsoft Software Co., Ltd.

Independent Non-executive Directors

Shun Tak WONG, aged 48, is an independent non-executive Director of our Company. Mr. Wong has a master degree in finance from the University of Lancaster in the United Kingdom and a master of accounting from Charles Stuart University in Australia. Mr. Wong is also a fellow CPA member of the Hong Kong Institute of Certified Public Accountants and a fellow CPA member of Australian Society of CPAs. In the past, Mr. Wong held key executive positions in various multi-nationals and Hong Kong listed companies, including working as the financial controller of AMF Bowling, Inc., a New York Stock Exchange listed company, between November 1996 and March 1998 and International Distillers China Ltd between December 1993 and October 1996. He has extensive experience in financial control, operations, strategic planning and implementation, private equity investments and exit strategies.

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

Guangming George LU, aged 44, is an independent non-executive Director of our Company. Mr. Lu graduated from Huazhong Normal University in 1984 and obtained a master degree of science from the University of Memphis in 1989. During the period from January 1998 to August 1999, Mr. Lu served as a founding executive and the chief technology officer of uBid, Inc., a leading U.S. based online auction company whose shares are publicly traded in the U.S. and which operates in a similar industry to ours.

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

DIRECTORS AND SENIOR MANAGEMENT (continued)

Mingming HUANG, aged 36, is an independent non-executive Director of our Company. Mr. Huang is a co-founder and the chief executive officer of Trend Media Corp, which was established in August 2005, a well-known Internet company in China which owns and operates websites such as Flashget, ZCOM and Myrice. In addition, Mr. Huang also serves on boards of many well-known Internet companies in China, which operate in similar industries to our industry, including 265.com (since June 2006), Baitai Media (since September 2005) and Cheshi.com (since September 2006).

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

Senior Management

Pak Kwan KAU, aged 44, is an executive Director and the chairman of the Board of our company. Mr. Kau has been employed by us since 1988. He graduated from National Defense University of Science and Technology in China in 1984 with a bachelor degree in Information Management Systems. Between 1984 and 1987, Mr. Kau worked at various Chinese companies as a software developer.

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

Mr. Kau is also director of Chengdu Kingsoft Interactive Entertainment Co., Ltd., Zhuhai Kingsoft Software Co., Ltd., Zhuhai Xishanju Software Co., Ltd., Zhuhai Juntian Electronic Technology Co., Ltd., Zhuhai Kingsoft Digital Technology Co., Ltd., Zhuhai Kingsoft Online Game Co., Ltd. and Dalian Kingsoft Interactive Entertainment Co., Ltd.

Donghui WANG, aged 38, is currently our chief financial officer. Mr. Wang received a bachelor's degree in engineering from Tianjin Polytechnic University in 1992 and a MBA degree from Victoria University of Technology, Australia in 1997. Mr. Wang worked at Ernst & Young Beijing from 1997 to 1999 as a senior accountant. From 1999 to 2005, Mr. Wang served as a consultant in the PricewaterhouseCoopers Sydney office and a senior manager in their Beijing office. Mr. Wang joined us at the beginning of 2005 as a vice president and was appointed as our chief financial officer in December 2005. Mr. Wang became a senior vice president of the company in December, 2007. And he has been an executive director of our company since May, 2008.

Mr. Wang is also a director of Zhuhai Xishanju Software Co., Ltd. and Dalian Kingsoft Interactive Entertainment Co., Ltd.

Tao ZOU, aged 33, is currently a senior vice president responsible for the overall operations of our entertainment software business, including the research and development of our online games. Mr. Zou graduated from Tianjin Nankai University in 1997. Mr. Zou joined us in 1998 and was responsible for the development of our PowerWord product. Mr. Zou has been responsible for our entertainment software business since 2004. Mr. Zou became a senior vice president of the Company in December, 2007.

Ke GE, aged 35, is currently a senior vice president and has the overall responsibility for our applications software business. Mr. Ge joined us in 1999 and was appointed as the assistant to our chief executive officer in 1999. He was the chief officer in our distribution department from 2000 to 2001. He was appointed the assistant president in 2001 and had overall responsibilities for our internal operations and management.

Mr. Ge graduated from the Electronic Science and Engineering Department of Nanjing University and worked at Founder Information System Engineering Company from 1995 to 1999, focusing on software development and software sales management. He was appointed as a vice president in 2002. Mr. Ge became a senior vice president of the company in December, 2007.

DIRECTORS AND SENIOR MANAGEMENT (continued)

ShouSheng LV, aged 37, is appointed as a vice president of human resources (the "HR") management since October, 2008. Before joining our company, he was the consulting director of Hay Group, a famous management consulting company in the worldwide. Over the last five years, he provided management consulting services for several multinational companies as well as leading Chinese companies on organizational transformation and human resources management. He once was a HR supervisor in a state-owned-company and HR director in a Sino-foreign joint venture before becoming a senior consultant.

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

Hai Yin SHEN, aged 35, is a vice president of the Company and CEO of Kingsoft Japan Inc.. Mr. Shen was appointed as a director of Kingsoft Japan in March 2007, a vice president of the Company in January 2008 and CEO of Kingsoft Japan Inc. in March 2008. Mr. Shen graduated from Shanghai Jiao Tong University in 1993 with double Bachelor's degrees in Automation Control and Industry Management. He founded ACCESSPORT INC. in Japan in 2000 and was the CEO of the company. The company was later renamed JWord INC., which was the fourth largest web search service provider. The company was acquired by GMO Internet Group and Yahoo! Japan (both companies are listed on the Tokyo Stock Exchange). Mr. Shen has eight years of Internet industry experience.

Quanguo WANG, aged 43, is currently our chief information officer. Mr. Wang graduated from Wuhan Mapping and Science Technology University in 1988, specialising in computer science and engineering. He worked as an engineer from 1988 to 1992 at Computer Science Department of Wuhan Mapping and Science Technology University.

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

Ningning GAO, aged 51, has been a vice president since he joined our company in 2001 and is responsible for our Zhuhai and Chengdu operations. Prior to joining our company, he was the chief officer in charge of large customers at Nanjing Tonchu Information and Industry Group.

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

Wenbing ZHANG, aged 43, is currently a vice president and is responsible for overseas business development. Mr. Zhang worked at Shenzhen Yuebao Electronic General Company from 1992 to 1995 as the factory director and the manager for overseas business department. He also served as the chief operating officer at several video game franchising companies in New Zealand prior to joining us in 2006. Mr. Zhang received a bachelor degree majoring in electronic engineering from Xi'an Jiaotong University in 1988.

Fei Zhou CHEN, aged 31, is currently a vice president of our Group and is responsible for the research and development of our online games in the entertainment software unit. Mr. Chen has obtained a Bachelor Degree in Computer & Application in 1998 from Huaqiao University. Mr. Chen joined the Group in 1998 and was responsible for the development of Kingsoft's anti-virus products. Mr. Chen has been responsible for the research and development of our online 3D games since 2004.

Li WAN, aged 34, is currently a vice president of our Group responsible for the research and development of our applications software products. He graduated from North West University in China with a bachelor degree in Chemical Engineering in 1997 and obtained a master degree in software engineering in 2006 from Harbin Institute of Technology. Mr. Wan joined us in 1998 and has been responsible for developing WPS Office products.

DIRECTORS AND SENIOR MANAGEMENT (continued)

Huan YANG, aged 36, is a vice president at Kingsoft. He obtained a Bachelor's degree in Decision-Making Science from Shanghai Jiao Tong University in 1994, and a Master's degree in Management Science from the University of Science and Technology of China in 1997. Mr. Yang worked as an operation analyst at Legend Technology Limited (HK) from 1997 to 1998. From the end of 1998 to 2000, he worked at Kingsoft as General Manager of Administration Department. From 2001 to 2005, Mr. Yang worked at Lenovo Group as the Investment Management Director and Investment Project Director of Strategic Investment Department respectively, during which time he was in charge of existing investments and new business development. He assisted in the establishment of Lenovo Global Offshore Transaction Center in Singapore from 2005 to early 2007. Mr. Yang rejoined Kingsoft since 2007.

Zhen Yang ZHAN, aged 29, is a vice president at Kingsoft. Mr. Zhan graduated from the Department of International Economy and Trade of Zhe Jiang University in 2001, with a bachelor degree of Economics. He joined Kingsoft after his graduation, and was in charge of the company's mobile software development, research management and sales of the products. In 2003, under Mr. Zhan's lead, the company set up a Mobile Software Business Department and he was appointed the deputy general manager of the department. Mr. Zhan left Kingsoft at the beginning of 2004 to set up his own business with a target to provide the whole-set handset design solutions to users. Mr. Zhan rejoined Kingsoft at the end of 2006, and was appointed as a vice president.

Xin WANG, aged 35, is currently a vice president of the Company, and is responsible for the operation and marketing & sales of Kingsoft Internet Security business. Ms. Wang joined the Company in 1999 and has been the product manager of Kingsoft PowerWord, Kingsoft Instant Translator and Kingsoft You Xia. She was appointed the Deputy General Manager of WPS Unit. Ms. Wang left Kingsoft in 2003 and joined MTone Wireless as General Manager of its handset game business unit and spearheaded the development and operation of the first handset online game in China. Ms. Wang rejoined Kingsoft in May 2006 and led Kingsoft's Internet Security's migration with internet.

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

Company Secretary and Board Secretary

Michelle Feng HARNETT, aged 39, is our Secretary of the Board and Company Secretary, who is responsible for our secretarial and accounting management affairs. Ms. Harnett is a member of the senior management team and is employed by us on a full time basis since May 2007.

She has more than ten years of experience in accounting, including working as a Senior Treasury Officer at a property development group based in London. She also previously worked as the Company Secretary and Qualified Accountant at Zhaojin Mining Industry Company Limited from September 2006 to April 2007, shares of which are listed on the Stock Exchange of Hong Kong Limited (the "Stock Exchange"). She was granted a National Vocational Qualification by the Association of Accounting Technicians in 2002 and is a member of the Association of Chartered Certified Accountants in the United Kingdom. She obtained the BSc (Hons) in Applied Accounting degree from Oxford Brookes University, the United Kingdom.

CORPORATE GOVERNANCE REPORT

CORPORATE GOVERNANCE PRACTICES

The Company is committed to maintaining and upholding sound corporate governance practices in order to protect the interests of shareholders, customers and staff. It abides strictly by the laws and regulations of jurisdictions where it operates, and observes the guidelines and rules issued by regulatory authorities relevant to the Company. The board of directors (the "Board") sets high standards for our employees, senior management and directors, and keeps the Company's corporate governance system under constant review to ensure that it is in line with global best practices.

During the year, the Company has adopted and complied with all code provisions (the "Code") set out in Appendix 14 to the Rules Governing the Listing of Securities (the "Listing Rules") on the Stock Exchange except for the deviation in respect of the code A.2.1 of the Code which provides that the roles of the chairman (the "Chairman") and chief executive officer ("CEO") should be separate and should not be performed by the same individual.

Mr. Pak Kwan Kau, Chairman of the Company took up the position of acting CEO since December 20, 2007 until May 30, 2008, when Mr. Pak Kwan Kau was officially appointed to be the CEO of the Company. During the year, the roles of Chairman and CEO were not separated. The Board considers that this structure does not impair the balance of power and authority between the Board and the management of the Company. The Board also believes that Mr. Kau's appointment being both the Chairman and CEO is beneficial to the business prospect of the Company.

The Company will continue to review its practices from time to time to achieve high standard of corporate governance.

DIRECTORS' SECURITIES TRANSACTIONS

The Board of Directors has adopted the Model Code for Securities Transactions by Director of Listed Issuers set out in Appendix 10 of the Listing Rules (the "Model Code"). The directors (the "Director", "Directors") have confirmed, following specific enquiry by the Company with each of them that they have complied with the required standards set out in the Model Code during the year. The designated senior management of the Company also have 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 Executives' Interests in Securities" on page 33 of this annual report.

BOARD OF DIRECTORS

The Board is the core function of the Company's corporate governance structure. The Board is responsible for directing and supervising the Company's affairs in line with the Company's strategies and missions. The Board's main responsibilities include:

- reviews and approves all transactions, arrangements and contracts that may have material impact to the current or future financial performance or operations of the Group;
- approves annual business plan and budget as proposed by the management and remains full control of the implementation of the approved annual budget and business plan;
- formulates strategic direction and policy of the Group;
- presents a balanced, clear and understandable assessment of the financial reports, other price sensitive announcements and financial disclosures required under the Listing Rules and other relevant statutory requirements; and
- ensures sound and effective internal controls to safeguard the shareholder's investments and the Group's assets.

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

CORPORATE GOVERNANCE REPORT (continued)

The Board acknowledged its responsibilities for the preparation of the Group's financial statements, and ensured that the financial statements are prepared in accordance with the requirements of laws and regulations and applicable accounting standards. The Directors also ensured the timely publication of the Group's financial statements. The Board is not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue on a going concern basis. The external auditors' responsibilities to shareholders are set out in the Independent Auditors' Report on page 40 of this annual report.

Composition of the Board

As at the date of this annual report, there are 9 Directors in our Board consisting of 2 executive Directors (the "Executive Director", "Executive Directors"), 4 non-executive Directors (the "Non-executive Director", "Non-executive Directors") and 3 independent non-executive Directors (the "Independent Non-executive Director", "Independent Non-executive Directors") with business management and consultancy, and accounting backgrounds. The Company's independent non-executive Directors are professionals in the fields of accounting, finance, technology and management with extensive experience in their respective professional areas, and all of them act in diligent manner to uphold the interests of the Company and the shareholders by maintaining the independence of their opinions and providing professional advice on the long-term development of the Company.

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

A list of all Directors is set out hereunder. A list of Directors' respective biographies and their relationship with other, if any, are set out on pages 15 to 17 of this annual report.

Executive Director

Pak Kwan KAU (*Chairman*)

Donghui WANG

Non-Executive Director

Jun LEI

Choon Chong TAY

Wai Ming WONG

Wing Chung Anders CHEUNG

Independent Non-Executive Director

Shun Tak WONG

Guangming George LU

Mingming HUANG

During the year and up to the date of this annual report, the following changes in the Board composition of the Company took place: (i) Mr. Lei Jun was re-designated from an executive Director to a non-executive Director on August 28, 2008; (ii) Mr. Wang Donghui was appointed as an executive Director on May 30, 2008; (iii) Mr. Koh Tuck Lye retired as a non-executive Director and did not offer himself for re-election at the annual general meeting of the Company held on May 23, 2008; and (iv) Mr. Tay Choon Chong was appointed as a non-executive Director on January 27, 2008.

Subsequent to this corporate governance report, Mr. Tay Choon Chong resigned as a non-executive Director on April 1, 2009.

Supply of and Access to information and resource

The Management supplies the Board and its committees with adequate, complete and reliable information in a timely manner to enable them to make informed decisions. Every newly appointed Director of the Company should receive a comprehensive, formal and tailored induction on the first occasion of his appointment, and subsequently such briefing and professional development as is necessary, to ensure that he has a proper understanding of the operations and business of the Company and

CORPORATE GOVERNANCE REPORT (continued)

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. Written procedures are in place for Directors to seek at the Company's expenses, independent professional advice in performing their Directors' duties.

The Company has arranged for adequate liability insurance to indemnify the Directors for any liabilities arising from corporate activities. The insurance coverage is reviewed on a yearly basis.

Board Meetings

The Board meets at least quarterly to review the financial performance of the Group, the overall strategies and operations. Of such regular board meetings, Directors will receive at least 14 days' prior written notice. A regular meeting does not include the practice of obtaining board consent through the circulation of written resolutions. Additional board meetings will be conducted if required and Directors are given as much notice as is reasonable and practicable in the circumstances. Senior vice presidents are invited as observers to attend board meetings. Other senior managements are invited to attend board meetings from time to time to report on certain matters.

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

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

In order to illustrate its focus on the Company's business management, the Board sets out the table below the attendance of meetings of the Board in 2008.

Meetings of the Board:

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

<i>Number of meetings</i>	8*
<i>Chairman and Executive Director</i>	
Pak Kwan KAU	8/8
<i>Executive Director</i>	
Donghui WANG (from May 30, 2008)	5/5
<i>Non-Executive Director</i>	
Jun LEI	8/8
Choon Chong TAY (from January 27, 2008)	6/8
Wing Chung Anders CHEUNG	8/8
Wai Ming WONG	3/8
Tuck Lye KOH (from August 18, 2006 to May 23, 2008)	2/3
<i>Independent Non-Executive Director</i>	
Shun Tak WONG	6/8
Guangming George LU	7/8
Mingming HUANG	7/8

* During the year, the Board had held 8 meetings, but as some of the Directors joined the Board during the year, the number of board meetings which they should have attended varies depending on when they joined the Board.

Chairman and Chief Executive Officer

Mr. Pak Kwan Kau, Chairman of the Company took up the position of acting CEO since December 20, 2007 until May 30, 2008, when Mr. Pak Kwan Kau was officially appointed to be the CEO of the Company. During the year, the roles of chairman and CEO were not separated. The Board considers that this structure does not impair the balance of power and authority between the Board and the

CORPORATE GOVERNANCE REPORT (continued)

management of the Company. The Board also believes that Mr. Kau's appointment being both the Chairman and CEO is beneficial to the business prospect of the Company.

Appointment and re-election

All the Directors including the Non-executive Directors have either service contracts or formal letters of appointments setting out the major terms and conditions of their appointment. Their terms are fixed at 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 retires may fill the vacated office.

BOARD COMMITTEES

The Board has established four specialized committees, namely the audit committee (the "Audit Committee"), remuneration committee (the "Remuneration Committee"), nomination committee (the "Nomination Committee") and strategy committee (the "Strategy Committee"). The Audit Committee, Remuneration Committee and Nomination Committee proceed their business according to their terms of reference (available upon written request to the Company Secretary). The Audit Committee, Remuneration Committee, and Nomination Committee are mainly consisted of the Independent Non-executive Directors and Non-executive Directors.

Audit Committee

- **Audit Committee composition and primary duties**

The Audit Committee currently consists of two Independent Non-executive Directors namely Mr. Shun

Tak Wong (chairman), Mr. Guangming George Lu and one Non-executive Director namely Mr. Wing Chung Anders Cheung. Non-executive Director Mr. Wai Ming Wong was a member of the Audit Committee until May 30, 2008 when he ceased to be a member of the Audit Committee due to his other work commitment. The Board approved the appointment of Mr. Wing Chung Anders Cheung to be a member of the Audit Committee on May 30, 2008. None of the Audit Committee members are members of the previous or existing auditors of the Company.

The Audit Committee is responsible for assisting the Board in providing an independent review of the financial statements and internal control system. It acts in an advisory capacity and makes recommendations to the Board. The primary duties of the Audit Committee are mainly to review the draft of the Company's annual report and accounts, interim and quarterly reports before submission to the Board, and provide advice to the Board on these matters; to review the material investment, capital operation and material financial system of our Company; to review the accounting policy, financial position and financial reporting procedures of our Company; to consider the appointment of external auditors, their audit fees and questions of resignation or dismissal; to communicate with external audit firms with or without the absence of the management where necessary; to assess the performance of internal financial and audit personnel; and to assess the internal control of our Company.

- **Meetings of Audit Committee**

During the year, the Audit Committee held 5 meetings and the attendance record of members is set out below:

<i>Number of meetings</i>	5*
Shun Tak WONG (<i>Chairman</i>)	5/5
Guangming George LU	4/5
Wai Ming WONG (ceased to be a member on May 30, 2008)	2/3
Wing Chung Anders CHEUNG (became a member on May 30, 2008)	2/2

* The Audit Committee had held 5 meetings during the year. Mr. Wai Ming Wong ceased to be a member on May 30, 2008 when Mr. Wing Chung Anders Cheung became a member of the Audit Committee, therefore the number of meetings which they should have attended during the year varies.

CORPORATE GOVERNANCE REPORT (continued)

- **Principal Work performed by the Audit Committee in 2008 includes reviewing and/or approving:**

- The financial reporting matters including the quarterly, interim and annual financial statements, results announcements, and financial reports before submission to the Board for approval;
- The accounting principles, policies and practices adopted by the Group;
- 2007 internal audit report of the Group and 2008 internal audit plan;
- 2007 external audit report and plan
- The effectiveness of the internal control systems adopted by the Company;
- The continuing connected transactions of the Group;
- The independence, authorities and resource of the internal and external auditors; and
- The recommendation of re-appointment and fee of external auditors.

- **External Auditors**

Ernst & Young, Certified Public Accountants, Hong Kong, were engaged as the Company's external auditors for the year ended December 31, 2008. 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 perform any self assessments; or acting in an advocacy role for the Group. The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditor's Report on page 40.

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

During the year, the fees paid to Ernst & Young in respect of the audit of the financial statements amounted to approximately RMB5.6 million, the review of the Group's interim financial statements amounted to approximately RMB2.1 million, and the fee paid/payable to Ernst & Young for non-audit activities amounted to approximately RMB1.59 million.

- **Internal Control**

The Company's internal control system is designed to provide reasonable assurance in safeguarding its assets, meeting specific business needs and to minimize the risks exposed, preventing and detecting frauds, providing reliable financial information as well as ensuring compliance with applicable laws and regulations. The internal control framework covers the setting of objectives, budgets and targets; the establishment of regular reporting of financial information, in particular, the tracking of deviations between actual performances and budgets/targets; the delegation of authority; and the establishment of clear lines of accountability.

The Board acknowledges its overall responsibility to ensure that the Company maintains sound and effective controls. While the management is responsible for the design, implementation and maintenance of internal controls, the Board and the Audit Committee oversee the actions of the management and monitor the effectiveness of the established controls. The Audit Committee reviews the Company's internal control system covering financial, operational and compliance controls and risk management procedures.

The Company has adopted the "Internal Control-Integrated Framework" of the Report of Committee of Sponsoring Organizations of the Treadway Committee (COSO) entitled ("the COSO internal control framework"), which is a recommended framework under HKICPA Corporate Governance guidelines. The COSO internal control framework leverages policies and procedures adopted at the company management, operational and financial reporting levels. The Directors adopted the COSO internal control framework to assess the effectiveness of the internal control system. Within this framework, the management perform company level and process level risk assessments and continuously monitor and report the progress of improvement plans to address risks in key areas.

The Company's internal audit team (the "IA") reports to the Audit Committee directly on audit matters. Our IA has unrestricted access to all corporate records and data files, assets, employees, and operations. Under the COSO framework, the IA undertakes a periodical risk assessment of the Company's overall activities and prepares its audit plan focusing on areas of the Company's operations with greatest perceived risk. The Audit Committee reviews audit plan and receives at least quarterly updates on the progress. Our IA conducts annual internal audit plan and subjective auditing projects of the operational areas

CORPORATE GOVERNANCE REPORT (continued)

which are material to the business or identified by the Audit Committee and/or senior management, results of which will be reported to the Audit Committee and senior management concerned. Our IA will follow up with the implementation of audit recommendations. Any major internal control weaknesses and findings will be firstly reported to the Audit Committee whenever necessary. During the year, our IA using a risk based audit approach, worked with the management to continuously improve our internal control, especially in the areas such as procurement to payment, revenue recognition system, policies and procedures compliance, information system, and cash management and treasury.

The external auditors meet and report to the Audit Committee and senior management on a regular basis on matters relating to internal control and financial reporting. Appropriate actions are taken to put in place external auditors' recommendations.

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

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

Remuneration Committee

Non-executive Director Mr. Wing Chung Anders Cheung (chairman), Independent Non-executive Directors Mr. Shun Tak Wong and Mr. Mingming Huang are the members of the Remuneration Committee of the Company. On May 23, 2008, Mr. Tuck Lye Koh retired from the Board at the annual general meeting and ceased to be the chairman of the Remuneration Committee. On May 30, 2008, Mr. Wing Chung Anders Cheung was appointed by the Board to be the chairman of the Remuneration Committee.

The primary duties of the remuneration committee mainly include review and determination of the terms of remuneration packages, bonuses and other compensation

payable to our Directors and other senior management, review and recommending to the Board the Company's annual remuneration policy and other findings after each meeting. The Remuneration policy is set to attract, motivate and retain high performing individuals who are essential to the success of the Company.

The emolument package for the Executive Directors, the senior managers and key personals includes basic salary, performance bonus and incentive stock options. The Non-executive Directors and Independent Non-executive Directors receive directors' fees. The basic salary and directors' fees depend on individuals' experience, responsibilities and relevant market rate. The bonus depends on actual performance of the Company's targets and individual performance. Details for the stock option scheme and the share award scheme (the "Share Award Scheme") can be found under the subtitle of "Share Option Schemes" and Share Award Scheme in the Directors' Report. The stock options and awarded shares are offered to qualified employees to reward them for their high level of performance and foster loyalty with the Group.

The information regarding the remuneration of the Directors for 2008 are set out in Note 7 to the financial statements. When a meeting is convened to discuss certain Directors' remuneration, the Directors in discussion can not determine his own remuneration.

Meetings of Remuneration Committee

During the year, the Remuneration Committee held 5 meetings and the attendance record of members is set out below:

<i>Number of meetings</i>	5*
Wing Chung Anders CHEUNG (<i>Chairman</i>) (became a member and chairman of the Remuneration Committee on May 30, 2008)	3/3
Shun Tak WONG	4/5
Mingming HUANG	5/5
Tuck Lye KOH (ceased to be a member and chairman of the Remuneration Committee on May 23, 2008)	2/2

* The Remuneration Committee had held 5 meetings during the year. Mr. Tuck Lye Koh ceased to be a member on May 23, 2008 and Mr. Wing Chung Anders Cheung became a member of the Remuneration Committee on May 30, 2008, therefore the number of meetings which they should have attended during the year varies.

CORPORATE GOVERNANCE REPORT (continued)

- **Principal Work performed by the Remuneration Committee in 2008 includes the following activities:**
 - Reviewed and recommended compensation policy for Directors to the Board
 - Reviewed and recommended performance bonus scheme of the Company to the Board
 - Reviewed and recommended the Share Award Scheme program to the Board
 - Reviewed and recommended the compensation policy and levels for Executive Directors and senior management
 - Approved the terms of Executive Directors' service contracts

Nomination Committee

The Nomination Committee consists of three members, and two of them are Independent Non-executive Directors namely Mr. Guangming George Lu (chairman) and Mr. Mingming Huang, and one Non-executive Director namely Mr. Wing Chung Anders Cheung.

The primary duties of the Nomination Committee are mainly to make recommendations to our Board regarding any proposed changes to the Board, identify suitably qualified individuals as members of our Board, assess the independence of our Independent Non-executive Directors, make recommendations to the Board on matters relating to appointment of Directors, and succession planning for Directors, particularly the Chairman and the CEO.

During the year, the Nomination Committee recommended to the Board candidates as members of the Board and the CEO.

- **Meetings of Nomination Committee:**

During the year, the Nomination Committee held 2 meetings and all members attended these 2 meetings.

<i>Number of meetings</i>	2
Guangming George LU (<i>Chairman</i>)	2/2
Mingming HUANG	2/2
Wing Chung Anders CHEUNG	2/2

COMMUNICATION WITH SHAREHOLDERS

Our Board is committed to uphold transparent communication with our shareholders in order to safeguard the right to information and participation of the shareholders, which ultimately enable the shareholders to make informed decisions about their investments and exercise their rights as shareholders. The Company establishes and maintains various communication channels with its shareholders through the publication of annual, interim and quarterly results announcements, annual and interim report, any other announcements on transactions requested to be disclosed by the Listing Rules, and press releases.

The Company encourages shareholders to actively participate at shareholders' meetings which are regarded as valuable platforms for shareholders to raise comments and communicate directly their views with the Board. The Chairman of the Company and management will attend the annual general meeting (the "AGM") to answer shareholders' questions. All AGM meeting materials including but not limited to circular, notice and proxy form will be sent to shareholders in time including all adequate information according to the Listing Rules. The AGM is conducted according to the relevant rules in the Listing Rules and the Articles of Association of the Company.

INVESTOR RELATIONS

The Company is dedicated to enhancing relationships and communications with investment community. The Company continues its effort to reach out its existing and potential investors, shareholders, media and analysts through non-deal road shows, conference calls, media briefings and press releases. The Company's investor relationship 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.

On behalf of the Board
Pak Kwan Kau
Chairman
PRC, March 31, 2009

DIRECTORS' REPORT

The Directors of the Company are pleased to present to the shareholders their report together with the audited financial statements of Kingsoft Corporation Limited (the "Company", or "Kingsoft") and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended December 31, 2008.

Principal Activities and Geographical Analysis of Operations

The principal activity of the Company is investment holding. The principal activities of the subsidiaries comprise the research, development, operation and distribution of online game, mobile game and casual game services; and the research, development, operation and distribution of internet security software, dictionary software and office application software 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 and contribution results by business segments and by geographical area of segments are set out in Note 29 to the financial statements.

Use of IPO Proceeds

The application of the proceeds from the initial public offering of the Company (the "IPO") does not materially change from the allocation stated in the prospectus of the Company dated September 24, 2007.

The Company has raised the aggregate net proceeds from the Global Offering of approximately HK\$649.1 million. The Global Offering was completed in the fourth quarter of 2007 and the use of proceeds as of the end of 2008 is set out in the table below:

Area of use	Planned amount (HK\$' Mil)	Amount remaining as at December 31, 2008 (HK\$' Mil)
Expansion of research and development capabilities	170.1	117.0
Expansion in certain overseas market	76.0	69.4
IT infrastructure upgrade	94.1	30.6
Strategic acquisitions and joint ventures	115.8	62.1
Construction of research and development facilities in Zhuhai	72.4	—
General corporate purposes	27.9	3.9

Results and Dividends

The Group's results for the year ended December 31, 2008 and the state of affairs of the Company and the Group at that date are set out in the consolidated financial statements on page 41 to 46.

During the year, a final dividend for year 2007 of HK\$0.10 per ordinary share, with the total amount of approximately HK\$106.6 million was paid to shareholders on June 6, 2008.

The Directors recommend the payment of a final dividend of HK\$0.15 per ordinary share totaling approximately HK\$161.0 million based on the number of total issued shares of 1,073,366,708 as at December 31, 2008 in respect of the year to shareholders whose names appear on the register of members of the Company on May 25, 2009. Such proposed dividend will be subject to approval of the shareholders at the forthcoming AGM to be held on

May 25, 2009. Such proposed dividend will be payable on June 5, 2009. This recommendation has been incorporated in the financial statements as an allocation of retained earnings within the equity section of the balance sheet.

Closure of Register

The register of members of the Company will be closed from Monday, May 18, 2009 to Monday, May 25, 2009 (both days inclusive), and during which period no transfer of shares will be registered. In order to be entitled to attend and vote at the forthcoming AGM and to qualify for the proposed final dividend, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong for registration not later than 4:30 p.m. on Friday, May 15, 2009.

DIRECTORS' REPORT (continued)

Reserves

For the year ended December 31, 2008, the profit attributable to equity holders of the Company amounted to RMB307.5 million. The Company's reserves available for distribution comprise share premium and retained earnings. Under the Companies Law of the Cayman Islands, the Company's share premium account may be applied by the Company in paying distributions or dividend to shareholders of the Company provided that immediately following the date on which the distribution or dividend is proposed to be paid, the Company shall be able to pay its debts as they fall due in the ordinary course of business.

As at December 31, 2008, the Company had distributable reserves amounting to RMB639.4 million, calculated in accordance with any statutory provisions applicable in Cayman Islands. Details of movements in the reserves of the Group and the Company during the year ended December 31, 2008 are set out in the consolidated statement of changes in equity on page 44, and in Note 31 to the financial statements, respectively.

Charitable Contributions

During the year, the Group made charitable contributions totaling RMB1.7 million (2007: HK\$1.0 million).

Retirement Scheme

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 and 3 to the financial statements on page 60 and 68 of this annual report.

Employee and Remuneration Policy

As at December 31, 2008, the Group had a total of 2,271 full-time employees (2007: 1,660). The staff cost of the Group (including Directors' and senior management's emoluments in 2007 and 2008 were approximately RMB244.1 million and RMB253.4 million, respectively. The Group remunerates its employees based on their performance and work experience and the prevailing market rates. Salaries of employees are maintained at competitive levels while bonuses are granted by reference to the performance of the Group and individual employees.

Employees' remuneration includes basic salaries, benefits, allowances, bonus, share options and awarded shares. The Directors' remuneration comprises Directors' fees, basic salaries, benefits, allowances, bonus, share options and awarded shares which are determined based on their responsibilities and contribution to the Group.

Please refer to Note 6 to the financial statements for the share options and awarded shares granted to certain Directors and employees of the Group, Note 7 to the financial statements for Directors' and senior executives' remuneration, and Note 3 to the financial statements for the employee benefit expense.

Subsidiaries

Details of the Company's principal subsidiaries as at December 31, 2008 are set out in Note 30 to the financial statements.

Material Investment and Acquisition

During the year, the Group has the following significant investment and acquisition activities:

1. The Group purchased a building in Beijing with a total consideration of RMB175.0 million;
2. The Group acquired a 29.4% equity interest in Dalian Kingsoft Interactive Entertainment Co., Ltd. ("Kingsoft Dalian"), with a total consideration of RMB30.3 million. Further details of the transaction are included in the section of "Non-exempt connected transactions" in the Directors' Report;
3. The Group entered into an agreement to acquire approximately 30.03% equity interest of Sky Profit Limited ("Sky Profit") for a total consideration of US\$8.0 million. Further details of the transaction are included in the section of "Non-exempt connected transactions" in the Directors' Report.

DIRECTORS' REPORT (continued)

Financial Summary

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

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

	YEAR ENDED DECEMBER 31,				
	2004 RMB'000	2005 RMB'000	2006 RMB'000	2007 RMB'000	2008 RMB'000
Profit for the year	3,782	34,432	99,110	155,452	304,035

	AS AT DECEMBER 31,				
	2004 RMB'000	2005 RMB'000	2006 RMB'000	2007 RMB'000	2008 RMB'000
Total assets	172,672	270,933	520,709	1,499,921	1,739,223
Total liabilities	189,525	229,180	252,882	366,264	410,858

Contract of Significance

The Company has entered into an agreement to acquire approximately 30.03% interest in aggregate in the share capital of Sky Profit, a company with a common shareholder of the Company. Further details of the transaction are included in the section of "Non-exempt connected transactions" in the Directors' Report.

Bank Borrowings

There has been no bank borrowing of the Group as at December 31, 2008.

Property, Plant and Equipment

Details of the movements in the property, plant and equipment of the Group for the year ended December 31, 2008 are set out in Note 11 to the financial statements.

Principal properties

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

Share Capital

Details of the movements in share capital of the Company for the year ended December 31, 2008 are set out in Note 28 to the financial statements.

Share Option Schemes

The Company adopted the 2004 and 2007 Pre-IPO Share Option Schemes which were approved by resolutions in writing of all the shareholders passed on June 30, 2004 and January 22, 2007. The details of these schemes and Kingsoft Japan Share Options are stated in Note 6 in the financial statements.

Details of the movements in share option of the Company for the year ended December 31, 2008 are set out in Note 6 to the financial statements. During the year, no share options have been granted to anybody.

DIRECTORS' REPORT (continued)

Summary of The Share Option Schemes

Detail	2004 Pre-IPO Share Option Scheme	2007 Pre-IPO Share Option Scheme	Kingsoft Japan Pre-IPO Share Option Scheme
1. Purposes	To retain the best available personnel, to provide additional incentive to employees, senior management and directors of the Group and to promote the success of the business of the Group	Same as 2004 Pre-IPO Share Option Scheme	To enhance the operational efficiency of Kingsoft Japan and to provide additional incentive for its employees and other related persons.
2. Qualifying participants	Any employee (whether full time or part time), chief executive or director (including executive or non-executive or independent non-executive) of any member of the Group of any associated company, in which the Company directly or indirectly holds more than 20% of its issued share capital or the voting power at general meetings or in which any equity interest is held by the Company for long term purpose and a significant influence is exercised over its management, or such other person as may be determined by the Board from time to time	Same as 2004 Pre-IPO Share Option Scheme	Not specified in the Scheme
3. Maximum number of shares	The maximum number of ordinary shares in respect of which options may be granted under the 2004 Pre-IPO Share Option Scheme shall not in aggregate exceed 10% of the total number of ordinary shares in issue. On August 12, 2005, the shareholders approved that the maximum number of ordinary shares in respect of which options may be granted shall not in aggregate exceed 18% of the total number of ordinary shares in issue of 35,410,000. Pursuant to a Share Subscription and Purchase Agreement dated July 21, 2006 ("Agreement Date"), the aggregate of all options issued from the Agreement Date to an initial public offering shall not constitute more than 15% of the issued capital of the Company.	The maximum number of ordinary shares in respect of which options may be granted under the 2007 Pre-IPO Share Option Scheme shall not in aggregate exceed 13% of the total number of issued Shares on the fully diluted basis of inclusion of all of the issued and outstanding shares of the Company, as well as 6,373,800 options under the 2004 Pre-IPO Share Option Scheme.	The maximum number of the shares which may be issued upon exercise of all issued and outstanding options shall be 1,000 ordinary shares of Kingsoft Japan in aggregate.
4. Maximum entitlement of each participant	Not specified in the scheme	Not specified in the scheme	Not specified in the scheme
5. Option period	The period set out in the relevant offer letter within which the option may be exercisable provided that such period must expire on the date falling on the tenth anniversary of the offer date	Same as 2004 Pre-IPO Share Option Scheme	(1) the option period of options granted on January 4, 2007 is from January 5, 2009 to November 1, 2016 (2) the option period of options granted on March 30, 2007 is from March 30, 2007 to March 30, 2017 (3) the option period of options granted on July 31, 2007 is from August 1, 2009 to November 1, 2016
6. Acceptance of offer	The offer of a grant of share options must be accepted within 28 business days from the date of offer, upon payment of a consideration of HK\$1 in total by the grantee	The offer of a grant of share options must be accepted within 28 business days from the date of offer, without a remittance of HK\$1 to the Company	Options shall be issued free
7. Subscription price	The exercise price shall be determined and notified by the Board and shall be at least a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time.	The exercise price shall be determined and notified by the Board and shall be a price US\$4.80 per share or a price being the fair market value for each Share as at the Offer Date as shall be determined by the Board from time to time.	Note
8. Remaining life of the Scheme	It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect	It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect	It will expire on the tenth anniversary of the date on which the Scheme is deemed to take effect

DIRECTORS' REPORT (continued)

Note:

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

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

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

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

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

Share Award Scheme

The Share Award Scheme was adopted by the Board on March 31, 2008 (the "Adoption Date"). Unless terminated earlier by the Board, the Share Award Scheme shall be valid and effective for a term of five years commencing on the Adoption Date. During the year, the Company granted 15,579,000 awarded shares since the Adoption Date.

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

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

More details regarding the Share Award Scheme are set out in Note 6 to the financial statements.

DIRECTORS' REPORT (continued)

Directors

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

	APPOINTMENT DATE	RESIGNATION DATE	RE-DESIGNATION DATE
EXECUTIVE DIRECTORS			
Mr. Pak Kwan KAU (求伯君)	July 27, 1998	N/A	N/A
Mr. Donghui WANG (王東暉)	May 30, 2008	N/A	N/A
NON-EXECUTIVE DIRECTORS			
Mr. Jun LEI (雷軍)	July 27, 1998	N/A	August 28, 2008
Mr. Choon Chong TAY (鄭俊聰)*	January 27, 2008	N/A	N/A
Mr. Wai Ming WONG (黃偉明)	April 24, 2007	N/A	N/A
Mr. Wing Chung Anders CHEUNG (張榮宗)	September 22, 2004	N/A	N/A
Mr. Tuck Lye KOH (許達來) (Retired at the annual general meeting held on May 23, 2008)	August 18, 2006	May 23, 2008	N/A
INDEPENDENT NON-EXECUTIVE DIRECTORS			
Mr. Shun Tak WONG (王舜德)	April 30, 2007	N/A	N/A
Mr. Guangming George LU (魯光明)	April 30, 2007	N/A	N/A
Mr. Mingming HUANG (黃明明)	June 18, 2007	N/A	N/A

* Subsequent to this directors' report, Mr. Choon Chong TAY resigned as a Non-executive Director on April 1, 2009.

In accordance with Article 108 and Article 112 of the Articles of Association of the Company, Mr. Shun Tak Wong, Mr. Guangming George Lu, Mr. Mingming Huang and Mr. Donghui Wang will retire at the forthcoming AGM of the Company to be held on May 25, 2009 and, being eligible, will offer themselves for re-election.

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

Directors' and Senior Management's Biographies

Biographical details of the Directors of the Company and the senior management of the Group are set out on pages 15 to 19 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 "Non-exempt connected transactions" in Directors' Report, no Directors had any direct or indirect material interests in any contracts of significance to the business of the Group to which the Company or any of its subsidiaries or fellow subsidiaries was a party at the end of the year or at any time during the year ended December 31, 2008.

DIRECTORS' REPORT (continued)

Directors' and Chief Executives' Interests in Securities

As at December 31, 2008, the interests and short positions of the Directors and the chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which (a) were required to be notified to the

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

Interests in the ordinary shares of the Company:

NAME OF DIRECTOR	NATURE OF INTERESTS	NUMBER OF SHARES HELD	PERCENTAGE OF ISSUED SHARE CAPITAL
Pak Kwan Kau	Corporate (Note 1)	223,489,800	20.82%
Jun Lei	Corporate (Note 2)	160,040,280	14.91%

Interests in underlying shares of the Company:

NAME OF DIRECTOR	INTERESTS IN UNDERLYING SHARES	NUMBER OF INTERESTS DIRECTLY BENEFICIALLY OWNED
Jun Lei (Note 3)	Share options	27,763,300
Wing Chung Anders Cheung (Note 4)	Share options	500,000
Donghui Wang (Note 5)	Share options	7,200,000
	Awarded shares (Note 6)	381,000

Notes:

- These shares are held by Topclick Holdings Limited, a BVI company wholly owned by Pak Kwan Kau.
- Color Link Management Limited, a BVI company wholly owned by Jun Lei, holds 158,230,280 shares, and Go Corporation Limited, a BVI company wholly owned by Jun Lei, holds 1,810,000 shares.
- The relevant interests include number of options of 22,451,800 which was granted on February 1, 2007 and its exercise period is from February 1, 2007 to February 1, 2017 with exercise price of US\$0.2400, and the number of options of 5,311,500 which was granted on August 1, 2004 and its exercise period is from August 1, 2004 to August 1, 2014 with exercise price of US\$0.0353.
- The relevant interests are 500,000 number of share options which were granted on August 1, 2004. Its exercise period is from August 1, 2004 to August 1, 2014 and exercise price is US\$0.0353.
- The relevant interests include number of options of 800,000 which was granted on March 1, 2005 and its exercise period is from March 1, 2005 to March 1, 2015 with exercise price of US\$0.2118, the number of options of 600,000 which was granted on August 1, 2005 and its exercise period is from August 1, 2005 to August 1, 2015 with exercise price of US\$0.2118, the number of options of 800,000 which was granted on December 1, 2006 and its exercise period is from December 1, 2006 to December 1, 2016 with exercise price of US\$0.24, and the number of options of 5,000,000 which was granted on February 1, 2007 and its exercise period is from February 1, 2007 to February 1, 2017 with exercise price of US\$0.24.
- The relevant interests include number of 381,000 awarded shares (the "Awarded Shares") granted on October 13, 2008 under the Share Award Scheme adopted at the Board meeting held on March 31, 2008, one third of which will be exercisable on October 13, 2009, October 13, 2010, and October 13, 2011 respectively. The price for grant is nil.
- For further details on share options and the Awarded Shares, please refer to the paragraph headed "Share Option Schemes" and "Share Award Scheme" respectively set out on page 29 to page 31 of this annual report respectively.

Save as disclosed above, none of the directors or chief executive and their associates, had interests or short positions in any shares, underlying shares or debentures of the Company and its associated corporations as at December 31, 2008.

DIRECTORS' REPORT (continued)

Directors' Rights to Acquire Shares or Debentures

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

Long position in the shares in the Company

Substantial Shareholders

As at December 31, 2008, 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:

NAME OF SHAREHOLDER	CAPACITY	NUMBER OF ORDINARY SHARES HELD IN THE COMPANY	PERCENTAGE OF ISSUED SHARE CAPITAL AS AT DECEMBER 31, 2008
Topclick Holdings Limited ⁽¹⁾	Beneficial owner	223,489,800	20.82%
Tetrad Ventures Pte Ltd	Beneficial owner	165,143,115	15.39%
GIC Special Investments Pte. Ltd. ⁽²⁾	Interest of a controlled corporation	165,143,115	15.39%
Government of Singapore Investment Corp. Pte. Ltd. ⁽²⁾	Interest of a controlled corporation	165,143,115	15.39%
Minister for Finance (Incorporated) ⁽²⁾	Interest of a controlled corporation	165,143,115	15.39%
Government of Singapore Investment Corporation (Ventures) Pte. Ltd. ⁽²⁾	Interest of a controlled corporation	165,143,115	15.39%
Color Link Management Limited ⁽³⁾	Beneficial owner	158,230,280	14.74%
Super Faith International Limited	Beneficial owner	101,946,386	9.50%
Caprice Pacific Limited ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Highland Crest Limited ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
World Conquest Limited ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Pacific Star Overseas Limited ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Shuen Lung Cheung ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Nien Shian Chu ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Siu Lung Cheung ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Tung Ping Lau ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Siu Ha Cheung ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Ka Yeung Yip ⁽⁴⁾	Interest of a controlled corporation	101,946,386	9.50%
Lenovo Manufacturing Limited ⁽⁵⁾	Beneficial owner	78,920,796	7.35%
Lenovo Holdings (BVI) Limited ⁽⁵⁾	Interest of a controlled corporation	78,920,796	7.35%
Lenovo Group Limited ⁽⁵⁾	Interest of a controlled corporation	78,920,796	7.35%

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

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

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

4. Each of Caprice Pacific Limited, Highland Crest Limited and World Conquest Limited is deemed to be interested in Super Faith International Limited's interest in the Company under the SFO because each of these entities is entitled to control the exercise of 33.3% of the voting power at general meetings of Super Faith. Caprice Pacific Limited is owned by Siu Ha Cheung and Ka Yeung Yip, who are husband and wife. Highland Crest

DIRECTORS' REPORT (continued)

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

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

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

Public Float

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

Purchase, Sale or Redemption of Shares

Pursuant to a resolution (the "Resolution") passed by our shareholders on May 23, 2008, a general unconditional mandate was granted to our Directors during the Relevant Period authorising the repurchase by our Company on the Stock Exchange or on any other stock exchange on which the securities of our Company may be listed and which is recognised by the Securities and Futures Commission of Hong Kong and the Stock Exchange for this purpose, such number of shares with an aggregate nominal value not exceeding 10% of the aggregate nominal value of our share capital in issue as at the date of the passing of the Resolution. For the purpose of the Resolution, Relevant Period means the period from the passing of this Resolution until whichever is the earlier of:

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

Save as disclosed above, none of the Company or any of its subsidiaries had purchased, sold or redeemed any of its listed securities during the year ended December 31, 2008, except that the trustee of the Share Award Scheme had, pursuant to the terms of the rules and trust deed of the Share Award Scheme, purchased from the market a total of 17,138,000 Kingsoft's shares being the awarded shares. The total amount paid to acquire these 17,138,000 shares during the year was about HK\$45,555,338.

DIRECTORS' REPORT (continued)

Month of purchase in 2008	No. of shares purchased	Purchase consideration per share		
		Highest price paid HK\$	Lowest price paid HK\$	Aggregate consideration paid HK\$
June	200,000	4.00	3.98	802,488
July	4,903,000	3.99	3.50	18,309,968
September	3,567,000	3.12	2.01	9,379,465
October	7,468,000	2.00	1.75	14,493,807
December	1,000,000	2.76	2.23	2,569,610
Total	17,138,000			45,555,338

Competing Interest

As of December 31, 2008, none of the Directors, controlling shareholders nor their respective associates (as defined in the Listing Rules) had any interest in a business which competed or might compete with the business of the Group.

Major Customers and Suppliers

For the financial year ended December 31, 2008, the five largest customers of the Group accounted for 18% of the total revenue of the Group and the five largest suppliers of the Group accounted for 51% of the total purchases. The largest customer accounted for about 8% of the total revenue. The largest supplier accounted for 13% of the total purchases. None of the Directors, their associates or any shareholders of the Company (which to the knowledge of the directors own more than 5% of the Company's issued share capital) had any interest in any of the Group's five largest suppliers or customers.

Related Party Transactions and Connected Transactions

Non-exempt Continuing Connected Transactions

According to the Administrative Rules for Foreign Investments in Telecommunications Enterprises, which were issued on December 11, 2001 by the State Council and became effective on January 1, 2002, a foreign investor is currently prohibited from owning more than 50% of the equity interest in a Chinese entity that provides value-added telecommunications services. Internet content provision services are classified as value-added telecommunications businesses, and a commercial operator of such services must obtain an ICP license from

the appropriate telecommunications authorities in order to carry on any commercial Internet content provision operations in China. In July 2006, the MII issued a notice which prohibits ICP license holders from leasing, transferring or selling a telecommunications business operating license to any foreign investors in any form, or providing any resource, sites or facilities to any foreign investors for their illegal operation of telecommunications businesses in China. The notice also requires that ICP license holders and their shareholders directly own the domain names and trademarks used by such ICP license holders in their daily operations. Therefore, in order for us to be able to carry on our business in China, the Group entered into a series of structure contracts with Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian"), its shareholders Weiqin Qiu and Peili Lei, and Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment"), which enable the Group to exercise control over Kingsoft Qijian, Beijing Kingsoft Digital Entertainment Co., Ltd. ("Beijing Digital Entertainment") and Chengdu Digital Entertainment and to consolidate these companies' financial results in our results. Beijing Digital Entertainment (which is wholly owned by Kingsoft Qijian) and Chengdu Digital Entertainment (which is owned as to 99% by Beijing Digital Entertainment and 1% by Weiqin Qiu) hold the requisite ICP licenses.

The structure contracts which were in place during the year ended December 31, 2008 are as follows:

Structure Contracts relating to Kingsoft Qijian

- (i) A loan agreement dated March 30, 2007 between Weiqin Qiu and Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment") which provided for an interest free loan by Chengdu Interactive Entertainment of

DIRECTORS' REPORT (continued)

RMB1,200,000 to Weiqin Qiu and of RMB300,000 to Peili Lei, entirely for the purpose of repaying the loan provided by Zhuhai Kingsoft Software Co. Ltd. ("Zhuhai Software") to Chengdu Digital Entertainment. The loans have no definite maturity date and Chengdu Digital Entertainment may request repayment at any time. Weiqin Qiu shall repay the loan by transferring the equity interest she holds in Chengdu Digital Entertainment to Chengdu Interactive Entertainment or as it may direct.

- (ii) A shareholder voting agreement dated March 30, 2007 among Chengdu Interactive Entertainment, Weiqin Qiu, Peili Lei and Kingsoft Qijian, under which Weiqin Qiu and Peili Lei irrevocably entrust all of their shareholder rights in Kingsoft Qijian to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Kingsoft Qijian.
- (iii) A call option agreement dated March 30, 2007 among Weiqin Qiu, Peili Lei, Kingsoft Qijian and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Weiqin Qiu's and Peili Lei's equity interest in Kingsoft Qijian at anytime, at a nominal amount subject to applicable PRC laws.
- (iv) An equity pledge agreement dated March 30, 2007 among Weiqin Qiu, Peili Lei, Chengdu Interactive Entertainment and Kingsoft Qijian, pursuant to which Weiqin Qiu and Peili Lei pledged all of their equity interests in Kingsoft Qijian (and any increase in their capital contributions) in favor of Chengdu Interactive Entertainment as security for their obligations and Kingsoft Qijian's performance of its obligations under the above loan agreement, shareholder voting agreement and call option agreement, and the performance by Chengdu Digital Entertainment of its obligations under the intellectual property license agreements (as described above) and the performance by Beijing Digital Entertainment of its obligations under the intellectual property licence agreements (as described below).
- (v) Zhuhai Software (as the licensor) and Beijing Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on June 15, 2007 for a term of 10 years from January 1, 2007 which will be automatically renewed for one year at the end of the term of any renewed

term, unless the licensor notifies otherwise. Zhuhai Software agreed to enter into agreements to licence certain intellectual property rights to Beijing Digital Entertainment on a case by case basis.

Structure Contracts relating to Chengdu Digital Entertainment

- (i) A loan agreement dated March 30, 2007 between Weiqin Qiu and Chengdu Interactive Entertainment which provided for an interest free loan of RMB100,000 by Chengdu Interactive Entertainment to Weiqin Qiu entirely for the purpose of capital funding of Chengdu Digital Entertainment. The loan has no definite maturity date and Chengdu Digital Entertainment may request repayment at any time. Weiqin Qiu shall repay the loan by transferring the equity interest she holds in Chengdu Digital Entertainment to Chengdu Interactive Entertainment or as it may direct.
- (ii) A shareholder voting agreement dated March 30, 2007 among Chengdu Interactive Entertainment, Weiqin Qiu and Chengdu Digital Entertainment, under which Weiqin Qiu irrevocably entrusts all of her shareholder rights in Chengdu Digital Entertainment to Chengdu Interactive Entertainment, including but not limited to the voting rights and the right to nominate directors of Chengdu Digital Entertainment.
- (iii) A call option agreement dated March 30, 2007 among Weiqin Qiu, Chengdu Digital Entertainment and Chengdu Interactive Entertainment, under which Chengdu Interactive Entertainment was granted an exclusive irrevocable option to purchase, or designate a third party to purchase, some or all of Weiqin Qiu's equity interest in Chengdu Digital Entertainment at any time, at a nominal amount subject to applicable PRC laws.
- (iv) An equity pledge agreement dated March 30, 2007 among Weiqin Qiu, Chengdu Interactive Entertainment, Chengdu Digital Entertainment and Beijing Digital Entertainment, pursuant to which Weiqin Qiu pledged her 1% equity interest in Chengdu Digital Entertainment (and any increase in her capital contribution) in favor of Chengdu Interactive Entertainment as security for the performance of her obligations under the above loan agreement, shareholder voting agreement and call option agreement as well as the performance by Chengdu Digital Entertainment of its obligations under the intellectual property license agreements (as described below).

DIRECTORS' REPORT (continued)

- (v) Chengdu Interactive Entertainment (as the licensor) and Chengdu Digital Entertainment (as the licensee) entered into a framework intellectual property license agreement on June 15, 2007 for a term of 10 years from January 1, 2007 which will be automatically renewed for one year at the end of the term of any renewed term, unless the licensor notifies otherwise. Chengdu Interactive Entertainment agreed to enter into agreements to licence certain intellectual property rights to Chengdu Digital Entertainment on a case by case basis. As Weiqin Qiu is the sister of our executive Director, Pak Kwan Kau, and Peili Lei is an aunt of our executive Director Jun Lei, Weiqin Qiu and Peili Lei are associates of Pak Kwan Kau and Jun Lei, and therefore, are our connected persons. Accordingly, certain transactions under the structure contracts technically constituted connected transactions. The Company applied to the Stock Exchange for and was granted a specific waiver from strict compliance with the applicable disclosure, reporting and shareholders' approval requirements of Chapter 14A of the Listing Rules in relation to the transactions contemplated under the structure contracts for so long as the shares of the Company are listed on the Stock Exchange.

The independent non-executive directors have reviewed the above structure contracts and have confirmed that:

- these structure contracts remain unchanged and are consistent with their disclosure in the prospectus of the Company dated September 24, 2007;
- no dividends or other distributions were made by Kingsoft Qijian, Beijing Digital Entertainment, or Chengdu Digital Entertainment to the holders of their equity interests for the year ended December 31, 2008; and
- apart from these structure contracts, there were no other new structure contracts entered into, renewed and/or "cloned" during the year ended December 31, 2008.

In accordance with rule 14A.37 of the Listing Rules, the independent non-executive directors have reviewed all of the continuing connected transactions referred to above

and have confirmed that the transactions have been entered into:

- (i) in the ordinary and usual course of the Group's business;
- (ii) either on normal commercial terms or on terms no less favorable than terms available to or from independent third parties; and
- (iii) in accordance with the relevant agreements governing such transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

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

Non-exempt Connected Transactions

Sky Profit Transaction

As disclosed in the announcement of the Company of December 18, 2008, the Company had on the same date entered into a transaction with Sky Profit Limited ("**Sky Profit**"), its subsidiaries (together, the "**Sky Profit Group**"), its shareholders, and Shanghai Qinhe Internet Technology Software Development Co., Ltd. and Shanghai Qiao Heng Internet Technology Co., Ltd., the latter two are effectively controlled by the Sky Profit Group (together, the "**Sky Profit Companies**") through control contract arrangements, pursuant to which: (a) the Company shall acquire in two tranches of subscription and purchase Sky Profit preferred shares (representing in aggregate approximately 30.03% of the entire enlarged issued share capital of Sky Profit) for a total consideration of US\$8.00 million; and (b) the Company shall enter into a strategic business partnership arrangement with the Sky Profit Companies, for purposes of mutual promotion and expansion (the "**Sky Profit Transaction**").

DIRECTORS' REPORT (continued)

Since a substantial shareholder (such term as defined in the Listing Rules) of Sky Profit is Lei Jun (a substantial shareholder and non-executive director of the Company) who (as a non-executive director of the Company) falls within the definition of a controller of the Company under the Listing Rules, the acquisition in the Sky Profit Transaction constituted a connected transaction under Rule 14A.13 (1)(b) and Rule 14A.32 of the Listing Rules.

Dalian Transaction

As disclosed in the announcement of the Company of May 27, 2008, the Group had on the same date entered into a transaction with Dalian Shang Shang Wang Digital Technology & Co., Ltd. ("**Dalian SSW**"), pursuant to which the Group acquired a further 29.4% equity interest in online-games developer, Dalian Kingsoft Interactive Entertainment Co., Ltd. (a 51.00% held subsidiary of the Group prior to the transaction) ("**Kingsoft Dalian**"), from Dalian SSW for a total cash consideration of RMB30.30 million, to better capitalise on the commercialisation of the games by Kingsoft Dalian (the "**Dalian Transaction**"). With the completion of the Dalian Transaction, Kingsoft Dalian has become an 80.40% owned subsidiary of the Group.

As Dalian SSW is a connected person of the Company under the Listing Rules, the Dalian Transaction constituted a connected transaction under Rule 14A.13 (1)(a) and Rule 14A.32 of the Listing Rules.

The Group has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules in respect of the above non-exempt connected transactions.

Related Party Transactions

Details of the related party transactions for the year are included in Note 35 to the financial statements.

Compliance with the Code on Corporate Governance Practices

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

Code of Conduct regarding Directors' Securities Transactions

The Board of Directors has adopted the Model Code. All directors of the Company complied with such code of conduct during the financial year ended December 31, 2008.

Pre-Emptive Rights

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

Post Balance Sheet Events

Details of the significant post balance sheet events of the Group are set out in Note 38 to the financial statement.

Audit and Remuneration Committees

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

Auditors

The consolidated financial statements of the Company for the year ended December 31, 2008 has been audited by Ernst & Young, who retire and, being eligible, offer themselves for reappointment.

By order of the Board
Pak Kwan Kau
Chairman
PRC, March 31, 2009

INDEPENDENT AUDITORS' REPORT



TO THE SHAREHOLDERS OF KINGSOFT CORPORATION LIMITED

(Continued into the Cayman Islands with limited liability)

We have audited the financial statements of Kingsoft Corporation Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") set out on pages 41 to 116, which comprise the consolidated and company balance sheets as at December 31, 2008, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITORS' RESPONSIBILITY

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

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

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

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

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at December 31, 2008 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

18th Floor

Two International Finance Centre

8 Finance Street, Central

Hong Kong

March 31, 2009

CONSOLIDATED INCOME STATEMENT

Year ended December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
REVENUE:			
Entertainment software		553,723	396,440
Applications software		261,150	156,521
Others		6,071	3,653
		820,944	556,614
Cost of revenue		(110,935)	(95,484)
Gross profit		710,009	461,130
Research and development costs, net of government grants		(124,926)	(68,450)
Selling and distribution costs		(148,565)	(108,723)
Administrative expenses		(93,772)	(65,785)
Share-based compensation costs	3, 6	(49,909)	(103,764)
Other operating costs	3	(4,822)	(2,249)
Other income and gains	4	18,898	11,531
Finance income	3	31,022	22,775
Finance costs	5	—	(1,211)
Share of profit/(loss) of an associate		27,263	(2,460)
Share of loss of a jointly-controlled entity	16	(1,278)	—
PROFIT BEFORE TAX	3	363,920	142,794
Income tax credit/(expense)	8	(59,885)	12,658
PROFIT FOR THE YEAR		304,035	155,452
Attributable to:			
Equity holders of the Company	31(b)	307,501	164,678
Minority interests		(3,466)	(9,226)
		304,035	155,452
PROPOSED FINAL DIVIDEND	9	139,723	95,710
		RMB	RMB
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY			
Basic	10	0.2895	0.1815
Diluted		0.2774	0.1725

CONSOLIDATED BALANCE SHEET

December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	11	345,626	45,446
Goodwill	12	2,377	—
Other intangible assets	13	39,071	14,281
Lease prepayment	14	7,138	7,304
Interest in an associate	15	27,077	1,014
Interest in a jointly-controlled entity	16	4,722	—
Loan receivables	17	2,520	1,784
Deferred tax assets	8	29,262	52,814
Deferred cost	18	273	1,890
Long-term prepayments	19	11,620	—
		469,686	124,533
CURRENT ASSETS			
Inventories	20	4,686	2,019
Trade receivables	21	84,819	60,226
Prepayments, deposits and other receivables	22	55,138	47,743
Income tax receivable		182	522
Deferred cost	18	5,889	8,939
Due from related parties	35	—	9,862
Credit-linked deposit	23	111,708	—
Cash and cash equivalents	24	1,007,115	1,246,077
		1,269,537	1,375,388
CURRENT LIABILITIES			
Trade payables	25	7,649	7,120
Dividend payable		134	—
Accrued expenses and other payables	26	160,972	147,062
Deferred revenue	27	183,445	162,002
Income tax payable		19,616	6,047
		371,816	322,231
NET CURRENT ASSETS		897,721	1,053,157
TOTAL ASSETS LESS CURRENT LIABILITIES		1,367,407	1,177,690

CONSOLIDATED BALANCE SHEET (continued)

December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
TOTAL ASSETS LESS CURRENT LIABILITIES		1,367,407	1,177,690
NON-CURRENT LIABILITIES			
Deferred revenue	27	31,179	29,726
Deferred tax liabilities	8	7,863	14,307
		39,042	44,033
Net assets		1,328,365	1,133,657
EQUITY			
Equity attributable to equity holders of the Company			
Issued capital	28	4,362	4,322
Share premium	28	639,034	735,510
Shares held for share award scheme	28	(40,050)	—
Ordinary shares subscribed		—	319
Statutory reserves	31	81,481	57,570
Employee share-based capital reserve		194,648	144,741
Foreign currency translation reserve		(66,128)	(28,918)
Retained earnings		362,447	101,953
Proposed final dividend	9	139,723	95,710
		1,315,517	1,111,207
Minority interests		12,848	22,450
Total equity		1,328,365	1,133,657

Pak Kwan Kau
Director

Donghui Wang
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended December 31, 2008

	ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY												
	ISSUED CAPITAL (NOTE 28) RMB'000	SHARE PREMIUM (NOTE 28) RMB'000	SHARES HELD FOR			EMPLOYEE			RETAINED EARNINGS RMB'000	PROPOSED FINAL DIVIDEND RMB'000	TOTAL RMB'000	MINORITY INTERESTS RMB'000	TOTAL EQUITY RMB'000
			SHARE AWARD SCHEME RMB'000	ORDINARY SHARES SUBSCRIBED RMB'000	STATUTORY RESERVES RMB'000	SHARE- BASED CAPITAL RESERVE RMB'000	FOREIGN CURRENCY TRANSLATION RESERVE RMB'000						
AT JANUARY 1, 2007	3,564	110,539	—	—	52,140	40,160	(1,657)	38,415	—	243,161	24,666	267,827	
Exchange realignment	—	—	—	—	—	—	(27,261)	—	—	(27,261)	(299)	(27,560)	
Total income and expense for the year recognised													
directly in equity	—	—	—	—	—	—	(27,261)	—	—	(27,261)	(299)	(27,560)	
Profit for the year	—	—	—	—	—	—	—	164,678	—	164,678	(9,226)	155,452	
Total income and expense for the year	—	—	—	—	—	—	(27,261)	164,678	—	137,417	(9,525)	127,892	
Capital contributions from minority interests	—	—	—	—	—	—	—	—	—	—	6,821	6,821	
Share-based compensation costs	—	—	—	—	—	104,581	—	—	—	104,581	488	105,069	
Issuance of shares	752	693,183	—	—	—	—	—	—	—	693,935	—	693,935	
Exercise of share options	6	807	—	319	—	—	—	—	—	1,132	—	1,132	
Profit appropriation (note 31(a))	—	—	—	—	5,430	—	—	(5,430)	—	—	—	—	
Share issuance expenses (note 28(c))	—	(69,019)	—	—	—	—	—	—	—	(69,019)	—	(69,019)	
Proposed final 2007 dividend (note 9)	—	—	—	—	—	—	—	(95,710)	95,710	—	—	—	
AT DECEMBER 31, 2007 AND JANUARY 1, 2008	4,322	735,510	—	319	57,570	144,741	(28,918)	101,953	95,710	1,111,207	22,450	1,133,657	
Exchange realignment	—	—	—	—	—	—	(37,210)	—	—	(37,210)	1,376	(35,834)	
Total income and expense for the year recognised													
directly in equity	—	—	—	—	—	—	(37,210)	—	—	(37,210)	1,376	(35,834)	
Profit for the year	—	—	—	—	—	—	—	307,501	—	307,501	(3,466)	304,035	
Total income and expense for the year	—	—	—	—	—	—	(37,210)	307,501	—	270,291	(2,090)	268,201	
2007 final dividend declared	—	—	—	—	—	—	—	—	(95,710)	(95,710)	—	(95,710)	
Dividend on shares issued for employee share options exercised after December 31, 2007	—	—	—	—	—	—	—	(421)	—	(421)	—	(421)	
Shares purchased for share award scheme	—	—	(40,050)	—	—	—	—	—	—	(40,050)	—	(40,050)	
Share-based compensation costs	—	—	—	—	—	49,907	—	—	—	49,907	113	50,020	
Issuance of share certificates for ordinary shares subscribed	3	316	—	(319)	—	—	—	—	—	—	—	—	
Capital contribution from shareholders (note 28(d))	—	32,741	—	—	—	—	—	—	—	32,741	—	32,741	
Profit appropriations (note 31(a))	—	—	—	—	23,911	—	—	(23,911)	—	—	—	—	
Exercise of share options	37	10,190	—	—	—	—	—	—	—	10,227	—	10,227	
Acquisition of minority interest (note 35(b)(i))	—	—	—	—	—	—	—	(22,675)	—	(22,675)	(7,625)	(30,300)	
Proposed final 2008 dividend (note 9)	—	(139,723)	—	—	—	—	—	—	139,723	—	—	—	
AT DECEMBER 31, 2008	4,362	639,034	(40,050)	—	81,481	194,648	(66,128)	362,447	139,723	1,315,517	12,848	1,328,365	

CONSOLIDATED CASH FLOW STATEMENT

Year ended December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit for the year		304,035	155,452
Adjustments to reconcile profit for the year to net cash generated from operating activities:			
Depreciation	3	20,585	18,185
Amortisation of lease prepayment	3	166	124
Loss on disposal of items of property, plant and equipment	3	89	113
Write-off/(write-back) of receivables	3	102	(2,549)
Write-down of inventories	3	1,206	458
Amortisation of purchased software	13	7,019	4,947
Amortisation of capitalised software costs	13	4,152	1,093
Amortisation of other intangible assets	13	444	—
Interest income from credit-linked deposit		(4,206)	—
Deferred income tax expense/(credit)	8	16,556	(28,039)
Share-based compensation costs		50,019	105,069
Share of loss/(profit) of an associate		(27,263)	2,460
Share of loss of a jointly-controlled entity		1,278	—
Transaction costs related to sale of issued ordinary shares by existing shareholders and the listing of existing shares	5	—	1,211
Changes in assets and liabilities:			
Trade receivables		(24,695)	(5,350)
Prepayments, deposits and other receivables		(7,395)	(12,912)
Income tax receivable		340	2,466
Loan receivables		(736)	(381)
Inventories		(2,282)	(751)
Balances with related parties		—	(5,246)
Deferred cost		4,667	197
Trade payables		529	1,670
Deferred revenue		24,896	52,402
Accrued expenses and other payables		(1,603)	49,498
Income tax payable		13,569	5,357
Net cash generated from operating activities		381,472	345,474
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from disposal of items of property, plant and equipment		87	73
Purchases of items of property, plant and equipment		(291,218)	(31,027)
Addition of lease prepayment		—	(6,827)
Deposit for construction project		—	(2,580)
Purchases of software	13	(16,488)	(9,810)
Addition of capitalised software costs	13	(11,167)	(3,333)
Purchase of credit-linked deposit		(108,807)	—
Interest received from credit-linked deposit		1,305	—
Increase in time deposits with original maturity of over three months when acquired		(33,005)	(342,155)
Dividend received from an associate		1,200	—
Acquisition of minority interests	35(b)(i)	(30,300)	—
Acquisition of assets from a business combination	32	(14,520)	—
Increase in long-term prepayments		(11,620)	—
Investment in jointly-controlled entity		(6,000)	—
Net cash used in investing activities		(520,533)	(395,659)

CONSOLIDATED CASH FLOW STATEMENT (continued)

Year ended December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of shares		—	670,833
Purchase of shares held for share award scheme		(40,050)	—
Repayment of borrowings		—	(2,000)
Share issuance expenses		(3,994)	(30,941)
Exercise of share options		10,227	1,132
Capital contributions from shareholders	28(d)	32,741	—
Dividends paid to equity holders		(95,997)	—
Capital contributions from minority interests		—	8,388
Net cash generated from/(used in) financing activities		(97,073)	647,412
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS			
		(236,134)	597,227
Cash and cash equivalents at the beginning of the year		888,922	318,508
Effect of foreign exchange rate changes, net		(35,833)	(26,813)
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		616,955	888,922
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS:			
Cash and bank balances	24	219,080	171,801
Time deposits with original maturity of three months or less when acquired	24	397,875	717,121
		616,955	888,922

BALANCE SHEET

December 31, 2008

	NOTES	2008 RMB'000	2007 RMB'000
			(Restated)
NON-CURRENT ASSETS			
Investments in subsidiaries	30	166,351	166,589
Other intangible assets	13	3,058	5,615
		169,409	172,204
CURRENT ASSETS			
Prepayments, deposits and other receivables	22	488	1,621
Due from related parties	35	—	9,862
Due from subsidiaries	30	319,967	—
Credit-linked deposit	23	111,708	—
Cash and cash equivalents	24	155,604	683,070
		587,767	694,553
CURRENT LIABILITIES			
Accrued expenses and other payables	26	1,072	13,879
Dividend payable		134	—
Deferred revenue	27	—	95
Due to subsidiaries	30	28,936	33,298
		30,142	47,272
NET CURRENT ASSETS		557,625	647,281
TOTAL ASSETS LESS CURRENT LIABILITIES		727,034	819,485
NET ASSETS		727,034	819,485
EQUITY			
Issued capital	28	4,362	4,322
Share premium	28	639,034	735,510
Shares held for share award scheme	28	(40,050)	—
Ordinary shares subscribed		—	319
Employee share-based capital reserve	31(b)	194,023	144,233
Foreign currency translation reserve	31(b)	(70,705)	(35,098)
Accumulated losses	31(b)	(139,353)	(125,511)
Proposed final dividend	9	139,723	95,710
TOTAL EQUITY		727,034	819,485

Pak Kwan Kau
Director

Donghui Wang
Director

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

1. CORPORATE INFORMATION

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

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

During the year, the Group was involved in the following principal activities:

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

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

2. PRINCIPAL ACCOUNTING POLICIES

Basis of preparation

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

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

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended December 31, 2008. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

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

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Group's subsidiaries, and are presented separately in the income statement and within equity in the consolidated balance sheet, separately from parent shareholders' equity. An acquisition of minority interests is accounted for using the entity concept method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as an equity transaction.

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impact of new and revised IFRSs

The Group has adopted the following new interpretations and amendments to IFRSs for the first time for the current year's financial statements. Except for in certain cases, giving rise to new and revised accounting policies and additional disclosures, the adoption of these new interpretations and amendments has had no significant effect on the consolidated financial statements.

IAS 39 and IFRS 7 Amendments	Amendments to IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and IFRS 7 <i>Financial Instruments: Disclosures — Reclassification of Financial Assets</i>
IFRIC-Int 11	<i>IFRS 2 — Group and Treasury Share Transactions</i>
IFRIC-Int 12	<i>Service Concession Arrangements</i>
IFRIC-Int 14	<i>IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction</i>

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

- (a) Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures — Reclassification of Financial Assets*

The amendments to IAS 39 permit an entity to reclassify a non-derivative financial asset classified as held for trading, other than a financial asset designated by an entity as at fair value through profit or loss upon initial recognition, out of the fair value through profit or loss category if the financial asset is no longer held for the purpose of selling or repurchasing in the near term, if specified criteria are met.

A debt instrument that would have met the definition of loans and receivables (if it had not been required to be classified as held for trading at initial recognition) may be classified out of the fair value through profit or loss category or (if it had not been designated as available for sale) may be classified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold it for the foreseeable future or until maturity.

In rare circumstances, financial assets that are not eligible for classification as loans and receivables may be transferred from the held-for-trading category to the available-for-sale category or to the held to maturity category (in the case of a debt instrument), if the financial asset is no longer held for the purpose of selling or repurchasing in the near term.

The financial asset shall be reclassified at its fair value on the date of reclassification and the fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable. The amendments to IFRS 7 require extensive disclosures of any financial asset reclassified in the situations described above. The amendments are effective from July 1, 2008.

As the Group has not reclassified any of its financial instruments, the amendments have had no impact on the financial position or results of operations of the Group.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impact of new and revised IFRSs (continued)

(b) IFRIC-Int 11 *IFRS 2 — Group and Treasury Share Transactions*

IFRIC-Int 11 requires arrangements whereby an employee is granted rights to the Group's equity instruments to be accounted for as an equity-settled scheme, even if the Group buys the instruments from another party, or the shareholders provide the equity instruments needed. IFRIC-Int 11 also addresses the accounting for share-based payment transactions involving two or more entities within the Group.

During the current and prior years, the Company has granted its own equity instruments as share-based compensation to the employees of its subsidiaries to reward the employees' services provided to the subsidiaries. The Company has charged all the related share-based compensation costs to the income statement of the Company in the past. Upon the adoption of IFRIC-Int 11, the subsidiaries shall measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions, with a corresponding increase recognised in equity as a contribution from the Company. The change in accounting policy has been recognised retrospectively and the comparative amounts for the year ended December 31, 2007 have been restated. The effects of the above change are summarised below:

	2008 RMB'000	2007 RMB'000
<i>Income statement of the Company for the year</i>		
Decrease in share-based compensation costs	35,572	82,860
<i>Company balance sheet and equity at January 1</i>		
Increase in investments in subsidiaries	111,596	27,431
Increase in due to subsidiaries	1,518	213
Increase in reserves (retained earnings)	110,078	27,218
<i>Company balance sheet and equity at December 31</i>		
Increase in investments in subsidiaries	147,278	111,596
Increase in due to subsidiaries	1,628	1,518
Increase in reserves (retained earnings)	145,650	110,078

(c) IFRIC-Int 12 *Service Concession Arrangements*

IFRIC-Int 12 applies to service concession operators and explains how to account for obligation undertaken and the rights received in service concession arrangements. No member of the Group is an operator and, therefore, this interpretation has had no impact on the financial position or results of operations of the Group.

(d) IFRIC-Int 14 *IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

IFRIC-Int 14 addresses how to assess the limit under IAS 19 *Employee Benefits*, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognised as an asset, including situations when a minimum funding requirement exists. As the Group has no defined benefit scheme, the interpretation has had no effect on these financial statements.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impact of issued but not yet effective IFRSs

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 1 and IAS 27 Amendments	Amendments to IFRS 1 <i>First-time Adoption of IFRSs</i> and IAS 27 <i>Consolidated and Separate Financial Statements — Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate</i> ¹
IFRS 2 Amendments	Amendments to IFRS 2 <i>Share-based Payment — Vesting Conditions and Cancellations</i> ¹
IFRS 3 (Revised)	<i>Business Combinations</i> ²
IFRS 7 Amendments	Amendments to IFRS 7 <i>Financial Instrument: Disclosures — Improving disclosures about financial instruments</i> ¹
IFRS 8	<i>Operating Segments</i> ¹
IAS 1 (Revised)	<i>Presentation of financial statements</i> ¹
IAS 23 (Revised)	<i>Borrowing Costs</i> ¹
IAS 27 (Revised)	<i>Consolidated and Separate Financial Statements</i> ²
IAS 32 and IAS 1 Amendments	Amendments to IAS 32 <i>Financial Instruments: Presentation</i> and IAS 1 <i>Presentation of Financial Statements — Puttable Financial Instruments and Obligations Arising on Liquidation</i> ¹
IAS 39 Amendment	Amendment to IAS 39 <i>Financial Instruments: Recognition and Measurement — Eligible Hedged Items</i> ²
IFRIC-Int 9 & IAS 39 Amendment	<i>Embedded Derivatives</i> ⁵
IFRIC-Int 13	<i>Customer Loyalty Programmes</i> ³
IFRIC-Int 15	<i>Agreements for the Construction of Real Estate</i> ¹
IFRIC-Int 16	<i>Hedges of a Net Investment in a Foreign Operation</i> ⁴
IFRIC-Int 17	<i>Distribution of Non-cash Assets to Owners</i> ²
IFRIC-Int 18	<i>Transfers of Assets from Customers</i> ⁶

Apart from the above, the IASB has also issued *Improvements to IFRSs** which sets out amendments to a number of IFRSs primarily with a view to removing inconsistencies and clarifying wording. Except for the amendment to IFRS 5 which is effective for the annual periods on or after July 1, 2009, other amendments are effective for annual periods beginning on or after January 1, 2009 although there are separate transitional provisions for each standard.

¹ Effective for annual periods beginning on or after January 1, 2009

² Effective for annual periods beginning on or after July 1, 2009

³ Effective for annual periods beginning on or after July 1, 2008

⁴ Effective for annual periods beginning on or after October 1, 2008

⁵ Effective for annual periods ending on or after June 30, 2009

⁶ Apply prospectively to transfers of assets from customers received on or after July 1, 2009

* *Improvements to IFRSs* contains amendments to IFRS 5, IFRS 7, IAS 1, IAS 8, IAS 10, IAS 16, IAS 18, IAS 19, IAS 20, IAS 23, IAS 27, IAS 28, IAS 29, IAS 31, IAS 34, IAS 36, IAS 38, IAS 39, IAS 40 and IAS 41.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impact of issued but not yet effective IFRSs (continued)

The Group is in the process of making an assessment of the impact of these new and revised IFRSs upon initial application. So far, it has concluded that while the adoption of IFRS 8 and IAS 1 (Revised) may result in new or amended disclosures and the adoption of IFRS 3 (Revised), IAS 27 (Revised) may result in changes in accounting policies, these new and revised IFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

Subsidiaries

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

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's 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 has unilateral control, directly or indirectly, over the joint venture;
- (b) a jointly-controlled entity, if the Group does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;
- (c) an associate, if the Group 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 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 entity

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Associate

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

The Group's interest in an associate is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post-acquisition results and reserves of the associate is included in the consolidated income statement and consolidated reserves, respectively.

Goodwill

Goodwill arising on the acquisition of subsidiaries, associates and jointly-controlled entities represents the excess of the cost of the business combination over the Group's interest in the net fair value of the acquirees' identifiable assets acquired, and liabilities and contingent liabilities assumed as at the date of acquisition.

Goodwill arising on acquisition is recognised in the consolidated balance sheet as an asset, initially measured at cost and subsequently at cost less any accumulated impairment losses.

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

Related parties

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Foreign currencies

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

The functional currencies of the Company and certain overseas subsidiaries are currencies other than the RMB. As at the balance sheet date, the assets and liabilities of these entities are translated into RMB at the exchange rates ruling at the balance sheet date and their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting exchange differences are included in the foreign currency translation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of 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.

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

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over the following estimated useful lives:

Electronic equipment	3 years
Office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	Over the shorter of the expected life of the leasehold improvements and the lease term

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

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at least at each balance sheet date.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Property, plant and equipment and depreciation (continued)

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

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

Intangible assets (other than goodwill)

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are 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 balance sheet date.

Purchased software

Purchased software (including upfront licensing fees) are carried at cost less accumulated amortisation. Amortisation is computed using the straight-line method over the shorter of the estimated economic life or the license period.

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

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of technical and financial resources to complete the project and the ability to measure reliably the expenditure during the development.

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Intangible assets (other than goodwill) (continued)

Website and internally used software development costs

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

Impairment of non-financial assets other than goodwill

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets, financial assets 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.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such 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 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.

Investments and other financial assets

Financial assets in the scope of IAS 39 are classified as financial assets at fair value through profit or loss, or loans and receivables, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

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

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

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. 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.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading or these financial assets are recognised in the income statement.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; (ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial asset contains an embedded derivative that would need to be separately recorded.

Loans and receivables

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

Fair value

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

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the impairment loss is recognised in the income statement. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Assets carried at amortised cost (continued)

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

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

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 where:

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

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

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

Financial liabilities at amortised cost

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

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.

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.

Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. A provision for impairment is made when there is objective evidence that the Group will not be able to collect the debts. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the trade receivable is impaired. In subsequent periods when a trade receivable is ascertained to be uncollectible, it is written off against the allowance account. The Group generally does not require collateral from its customers.

Cash and cash equivalents

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

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

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 embodying economic benefits 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 balance sheet date 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.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Defined contribution plan for PRC employees

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

Share-based payment transactions

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

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date when they are granted. The fair value of the Company's ordinary shares on the dates of share option grants before the listing of the Company were assessed by an external appraiser. The fair values of share options are determined by management using the Black-Scholes valuation model (the "BS Model"), further details of which are set out in note 6. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ("market conditions"), if applicable.

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

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

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

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Operating 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 the operating leases are charged to the income statement on the straight-line basis over the lease terms.

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

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

Revenue recognition

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

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

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(a) *Applications software products*

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

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

In addition to multi-year licensing arrangements, the Group also sells perpetual information security and utilities software licenses to OEMs for them to install into their own products. Revenue from the license agreements is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold. For those licenses to OEMs which involve virus definition updates to end users of OEM's products, revenue of this element is recognised over the period during which the virus definition update service is provided.

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

The Group sells information security and utilities packaged software products to non-OEM customers, most of which are for individual usage through distributors. The Group also sells information security and dictionary packaged software through electronic download, via the internet, directly to individual end users. The Group offers cash rebates (both contractual and non-contractual, which are determined by management on a discretionary basis) and rights of returns of its products under various policies and programs with its distributors and resellers. Revenue related to packaged software products is deferred and recognised when the price can be measured reliably and the amount of future rebates and returns can be reasonably estimated, provided that all other basic criteria for revenue recognition have been met. The Group accounts for reserves on cash rebates and returns as an offset to revenue. The Group accounts for the cash rebates which are offset against revenue in the income statement, together with an accrual in the balance sheet. Besides, the Group determines the amount of returns, which is offset against revenue in the income statement, together with deferred revenue in the balance sheet.

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(a) Applications software products (continued)

- Software license to government agencies

The Group sells information security and utilities packaged software and office applications licenses through direct sales to government agencies and indirect sales with resellers to government agencies. The license agreements to government agencies generally include services and PCS, such as when-and-if-available upgrades, training and product maintenance, for one to three years. Revenue is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold. When the selling price includes an identifiable amount for subsequent servicing, the amount is deferred and recognised as revenue over the period during which the service is performed.

- Starting from April 2005, the Group adopted online subscription model for all the individual information security products, of which revenue is recognised upon activation of the prepaid service cards or online downloads based on the actual usage of subscribed time by end customers.

(b) Entertainment software — Online game services

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

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

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

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

(c) *Software consultancy services*

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

(d) *Advertising services*

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

(e) *Interest income*

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

Cost of revenue

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

Deferred revenue

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

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

Government grants

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Taxes

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

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

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

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

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

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

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

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

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.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained earnings within the equity section of the balance sheet, 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.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Estimation uncertainty

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

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

(a) Recognition of share-based compensation costs

As mentioned in note 6, the Company has granted share options to its employees. The management have used the BS Model to determine the total fair value of the options granted, which is to be expensed over the vesting period. Judgement regarding the terms and conditions upon which the options were granted, such as risk-free rate, dividend yield, expected volatility and expected life of options, is required to be made by the management as the parameters for applying the BS Model. The Company engaged American Appraisal China Limited, independent appraiser, to perform an appraisal of the fair value of the Company's ordinary share prior to the listing of the Company.

The Company also has granted Awarded Shares to its employees. The fair value of the Awarded Shares was based on the market value of the Company's shares at grant date. The fair value of the Awarded Shares for the year ended December 31, 2008 was approximately RMB35,087 thousand.

The grant of equity instruments is conditional upon satisfying specified vesting conditions, including service period, performance condition linked to financial performance measure and successful initial public offering. Management judgement is required to take into account the vesting conditions and adjust the number of equity instruments included in the measurement of share-based compensation costs. Determining the number of equity instruments that eventually vest requires management to make assumptions regarding the profit forecast, and hence they are subject to uncertainty.

No share options were granted during the year ended December 31, 2008. The fair value of options granted for the year ended December 31, 2007 determined using the BS Model was approximately RMB194,838 thousand. The fair value of options granted by Kingsoft Japan Inc. ("Kingsoft Japan") for the year ended December 31, 2007 determined using the BS Model was approximately RMB2,136 thousand.

(b) Software development costs

Software development costs are capitalised in accordance with the accounting policy for research and development costs. Determining the amounts to be capitalised requires management to make assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits. At December 31, 2008, the best estimate of the carrying amount of capitalised development costs was RMB9,003 thousand (2007: RMB3,988 thousand).

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

2. PRINCIPAL ACCOUNTING POLICIES (continued)

Estimation uncertainty (continued)

(c) Revenue recognition

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

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

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

- (ii) Entertainment software — Online games services

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

(d) Deferred tax assets

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies. The carrying value of deferred tax assets relating to recognised tax losses was RMB44 thousand for the year ended December 31, 2008 (2007: Nil). The amount of unrecognised tax losses as at December 31, 2008 was RMB24,661 thousand (2007: RMB10,892 thousand). Further details are contained in note 8.

(e) Impairment of trade receivables

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

(f) Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires management to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

3. PROFIT BEFORE TAX

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

	NOTES	2008 RMB'000	2007 RMB'000
Employee benefit expense	(a)	253,405	244,082
Minimum lease payments under operating leases	(b)	38,985	25,554
Depreciation	(c)	20,585	18,185
Amortisation of lease prepayment	(c)	166	124
Amortisation of intangible assets:			
Amortisation of capitalised software costs*		4,110	882
Amortisation of purchased software	(c)	7,019	4,947
Amortisation of other intangible assets	(c)	444	—
Write-down of inventories	(d), 20	1,206	458
Write-off/(write-back) of receivables	(d)	102	(2,549)
Loss on disposal of items of property, plant and equipment	(d)	89	113
Foreign exchange differences	(d)	1,602	1,053
Auditors' remuneration		5,600	5,600
Bank interest income		(31,022)	(22,775)
Government grants**		(7,589)	(18,788)

* The amortisation of capitalised software costs is included in research and development costs on the face of the consolidated income statement.

** Government grants were granted to support the development of software and online game technology and 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 related expenditure has not yet been undertaken are included in deferred revenue in the consolidated balance sheet. There are no unfulfilled conditions or contingencies relating to these grants.

(a) Employee benefit expense

	2008 RMB'000	2007 RMB'000
Wages and salaries	158,703	110,483
Social insurance costs and staff welfare	31,763	20,516
Share-based compensation costs	49,909	103,764
Pension plan contributions	13,030	9,319
	253,405	244,082

(b) Minimum lease payments under operating leases

	2008 RMB'000	2007 RMB'000
Plant and machinery	26,824	14,972
Land and buildings	12,161	10,582
	38,985	25,554

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

3. PROFIT BEFORE TAX (continued)

(c) Depreciation of property, plant and equipment and amortisation of lease prepayment, purchased software and other intangible assets

	2008 RMB'000	2007 RMB'000
Included in:		
Cost of revenue	12,044	10,908
Research and development costs	6,869	4,467
Selling and distribution costs	670	468
Administrative expenses	8,631	7,413
	28,214	23,256

(d) Other operating costs

	2008 RMB'000	2007 RMB'000
Write-down of inventories	1,206	458
Write-off/(write-back) of receivables	102	(2,549)
Loss on disposal of items of property, plant and equipment	89	113
Foreign exchange differences	1,602	1,053
Donation	1,703	1,123
Others	120	2,051
	4,822	2,249

4. OTHER INCOME AND GAINS

	NOTES	2008 RMB'000	2007 RMB'000
Government grants	(a)	18,898	7,171
License fee	(b)	—	4,359
Others		—	1
		18,898	11,531

(a) Various government grants were granted by certain municipal governments in the PRC to the Group for its general business development and further expansion.

There are no unfulfilled conditions or contingencies relating to the above grants.

(b) The license fee in 2007 arose from the sale of entertainment software license to the minority equity holder of Dalian Kingsoft Interactive Entertainment Co., Ltd. ("Kingsoft Dalian"), which had been paid by the minority equity holder prior to the Group's investment in Kingsoft Dalian.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

5. FINANCE COSTS

	2008 RMB'000	2007 RMB'000
Transaction costs related to sale of issued ordinary shares by existing shareholders and the listing of existing shares	—	1,211

6. SHARE-BASED COMPENSATION COSTS

(a) Share options

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

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

2004 Pre-IPO Share Option Scheme

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

Options granted under the 2004 Scheme generally vest over a period of four years, with one fourth of the options to vest on the first anniversary of the grant date, and an additional one eighth to vest at the end of each of the third to eighth six-month periods after the grant date as stipulated in the share option agreement. The offer of a grant of share options under the 2004 Scheme must be accepted within 28 business days from the date of offer, upon payment of a consideration of one Hong Kong dollar in total by the grantee.

The Company has reserved 4,590,000 ordinary shares for issuance under the 2004 Scheme. The maximum number of ordinary shares in respect of which options may be granted under the 2004 Scheme shall not in aggregate exceed ten percent of the total number of ordinary shares in issue. On August 12, 2005, the shareholders approved that the maximum number of ordinary shares in respect of which options may be granted shall not in aggregate exceed 18% of the total number of ordinary shares in issue of 35,410,000. Options under the 2004 Scheme may be granted for periods of up to ten years. The exercise price of share options is determined by the directors. On July 15, 2006, the Company increased its number of authorised ordinary shares to 70,000,000. Pursuant to a Share Subscription and Purchase Agreement dated July 21, 2006 ("Agreement Date"), the aggregate of all options issued from the Agreement Date to an initial public offering shall not constitute more than 15% of the issued capital of the Company.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

2004 Pre-IPO Share Option Scheme (continued)

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

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

2007 Pre-IPO Share Option Scheme

Pursuant to a directors' resolution dated January 22, 2007, the Company adopted the 2007 Pre-IPO Share Option Scheme (the "2007 Scheme"), for the purpose of providing incentives and awards to employees, senior management and directors of the Group. The vesting terms of the 2007 Scheme are the same as those of the 2004.

The maximum number of ordinary shares in respect of which options may be granted under the 2007 Scheme shall not in aggregate exceed 13% of the total number of issued shares on the fully diluted basis of inclusion of all of the issued and outstanding shares of the Company, as well as 6,373,800 options under the 2004 Scheme. The exercise price shall be determined and notified by the directors from time to time.

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

The total expense recognised for employee services received in respect of the 2004 Scheme and the 2007 Scheme for the year ended December 31, 2008 was RMB44,242 thousand (2007: RMB102,769 thousand).

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

2004 and 2007 Pre-IPO Share Option Schemes

The 2004 Scheme and the 2007 Scheme were terminated on September 3, 2007. No share options were granted since then. The following table illustrates the number and weighted average exercise prices ("WAEP") of, and movements in, the Company's share options for the years ended December 31, 2008 and 2007. All numbers/per share data of ordinary share of the Company have been presented after the effect of the share split, which is mentioned in note 28(a), except where otherwise indicated.

	COMPANY			
	2008 NUMBER OF SHARE OPTIONS	2008 WAEP US\$ PER SHARE	2007 NUMBER OF SHARE OPTIONS	2007 WAEP US\$ PER SHARE
2004 Scheme				
Outstanding at January 1	32,646,280	0.1093	36,077,960	0.1062
Forfeited during the year	(311,000)	0.1806	(950,000)	0.1189
Exercised during the year	(8,453,155)¹	0.1093	(2,481,680) ¹	0.0615
Outstanding at December 31	23,882,125	0.1083	32,646,280	0.1093
Exercisable at December 31	19,935,000	0.0847	15,553,660	0.1008
2007 Scheme				
Outstanding at January 1	109,031,400	0.2411	—	—
Granted during the year	—	—	112,647,400	0.2411
Forfeited during the year	(6,841,467)	0.2439	(3,616,000)	0.2400
Exercised during the year	(2,292,533)¹	0.2400	—	—
Outstanding at December 31	99,897,400	0.2410	109,031,400	0.2411
Exercisable at December 31	35,272,640	0.2407	—	—
Total outstanding at December 31	123,779,525	0.2154	141,677,680	0.2108
Total exercisable at December 31	55,207,640	0.1843	15,553,660	0.1008

¹ The weighted average share price at the date of exercise for the options exercised in 2008 was US\$0.2996 (2007: US\$0.5180).

The weighted average remaining contractual life for the Company's share options outstanding as at December 31, 2008 was 7.73 years (2007: 8.64 years). No share options were granted in 2008, whereas the weighted average fair value of the Company's options granted during 2007 was US\$0.2292 each. The range of exercise prices for options outstanding at the end of 2008 was US\$ 0.0005 to US\$ 0.4616 (2007: US\$0.0005 to US\$0.4616).

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

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

The fair value of equity-settled share options granted is estimated as at the date of grant using the BS Model, taking into account the terms and conditions upon which the options were granted. The measurement dates used in the valuation calculations were the dates on which the options were granted. No share options were granted in 2008. The following table lists the inputs to the model used for the year ended December 31, 2007.

	2007
Dividend yield (%)	0%
Expected volatility (%)	70%
Risk-free interest rate (%)	4.4%–5.2%
Expected forfeiture rate (%)	0–20.59%
Expected life of options (years)	3–6
Weighted average share price (US\$)	0.4380

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

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

The following share options were outstanding under the 2004 Scheme and the 2007 Scheme during the years ended December 31, 2008 and 2007. All numbers/per share data of ordinary share of the Company have been presented after the effect of the share split, which was mentioned in note 28(a), except where otherwise indicated.

NAME OR CATEGORY OF PARTICIPANT	NUMBER OF SHARE OPTIONS					DATE OF GRANT OF SHARE OPTIONS	EXERCISE PRICE OF SHARE OPTIONS US\$ PER SHARE
	AT JANUARY 1, 2008	GRANTED DURING THE YEAR	EXERCISED DURING THE YEAR	FORFEITED DURING THE YEAR	AT DECEMBER 31, 2008		
EXECUTIVE DIRECTOR							
Donghui Wang*	800,000	—	—	—	800,000	March 1, 2005	0.2118
	600,000	—	—	—	600,000	August 1, 2005	0.2118
	800,000	—	—	—	800,000	December 1, 2006	0.2400
	5,000,000	—	—	—	5,000,000	February 1, 2007***	0.2400
	7,200,000	—	—	—	7,200,000		
NON-EXECUTIVE DIRECTORS							
Jun Lei**	5,311,500	—	—	—	5,311,500	August 1, 2004	0.0353
	22,451,800	—	—	—	22,451,800	February 1, 2007***	0.2400
	27,763,300	—	—	—	27,763,300		
Wing Chung Anders Cheung	500,000	—	—	—	500,000	August 1, 2004	0.0353
OTHER EMPLOYEES							
In aggregate	1,770,500	—	—	—	1,770,500	January 1, 2000	0.0005
	152,460	—	(152,460)	—	—	January 1, 2001	0.0283
	11,547,820	—	(4,760,820)	(55,000)	6,732,000	August 1, 2004	0.0353
	3,541,000	—	(3,098,375)	—	442,625	January 1, 2005	0.2118
	250,000	—	—	—	250,000	April 1, 2005	0.2118
	2,617,000	—	(234,000)	(73,500)	2,309,500	August 1, 2005	0.2118
	556,000	—	(157,500)	(182,500)	216,000	January 1, 2006	0.2118
	800,000	—	—	—	800,000	August 1, 2006	0.2118
	3,400,000	—	(50,000)	—	3,350,000	December 1, 2006	0.2400
	79,341,600	—	(2,237,533)	(6,556,467)	70,547,600	February 1, 2007***	0.2400
	1,008,000	—	(55,000)	(165,000)	788,000	April 1, 2007***	0.2400
	680,000	—	—	—	680,000	May 8, 2007***	0.2400
	550,000	—	—	(120,000)	430,000	August 1, 2007***	0.4616
	106,214,380	—	(10,745,688)	(7,152,467)	88,316,225		
	141,677,680	—	(10,745,688)	(7,152,467)	123,779,525		

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

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

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

* Mr. Donghui Wang has been appointed as an executive director of the Company with effect from May 30, 2008.

** Mr. Jun Lei, an executive director of the Company, has been re-designated as a non-executive director of the Company with effect from August 28, 2008.

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

At the balance sheet date, the Company had 123,779,525 share options outstanding under the 2004 and 2007 Scheme. The exercise in full of the outstanding share options would, under the present capital structure of the Company, result in the issue of 123,779,525 additional ordinary shares of the Company and additional share capital of RMB423 thousand and share premium of RMB181,773 thousand.

At the date of approval of these financial statements, the Company had 120,949,525 share options outstanding under the 2004 and 2007 Scheme, which represented approximately 11.3% of the Company's shares in issue as at that date.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(a) Share options (continued)

Kingsoft Japan Share Options

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

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

No share options were granted or exercised in 2008, while 225 options were forfeited (2007: 210).

The expense recognised in respect of Kingsoft Japan share options during the year ended December 31, 2008 was RMB230 thousand (2007: RMB995 thousand).

(b) Share Award Scheme

On the Adoption Date, the board of directors of the Company approved and adopted the Share Award Scheme in which selected employees of the Group are entitled to participate. Unless early terminated by the board of directors, the Share Award Scheme shall be valid and effective for a term of five years commencing on the Adoption Date. The board of directors 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 of directors under the Share Award Scheme (but not counting any which have lapsed or have been forfeited), representing in aggregate over 10% of the issued capital of the Company as at the date of such grant.

For the Awarded Shares granted under the Share Award Scheme, the fair value of the employee services received in exchange for the grant of the Awarded Shares is recognised as an expense and credited to equity over the period in which the vesting conditions (i.e., service conditions and/or performance conditions) are fulfilled. The total amount to be expensed over the vesting period is determined by reference to the fair value of the Awarded Shares granted. Non-vesting conditions and market conditions shall be taken into account when estimating the fair value of the equity instruments granted.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(b) Share Award Scheme (continued)

On June 26, 2008, 5,079,000 shares were awarded to a number of employees which will be transferred to the employees at nil consideration upon vesting between June 26, 2009 and June 26, 2011. In October 2008, another 9,450,000 shares were awarded, most of which were subject to vesting over three years and certain performance conditions. In addition, in November and December 2008, another 1,050,000 shares were awarded with vesting period of three years. During the year ended December 31, 2008, the Share Award Scheme Trust acquired 17,138,000 shares of the Company through purchases on the open market at a total cost (including related transaction costs) of approximately RMB40,050 thousand. The excess 1,559,000 shares would be awarded to employees in future.

The expense recognised for employee services received in respect of the Share Award Scheme for the year ended December 31, 2008 was RMB5,437 thousand.

The following table illustrates the number of and movements in the Company's Awarded Shares for the year ended December 31, 2008.

	2008 NUMBER OF AWARDED SHARES
Outstanding at January 1	—
Awarded during the year	15,579,000
Forfeited during the year	(21,000)
Vested during the year	—
Outstanding at December 31	15,558,000

The fair value of the Awarded Shares was based on the market value of the Company's shares at the grant date. The weighted average fair value of the shares awarded during 2008 was RMB2.25 each.

As at December 31, 2008, 1,580,000 forfeited or unawarded shares were held by the Share Award Scheme Trust and would be awarded in future.

Subsequent to the balance sheet date, on January 1, 2009, 1,600,000 shares were granted to a member of key management personnel of the Group in respect of his services to the Group in the forthcoming years. These Awarded Shares vest between January 1, 2009 and January 1, 2012. The price of the Company's shares at the date of grant was HK\$2.58 per share.

At the date of approval of these financial statements, the Company had 16,678,000 Awarded Shares outstanding under the Share Award Scheme, which represented approximately 1.6% of the Company's shares in issue as at that date.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

6. SHARE-BASED COMPENSATION COSTS (continued)

(b) Share Award Scheme (continued)

The following Awarded Shares were outstanding under the Share Award Scheme during the year ended December 31, 2008.

NAME OR CATEGORY OF PARTICIPANT	NUMBER OF AWARDED SHARES					AWARD DATE
	AT JANUARY 1, 2008	AWARDED DURING THE YEAR	FORFEITED DURING THE YEAR	VESTED DURING THE YEAR	AT DECEMBER 31, 2008	
EXECUTIVE DIRECTOR						
Donghui Wang	—	381,000	—	—	381,000	October 13, 2008
	—	381,000	—	—	381,000	
OTHER EMPLOYEES						
In aggregate	—	5,079,000	(21,000)	—	5,058,000	June 26, 2008
	—	7,068,000	—	—	7,068,000	October 13, 2008
	—	2,001,000	—	—	2,001,000	October 24, 2008
	—	600,000	—	—	600,000	November 27, 2008
	—	150,000	—	—	150,000	December 1, 2008
	—	300,000	—	—	300,000	December 25, 2008
	—	15,198,000	(21,000)	—	15,177,000	
	—	15,579,000	(21,000)	—	15,558,000	

7. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS

(a) Directors' remuneration

Details of directors' remuneration are as follows:

	GROUP	
	2008 RMB'000	2007 RMB'000
Fees	615	286
Other emoluments:		
Salaries, allowances and benefits in kind	2,541	1,882
Discretionary bonuses	1,465	808
Pension plan contributions	8	15
Share-based compensation	14,108	19,908
	18,737	22,899

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

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

(a) Directors' remuneration (continued)

Year ended December 31, 2008

	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:						
Pak Kwan Kau	—	712	780	—	—	1,492
Donghui Wang	—	660	685	—	2,781	4,126
Non-executive directors:						
Wing Chung Anders Cheung	—	188	—	—	5	193
Tuck Lye Koh	—	64	—	—	—	64
Wai Ming Wong	—	188	—	—	—	188
Choon Chong Tay	—	178	—	—	—	178
Jun Lei	—	551	—	8	11,322	11,881
Independent non-executive directors:						
Guangming George Lu	188	—	—	—	—	188
Shun Tak Wong	239	—	—	—	—	239
Mingming Huang	188	—	—	—	—	188
	615	2,541	1,465	8	14,108	18,737

Year ended December 31, 2007

	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:						
Pak Kwan Kau	—	704	—	—	—	704
Jun Lei	—	846	808	15	19,884	21,553
Non-executive directors:						
Wing Chung Anders Cheung	—	114	—	—	24	138
Tuck Lye Koh	—	114	—	—	—	114
Wai Ming Wong	—	104	—	—	—	104
Independent non-executive directors:						
Guangming George Lu	102	—	—	—	—	102
Shun Tak Wong	102	—	—	—	—	102
Mingming Huang	82	—	—	—	—	82
	286	1,882	808	15	19,908	22,899

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

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

(b) Five highest paid individuals

The five highest paid individuals included two (2007: one) directors, details of whose remuneration are set out above. Details of the remuneration of the three (2007: four) non-director, highest paid employees for each of the years ended December 31, 2008 and 2007 are as follows:

	GROUP	
	2008 RMB'000	2007 RMB'000
Salaries, allowances and benefits in kind	1,242	2,383
Bonus	717	490
Pension plan contributions	25	16
Share-based compensation	5,932	18,079
	7,916	20,968

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

	NUMBER OF EMPLOYEES	
	2008	2007
HK\$1,500,001 to HK\$2,000,000	1	—
HK\$2,000,001 to HK\$2,500,000	1	—
HK\$3,000,001 to HK\$3,500,000	—	1
HK\$4,000,001 to HK\$4,500,000	—	1
HK\$4,500,001 to HK\$5,000,000	1	—
HK\$6,000,001 to HK\$6,500,000	—	1
HK\$7,500,001 to HK\$8,000,000	—	1

During the year ended December 31, 2008, shares were awarded to certain highest paid employees in respect of their services to the Group under the Share Award Scheme of the Company, further details of which are set out in note 6.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

8. INCOME TAX

- (a) On January 1, 2008, the People's Republic of China Corporate Income Tax Law (the "New CIT Law") became effective, after being concluded and approved during the 5th Session of the 10th National People's Congress on March 16, 2007. The New CIT Law introduces a wide range of changes which include, but are not limited to, the unification of the corporate income tax rate of 25% for domestic incorporated enterprises and foreign-invested enterprises ("FIE"), tax concessions and tax treatment on certain expenses, etc. The New CIT Law Implementation Regulations ("CITLIR") and State Council Circular GuoFa [2007] No.39 were released at the end of 2007.
- (b) In 2008, the Company's PRC subsidiaries are governed by the New CIT Law, and are subject to corporate income tax at 25%. Major subsidiaries entitled to preferential income tax rates are as follows:
- (i) Zhuhai Kingsoft Software Co., Ltd. ("Zhuhai Software"), which was certified as an important software enterprise (國家規劃佈局內重點軟件企業) in the year 2008, was entitled to enjoy a reduced tax rate of 10% for the year of 2008 on its taxable income.
 - (ii) Beijing Kingsoft Software Co., Ltd. ("Beijing Software"), as an advanced technology enterprise (高新技術企業), was entitled to enjoy a reduced tax rate of 15% for the three years from 2008.
 - (iii) Beijing Kingsoft Digital Entertainment Co., Ltd. ("Beijing Digital Entertainment"), an advanced technology enterprise, was exempted from corporate income tax for the years from 2003 to 2005, and entitled to a 50% tax reduction for the three years from 2006 to 2008.
 - (iv) As a software enterprise, Chengdu Kingsoft Interactive Entertainment Co., Ltd. ("Chengdu Interactive Entertainment") was exempted from state income tax from 2006 and 2007 and is entitled to a 50% tax reduction for the three years from 2008.
 - (v) Shenzhen Kingsoft Information Security Technology Co., Ltd. ("Kingsoft Shenzhen"), as a new software enterprise in 2008, is entitled to an exemption from corporate income tax for two years since the first profit-making year, and a 50% tax reduction for three years after then.
 - (vi) As foreign investment enterprises in the City of Zhuhai, Zhuhai Xishanju Software Co., Ltd. ("Zhuhai Xishanju"), Zhuhai Kingsoft Digital Technology Co., Ltd. ("Zhuhai Digital Technology") and Zhuhai Juntian Electronic Technology Co., Ltd. ("Zhuhai Juntian"), were entitled to enjoy a lower income tax rate in accordance with the Income Tax Law of the PRC concerning Foreign Investment and Foreign Enterprises (the "Old FIE CIT Law"). They are subject to a reduced income tax rate of 18% for the year of 2008, and their expected applicable tax rates will be 20%, 22%, 24%, and 25% for the years of 2009, 2010, 2011 and the years after 2011 respectively.
- (c) In accordance with Japanese tax laws, the income tax rate applicable to Kingsoft Japan is 40.86%.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

8. INCOME TAX (continued)

The major components of income tax expense/(credit) for the years ended December 31, 2008 and 2007 are:

	GROUP	
	2008 RMB'000	2007 RMB'000
<i>Current income tax</i>		
Current income tax charge	43,329	15,381
<i>Deferred income tax</i>		
Resulting from change in the tax rates	16,128	(15,103)
Relating to origination and reversal of temporary differences	428	(12,936)
Income tax expense/(credit) reported in the consolidated income statement	59,885	(12,658)

The reconciliation between the product of the accounting profit multiplied by the PRC's statutory tax rate and the tax expense/(credit) for the years ended December 31, 2008 and 2007 is as follows:

	GROUP	
	2008 RMB'000	2007 RMB'000
Accounting profit before tax	363,920	142,794
At the PRC statutory income tax rate of 25% (2007: 33%)	90,980	47,122
Tax holiday or lower tax rates for PRC subsidiaries	(53,801)	(89,759)
Effect on deferred tax of change in rates	16,128	(15,103)
Non-deductible expenses	11,533	41,229
Non-taxable income	(11,867)	(1,654)
Unrecognised deferred income tax assets	6,912	5,507
Income tax expense/(credit) reported in the consolidated income statement	59,885	(12,658)
Effective income tax rate	16%	(9%)

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

8. INCOME TAX (continued)

Deferred income tax relates to the following:

	CONSOLIDATED BALANCE SHEET		CONSOLIDATED INCOME STATEMENT	
	2008 RMB'000	2007 RMB'000	2008 RMB'000	2007 RMB'000
<i>Deferred income tax liabilities</i>				
Government grants	(1,525)	(7,747)	(6,222)	2,700
Deferred cost	(2,726)	(5,511)	(2,785)	2,174
Waiver of reorganisation consideration	(583)	(583)	—	108
Fair value adjustments arising from acquisition of business	(441)	—	(111)	—
Others	(2,588)	(466)	2,122	316
	(7,863)	(14,307)	(6,996)	5,298
<i>Deferred income tax assets</i>				
Property, plant and equipment	676	698	22	(219)
Deferred revenue	24,073	39,549	15,476	(29,078)
Accrued expenses	1,466	6,577	5,111	(2,043)
Provisions	2,718	3,915	1,197	(1,238)
Capitalised software costs	285	2,075	1,790	(759)
Tax losses carryforward	44	—	(44)	—
	29,262	52,814	23,552	(33,337)
Deferred income tax expense/(credit)			16,556	(28,039)

The Group has tax losses arising in the PRC and Japan of RMB24,836 thousand (2007: RMB10,892 thousand) that are available for offsetting against future taxable profits of the companies in which the losses arose.

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

	2008 RMB'000	2007 RMB'000
Tax losses	24,661	10,892
Deductible temporary differences	25,230	25,188
	49,891	36,080

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

8. INCOME TAX (continued)

The amounts and expiration dates of the tax losses carryforward at December 31, 2008 and 2007 are listed below:

EXPIRATION DATE	2008 RMB'000	2007 RMB'000
December 31, 2008	—	37
December 31, 2009	37	37
December 31, 2010	36	42
December 31, 2011	158	491
December 31, 2012	9,068	10,285
After December 31, 2012	15,362	—

9. DIVIDEND

	2008 RMB'000	2007 RMB'000
Final dividend proposed (notes a and b):		
HK\$0.15 (2007: HK\$0.1) per share based on issued share capital as at year end	141,990	95,710
Less: Dividend for shares held for share award scheme as at year end	(2,267)	—
	139,723	95,710

(a) Actual 2007 final dividend payable was RMB96,131 thousand, of which RMB421 thousand was payable for shares issued for employee share options exercised after December 31, 2007.

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

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

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

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

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

EARNINGS	2008 RMB'000	2007 RMB'000
Profit attributable to ordinary equity holders of the Company	307,501	164,678

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

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

	NUMBER OF SHARES	
	2008	2007
SHARES		
Weighted average number of ordinary shares in issued less shares held for share award scheme*	1,062,346,787	907,336,598
Effect of dilution:		
Share options	45,509,235	47,376,651
Awarded Shares	539,693	—
Weighted average number of ordinary shares for the purpose of calculating diluted earnings per share	1,108,395,715	954,713,249

The weighted average number of ordinary shares in issued for year ended December 31, 2007 has been retrospectively adjusted for the effect of the share split of the ordinary shares as set out in note 28(a).

* Weighted average number of ordinary shares in issued included ordinary shares subscribed as the issuance of the related shares is mandatory to the Company and the subscriptions were paid by subscribers.

11. PROPERTY, PLANT AND EQUIPMENT

GROUP	ELECTRONIC	OFFICE	MOTOR	LEASEHOLD	CONSTRUCTION	TOTAL
	EQUIPMENT	EQUIPMENT	VEHICLES	IMPROVEMENTS	IN PROGRESS	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At January 1, 2007, net of accumulated depreciation	24,650	1,772	1,160	5,092	116	32,790
Additions	20,842	312	—	1,730	8,143	31,027
Disposals	(186)	—	—	—	—	(186)
Depreciation charge for the year	(13,978)	(587)	(240)	(3,380)	—	(18,185)
At December 31, 2007, and January 1, 2008, net of accumulated depreciation	31,328	1,497	920	3,442	8,259	45,446
Additions	33,890	267	270	539	285,621	320,587
Acquisition from a business combination (note 32)	125	—	229	—	—	354
Disposals	(176)	—	—	—	—	(176)
Depreciation charge for the year	(16,253)	(746)	(291)	(3,295)	—	(20,585)
At December 31, 2008, net of accumulated depreciation	48,914	1,018	1,128	686	293,880	345,626

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

11. PROPERTY, PLANT AND EQUIPMENT (continued)

GROUP	ELECTRONIC EQUIPMENT RMB'000	OFFICE EQUIPMENT RMB'000	MOTOR VEHICLES RMB'000	LEASEHOLD IMPROVEMENTS RMB'000	CONSTRUCTION IN PROGRESS RMB'000	TOTAL RMB'000
AT DECEMBER 31, 2008:						
Cost	100,858	4,343	2,094	13,938	293,880	415,113
Accumulated depreciation	(51,944)	(3,325)	(966)	(13,252)	—	(69,487)
Net carrying amount	48,914	1,018	1,128	686	293,880	345,626
AT DECEMBER 31, 2007:						
Cost	68,719	4,076	1,595	13,454	8,259	96,103
Accumulated depreciation	(37,391)	(2,579)	(675)	(10,012)	—	(50,657)
Net carrying amount	31,328	1,497	920	3,442	8,259	45,446

12. GOODWILL

	RMB'000
AT JANUARY 1, 2008:	
Cost	—
Accumulated impairment	—
Net carrying amount	—
Cost at January 1, 2008, net of accumulated impairment	—
Acquisition of a business (note 32)	2,377
Cost and carrying amount at December 31, 2008	2,377
AT DECEMBER 31, 2008:	
Cost	2,377
Accumulated impairment	—
Net carrying amount	2,377

Goodwill acquired through a business combination has been allocated to the INFOGATE cash-generating unit, which is included in the reportable segment of application software, for impairment testing.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

13. OTHER INTANGIBLE ASSETS

GROUP	PURCHASED SOFTWARE RMB'000	CAPITALISED SOFTWARE COSTS RMB'000	OTHERS RMB'000	TOTAL RMB'000
At January 1, 2007	5,430	1,748	—	7,178
Addition of software costs	9,810	3,333	—	13,143
Amortisation, net	(4,947)	(1,093)	—	(6,040)
At December 31, 2007 and January 1, 2008	10,293	3,988	—	14,281
Addition of software costs	16,488	11,167	—	27,655
Net of government grants	—	(2,000)	—	(2,000)
Acquisition from a business combination (note 32)	5,670	—	5,080	10,750
Amortisation, net	(7,019)	(4,152)	(444)	(11,615)
At December 31, 2008	25,432	9,003	4,636	39,071
AT DECEMBER 31, 2008				
Cost	40,010	18,270	5,080	63,360
Accumulated amortisation	(14,578)	(9,267)	(444)	(24,289)
Net carrying amount	25,432	9,003	4,636	39,071
AT DECEMBER 31, 2007				
Cost	17,852	9,103	—	26,955
Accumulated amortisation	(7,559)	(5,115)	—	(12,674)
Net carrying amount	10,293	3,988	—	14,281

During the years ended December 31, 2008 and 2007, capitalised software costs were related to development expenditure on applications software products.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

13. OTHER INTANGIBLE ASSETS (continued)

	COMPANY	
	2008 RMB'000	2007 RMB'000
At January 1	5,615	—
Addition	—	7,304
Amortisation	(2,557)	(1,689)
At December 31	3,058	5,615
AT DECEMBER 31:		
Cost	7,304	7,304
Accumulated amortisation	(4,246)	(1,689)
Net carrying amount	3,058	5,615

The Company's intangible assets represent the purchased software.

14. LEASE PREPAYMENT

	GROUP	
	2008 RMB'000	2007 RMB'000
Carrying amount at January 1	7,304	601
Addition	—	6,827
Amortisation	(166)	(124)
Carrying amount at December 31	7,138	7,304
AT DECEMBER 31:		
Cost	7,468	7,468
Accumulated amortisation	(330)	(164)
Net carrying amount	7,138	7,304

The leasehold land is held under a long-term lease of 50 years and is situated in Zhuhai, the PRC.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

15. INTEREST IN AN ASSOCIATE

	GROUP	
	2008 RMB'000	2007 RMB'000
Share of net assets	27,077	1,014

Particulars of the associate are as follows:

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

* Indirectly held by the Company

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

	2008 RMB'000	2007 RMB'000
Assets	79,188	8,271
Liabilities	(11,496)	(5,737)
Revenue	101,361	2,292
Profit/(loss)	68,158	(6,150)

The Group received a RMB1,200 thousand interim dividend from Kingsoft Guangzhou during the year ended December 31, 2008 (2007: Nil).

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

16. INTEREST IN A JOINTLY-CONTROLLED ENTITY

	GROUP	
	2008 RMB'000	2007 RMB'000
Share of net assets	1,122	—
Goodwill — at cost	3,600	—
	4,722	—

Particulars of the jointly-controlled entity are as follows:

NAME	PLACE AND DATE OF REGISTRATION AND PLACE OF OPERATIONS	NOMINAL VALUE OF REGISTERED CAPITAL	PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE GROUP	PRINCIPAL ACTIVITIES
Beijing Kingsoft Lianking Technology Corporation Limited ("Kingsoft Lianking")	PRC June 10, 2008	RMB 6,000,600	40	Research and development of games

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

	2008 RMB'000	2007 RMB'000
SHARE OF THE JOINTLY-CONTROLLED ENTITY'S ASSETS AND LIABILITIES		
Current assets	939	—
Non-current assets	183	—
Current liabilities	—	—
Non-current liabilities	—	—
Net assets	1,122	—
SHARE OF THE JOINTLY-CONTROLLED ENTITY'S RESULT		
Revenue	—	—
Other income	—	—
	—	—
Total expenses	(1,278)	—
Tax	—	—
Loss after tax	(1,278)	—

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

16. INTEREST IN A JOINTLY-CONTROLLED ENTITY (continued)

Pursuant to the cooperative agreement, 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% equity interest of 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. In addition, 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.

17. LOAN RECEIVABLES

The loan receivables are interest-free housing loans granted to employees, which were carried at amortised cost with effective interest rates of 7.22% and 7.38% per annum during the years ended December 31, 2008 and 2007, respectively. The general terms of the loan receivables are three to five years and they are repaid monthly by employees.

18. DEFERRED COST

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

19. LONG-TERM PREPAYMENTS

	GROUP	
	2008 RMB'000	2007 RMB'000
Prepayments for investments	1,620	—
Deposit for land use right	10,000	—
	11,620	—

The long-term prepayments are unsecured and interest-free.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

20. INVENTORIES

	GROUP	
	2008 RMB'000	2007 RMB'000
Packaging materials	210	551
Packaged goods	4,476	1,375
Consignment	—	93
	4,686	2,019

The amount of the write-down of inventories recognised as an expense for the year ended December 31, 2008 was RMB1,206 thousand (2007: RMB458 thousand). This expense is included in "Other operating costs", and is disclosed in note 3.

21. TRADE RECEIVABLES

Trade receivables, which are non-interest-bearing and generally on credit terms of 30 to 90 days, are recognised and carried at original invoiced amounts less any impairment loss. An estimate for doubtful debts is made when there is objective evidence that an impairment loss on receivables has been incurred. Bad debts are written off as incurred. The Group generally does not require collateral from its customers.

An aged analysis of the Group's trade receivables as at the balance sheet dates, based on the invoice date, is as follows:

	GROUP	
	2008 RMB'000	2007 RMB'000
0-30 days	60,032	51,147
31-60 days	7,408	1,141
61-90 days	9,715	1,926
91-365 days	6,348	2,555
Over one year	1,316	3,457
	84,819	60,226

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	GROUP	
	2008	2007
	RMB'000	RMB'000
Government grants receivable	6,033	5,830
Prepaid license fee	9,889	9,889
Prepaid corporate income tax	3,681	3,980
Value-added tax receivable	3,449	10,427
Prepaid value-added tax	478	691
Advances to staff	6,031	3,317
Deposits	10,076	3,783
Accrued interest income	6,767	5,056
Advances to suppliers	2,778	172
Deposits for construction project	2,580	2,580
Prepaid expenses	2,237	1,457
Other current assets	1,139	561
	55,138	47,743

	COMPANY	
	2008	2007
	RMB'000	RMB'000
Accrued interest income	11	1,227
Prepaid expenses	458	394
Other current assets	19	—
Total	488	1,621

23. CREDIT-LINKED DEPOSIT

At December 31, 2008, the Group held asset in the form of a credit-linked deposit. The Group placed deposit with a financial institution and the deposit was credit-linked to debt securities ("reference securities") issued by other entities ("reference entities"). The ultimate repayment of the deposit is dependent on the occurrence of credit event, such as bankruptcy or default by the reference entities. In addition, as those reference securities may be denominated in a currency other than the principal amount of the credit-linked deposit, the credit-linked deposit may also contain cross-currency swap. The Group can receive deposit interests periodically under a predetermined rate. If a credit event occurs, the Group may suffer a loss on its credit-linked deposit because the financial institution can terminate the interest payment and settle the Group's credit-linked deposit with cash received from the sale of the reference securities, if any, or by transferring the reference securities to the Group.

As the Group managed and evaluated the performance of the individual credit-linked deposit on a fair value basis, credit-linked deposit is considered as a financial asset at fair value through profit or loss and is measured at fair value at each reporting date with changes in fair value recorded in the consolidated income statement.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

23. CREDIT-LINKED DEPOSIT (continued)

The details of the credit-linked deposit held by the Group at the balance sheet date are disclosed as follows:

As at December 31, 2008

CREDIT-LINKED DEPOSIT REFERENCED TO	PRINCIPAL AMOUNT	DUE DATE	FAIR VALUE AND CARRYING VALUE RMB'000
Bank of Korea 4.94% Monetary Stabilisation Bonds	HK\$123,377 thousand	January 10, 2009	111,708

As at December 31, 2007

The Group did not hold any credit-linked deposit as at December 31, 2007.

24. CASH AND CASH EQUIVALENTS

	GROUP	
	2008 RMB'000	2007 RMB'000
Cash and bank balances	219,080	171,801
Time deposits with original maturity of three months or less when acquired	397,875	717,121
	616,955	888,922
Time deposits with original maturity of over three months when acquired	390,160	357,155
	1,007,115	1,246,077

	COMPANY	
	2008 RMB'000	2007 RMB'000
Cash and bank balances	49,678	16,649
Time deposits	105,926	666,421
	155,604	683,070

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

24. CASH AND CASH EQUIVALENTS (continued)

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and a year depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. The carrying amounts of the cash and cash equivalents as at December 31, 2008 and 2007 approximate to their fair values.

At the balance sheet date, the cash and bank balances of the Group denominated in RMB amounted to RMB809,953 thousand (2007: RMB537,006 thousand). 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.

25. TRADE PAYABLES

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

	GROUP	
	2008 RMB'000	2007 RMB'000
0-30 days	4,813	2,328
31-60 days	223	1,307
61-90 days	224	1,192
91-365 days	580	773
Over one year	1,809	1,520
	7,649	7,120

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

26. ACCRUED EXPENSES AND OTHER PAYABLES

	GROUP	
	2008 RMB'000	2007 RMB'000
Deposits received from customers	12,616	10,621
Staff costs and welfare accruals	50,009	41,385
Marketing and administrative expense accruals	48,393	72,125
Other taxes payable	14,296	19,118
Payable for property, plant and equipment	29,369	—
Others	6,289	3,813
	160,972	147,062

Other payables are non-interest-bearing.

The Company's accruals are related to administrative expenses.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

27. DEFERRED REVENUE

	GROUP	
	2008	2007
	RMB'000	RMB'000
Entertainment software	119,536	82,055
Applications software	83,225	105,016
Government grants	11,863	4,657
	214,624	191,728
Less: Current portion	(183,445)	(162,002)
Non-current portion	31,179	29,726

28. AUTHORISED AND ISSUED CAPITAL

	GROUP AND COMPANY	
	2008	2007
	RMB'000	RMB'000
Authorised:		
2,400,000,000 (2007: 2,400,000,000) ordinary shares of US\$0.0005 each	9,260	9,260
Issued and fully paid:		
1,073,366,708 (2007: 1,061,726,020) ordinary shares of US\$0.0005 each	4,362	4,322

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

28. AUTHORISED AND ISSUED CAPITAL (continued)

During the years ended December 31, 2007 and 2008, the movements in 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 January 1, 2007		43,065,777	3,564	110,539	—	114,103
Exercise of share options granted before share split		4,000	—	21	—	21
Share split at 1:20	(a)	818,325,763	—	—	—	—
Issuance of shares	(b)	198,823,800	752	693,183	—	693,935
Exercise of share options granted after share split		1,506,680	6	786	—	792
Share issuance expenses	(c)	—	—	(69,019)	—	(69,019)
At December 31, 2007 and January 1, 2008		1,061,726,020	4,322	735,510	—	739,832
Issuance of share certificates for ordinary shares subscribed		895,000	3	316	—	319
Share options exercised		10,745,688	37	10,190	—	10,227
Capital contribution from equity holders	(d)	—	—	32,741	—	32,741
Proposed final 2008 dividend		—	—	(139,723)	—	(139,723)
Purchase of shares held for share award scheme	(e)	(17,138,000)	—	—	(40,050)	(40,050)
AT DECEMBER 31, 2008		1,056,228,708	4,362	639,034	(40,050)	603,346

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

28. AUTHORISED AND ISSUED CAPITAL (continued)

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

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

- (b) The Company's shares have been listed on the Stock Exchange since October 9, 2007. The initial public offering consisted of 213,337,000 shares, among which 198,823,800 shares were newly issued by the Company and 14,513,200 shares were offered by Lenovo Manufacturing Limited ("Lenovo"), an existing shareholder. The net proceeds from the listing were approximately HK\$649,083 thousand and were fully received on October 9, 2007.
- (c) Transaction costs amounted to RMB69,019 thousand that relate to the issue of new shares, which is mentioned in note (b) above, are recorded as a reduction of share premium.
- (d) On August 18, 2006, 3,571,429 shares of US\$0.01 each were issued for cash at a subscription price of US\$4.00 per share (the "Share Subscription and Purchase Agreement"). Pursuant to the Share Subscription and Purchase Agreement, the purchase price for the newly issued shares is subject to a future upward adjustment if the adjusted audited 2007 net profit of the Group exceeds US\$25,000 thousand according to a predetermined formula, with a cap at US\$5.60.

In April 2008, based on the audited financial statements of the Company for the year ended December 31, 2007, the purchase price was adjusted from US\$4.0 per share to US\$5.6 per share less the portion of IPO expenses to be paid by the Pre-IPO Investors on April 29, 2008. In accordance with the Share Subscription and Purchase Agreement, Pre-IPO Investors paid HK\$36,854 thousand (approximately RMB32,741 thousand) to the Company as an additional contribution to the Company.

- (e) The Company adopted the Share Award Scheme in 2008, as set out in note 6(b). During the year, the Share Award Scheme Trust acquired 17,138,000 shares of the Company through purchases on the open market for the Share Awarded Scheme. The total cost (including related transaction costs) was approximately RMB40,050 thousand, and has been deducted from shareholders' equity.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

29. SEGMENT INFORMATION

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

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

- (a) the entertainment software segment provides online game, mobile game and casual game services;
- (b) the applications software segment engages in the research, development and distribution of internet security software, dictionary software and office applications software products; and
- (c) the "others" segment comprises principally the Group's software consultancy services and advertising services.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. Over 90% of the Group's assets are located in the Mainland China and Hong Kong as at December 31, 2008.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

29. SEGMENT INFORMATION (continued)

(a) Business segments

	ENTERTAINMENT SOFTWARE RMB'000	APPLICATIONS SOFTWARE RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
YEAR ENDED DECEMBER 31, 2008					
REVENUE					
Sales to external customers	553,723	261,150	6,071	—	820,944
TOTAL REVENUE	553,723	261,150	6,071	—	820,944
RESULTS					
Segment results	340,155	106,454	6,071	—	452,680
Unallocated expenses					(145,767)
Finance income					31,022
Share of profit of an associate	27,263	—	—	—	27,263
Share of loss of a jointly-controlled entity	(1,278)	—	—	—	(1,278)
Profit before tax					363,920
Income tax expense					(59,885)
PROFIT FOR THE YEAR					304,035
AS AT DECEMBER 31, 2008					
ASSETS AND LIABILITIES					
Segment assets	753,261	536,664	—	—	1,289,925
Interest in an associate	27,077	—	—	—	27,077
Interest in a jointly-controlled entity	4,722	—	—	—	4,722
Corporate and other unallocated assets					417,499
TOTAL ASSETS					1,739,223
Segment liabilities	127,657	119,782	—	—	247,439
Corporate and other unallocated liabilities					163,419
TOTAL LIABILITIES					410,858
OTHER SEGMENT INFORMATION					
DEPRECIATION AND AMORTIZATION:					
Depreciation and amortization	11,641	15,566	—	—	27,207
Corporate and other unallocated amounts					5,159
TOTAL DEPRECIATION AND AMORTISATION					32,366
CAPITAL EXPENDITURE:					
Tangible assets	173,207	146,842	—	—	320,049
Intangible assets	1,837	27,227	—	—	29,064
Other unallocated amounts					9,879
TOTAL CAPITAL EXPENDITURE					358,992
Impairment loss recognised in the income statement	137	1,069	—	—	1,206
Write-off of receivables	—	102	—	—	102

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

29. SEGMENT INFORMATION (continued)

(a) Business segments (continued)

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

29. SEGMENT INFORMATION (continued)

(b) Geographical segments

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

	MAINLAND CHINA AND HONG KONG RMB'000	OTHERS RMB'000	ELIMINATIONS RMB'000	CONSOLIDATED RMB'000
YEAR ENDED DECEMBER 31, 2008				
SEGMENT REVENUE				
Sales to external customers	722,029	98,915	—	820,944
OTHER SEGMENT INFORMATION				
Segment assets	1,697,609	41,614	—	1,739,223
Capital expenditure	358,275	717	—	358,992
YEAR ENDED DECEMBER 31, 2007				
SEGMENT REVENUE				
Sales to external customers	481,676	74,938	—	556,614
OTHER SEGMENT INFORMATION				
Segment assets	1,468,478	31,443	—	1,499,921
Capital expenditure	49,897	1,100	—	50,997

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

	COMPANY	
	2008 RMB'000	2007 RMB'000
		(Restated)
Unlisted shares, at cost	19,073	54,993
Capital contribution in respect of employee share-based compensation	147,278	111,596
	166,351	166,589

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

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

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

	NOTES	COUNTRY OF INCORPORATION/ REGISTRATION AND OPERATIONS	NOMINAL VALUE OF ISSUED ORDINARY/ REGISTERED SHARE CAPITAL	PERCENTAGE OF EQUITY INTEREST ATTRIBUTABLE TO THE COMPANY AS AT DECEMBER 31, 2008
Zhuhai Digital Technology		PRC	RMB198,048,000	100
Zhuhai Juntian		PRC	RMB18,952,000	100
Zhuhai Software		PRC	RMB215,500,000	100
Beijing Software		PRC	RMB10,000,000	100
Beijing Digital Entertainment	(a)	PRC	RMB10,000,000	100
Zhuhai Xishanju		PRC	RMB2,200,000	100
Kingsoft Japan		Japan	JPY447,875,000	51
Kingsoft Dalian		PRC	RMB30,000,000	80
Chengdu Kingsoft Digital Entertainment Co., Ltd. ("Chengdu Digital Entertainment")	(b)	PRC	RMB10,000,000	100
Chengdu Interactive Entertainment		PRC	RMB100,000,000	100
Beijing Kingsoft Qijian Digital Technology Co., Ltd. ("Kingsoft Qijian")	(a)	PRC	RMB1,500,000	100
Kingsoft Entertainment Software Corporation Limited ("Kingsoft Entertainment")		Hong Kong	HK\$1	100
Kingsoft Application Software Holdings Limited ("Kingsoft Application Holdings")		Cayman Islands	HK\$1	100
Kingsoft Application Software Corporation Limited ("Kingsoft Application")		Hong Kong	HK\$1	100
Kingsoft Shenzhen		PRC	RMB20,000,000	100
Kingsoft (M) SDN. BHD ("Kingsoft Malaysia")		Malaysia	MYR1,000,000	100

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

- (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. The loans are secured by the respective equity interests of the equity holders in Kingsoft Qijian. Besides, Chengdu Interactive Entertainment has been granted an exclusive irrevocable option to purchase the equity interests in Kingsoft Qijian held by Kingsoft Qijian's equity holders. Kingsoft Qijian's equity holders entrusts all of their respective voting rights in Kingsoft Qijian to Chengdu Interactive Entertainment. Kingsoft Qijian's equity holders give up the dividends in Kingsoft Qijian and Chengdu Interactive Entertainment is entitled to dividends if Kingsoft Qijian declares dividend. The Company has rights to obtain the majority of the benefits from Kingsoft Qijian's operations, and therefore may be exposed to risk incident to the activities of Kingsoft Qijian. Accordingly, Kingsoft Qijian is accounted for as a subsidiary by virtue of the Company's control over it.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

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

Kingsoft Qijian wholly owns Beijing Digital Entertainment. Further to the contractual arrangements stated in the above paragraph, Beijing Digital Entertainment entered into license agreement with Zhuhai Software and the Company, via Zhuhai Software, has rights to obtain the majority of the benefits from Beijing Digital Entertainment's operations. Therefore, the Company may be exposed to risk incident to the activities of Beijing Digital Entertainment. Accordingly, Beijing Digital Entertainment continues to be accounted for as a subsidiary by virtue of the Company's control over it.

- (b) As at December 31, 2008, Chengdu Digital Entertainment is 99% owned by Beijing Digital Entertainment, which is accounted for as subsidiary as detailed in note (a) above. The minority equity holder of Chengdu Digital Entertainment borrowed a loan from Chengdu Interactive Entertainment for its investment in Chengdu Digital Entertainment and the loan is secured by its equity interests in Chengdu Digital Entertainment. Chengdu Interactive Entertainment is granted an exclusive call option to buy at its sole discretion at any time part or all of the equity holding held by the minority equity holder in Chengdu Digital Entertainment. During the pledge period, the minority equity holder forfeits the right to dividend from Chengdu Digital Entertainment and Chengdu Interactive Entertainment is entitled to this portion of dividend from Chengdu Interactive Entertainment. Chengdu Digital Entertainment entered into license agreement with Chengdu Interactive Entertainment and the Company, via Chengdu Interactive Entertainment, has rights to obtain the majority of the benefits from Chengdu Digital Entertainment's operations, and therefore may be exposed to risk incident to the activities of Chengdu Digital Entertainment. Accordingly, Chengdu Digital Entertainment is accounted for as a subsidiary by virtue of the Company's control over it.

31. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the year ended December 31, 2008 are presented in the consolidated statement of changes in equity.

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

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

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

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

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

31. RESERVES (continued)

(b) Company

	NOTES	SHARE PREMIUM RMB'000	EMPLOYEE SHARE-BASED CAPITAL RESERVE RMB'000	FOREIGN CURRENCY TRANSLATION RESERVE RMB'000	ACCUMULATED LOSSES RMB'000	TOTAL RMB'000
AT JANUARY 1, 2007						
As previously reported		110,539	40,160	(3,656)	(53,025)	94,018
Prior year adjustment	2	—	—	—	27,218	27,218
As restated		110,539	40,160	(3,656)	(25,807)	121,236
Exchange realignment		—	—	(31,442)	—	(31,442)
Total income and expense for the year recognised directly in equity		—	—	(31,442)	—	(31,442)
Loss for the year (as restated)	2	—	—	—	(3,994)	(3,994)
Total income and expense for the year		—	—	(31,442)	(3,994)	(35,436)
Exercise of share options		807	—	—	—	807
Share-based compensation costs		—	104,073	—	—	104,073
Issuance of shares		693,183	—	—	—	693,183
Share issuance expenses	28(c)	(69,019)	—	—	—	(69,019)
Proposed final 2007 dividend	9	—	—	—	(95,710)	(95,710)
AT DECEMBER 31, 2007 (restated)						
		735,510	144,233	(35,098)	(125,511)	719,134
AT JANUARY 1, 2008						
		735,510	144,233	(35,098)	(125,511)	719,134
Exchange realignment		—	—	(35,607)	—	(35,607)
Total income and expense for the year recognised directly in equity		—	—	(35,607)	—	(35,607)
Loss for the year		—	—	—	(13,421)	(13,421)
Total income and expense for the year		—	—	(35,607)	(13,421)	(49,028)
Issuance of share certificates for ordinary shares subscribed		316	—	—	—	316
Dividend on shares issued for employee share options exercised after December 31, 2007		—	—	—	(421)	(421)
Contribution from shareholders		32,741	—	—	—	32,741
Exercise of share options		10,190	—	—	—	10,190
Share-based compensation costs		—	49,790	—	—	49,790
Proposed final 2008 dividend	9	(139,723)	—	—	—	(139,723)
AT DECEMBER 31, 2008						
		639,034	194,023	(70,705)	(139,353)	622,999

The consolidated profit attributable to equity holders of the Company for the year ended December 2008 includes a loss of RMB13,421 thousand (2007 (restated): RMB3,994 thousand) which has been dealt with in the financial statements of the Company.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

32. BUSINESS COMBINATION

On July 31, 2008, the Group acquired the business of Shenzhen Zhaoshangzhuoer Infogate Co., Ltd. ("Shenzhen ZSZE"), an unlisted company specialising in the manufacture of Unified Threat Management ("UTM") defence system products. According to the acquisition contract, the business acquired was defined as "INFOGATE Business". The purchase consideration for the acquisition was in the form of cash, of RMB14,520 thousand.

The fair values of the identifiable assets of the INFOGATE Business as at the date of acquisition and the corresponding carrying amounts immediately before the acquisition were as follows:

	NOTES	FAIR VALUE RECOGNISED ON ACQUISITION RMB'000	PREVIOUS CARRYING AMOUNT RMB'000
Property, plant and equipment	11	354	544
Inventories		1,591	1,865
Software	13	5,670	1,210
Other intangible assets	13	5,080	—
Deferred income tax liabilities		(552)	—
NET ASSETS		12,143	<u>3,619</u>
Goodwill on acquisition	12	2,377	
TOTAL CONSIDERATION, SATISFIED BY CASH		<u>14,520</u>	

An analysis of net outflow of cash equivalents in respect of the acquisition of business is as follows:

	RMB'000
Cash consideration	14,520
Cash and bank balances acquired	—
NET CASH OUTFLOW OF CASH AND CASH EQUIVALENTS IN RESPECT OF THE ACQUISITION OF BUSINESS	<u>14,520</u>

Since the acquisition of INFOGATE Business, it contributed RMB2,963 thousand to the Group's turnover and led to a loss of RMB1,725 thousand to the Group for the year ended December 31, 2008.

Had the combination taken place at the beginning of the year, the revenue of the Group and the profit of the Group for the year would have been RMB823,409 thousand and RMB303,550 thousand, respectively.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

33. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENTS

Supplemental cash flow information

	2008 RMB'000	2007 RMB'000
Cash received from interest	26,409	17,719
Cash paid for income tax	(23,966)	(2,357)

34. COMMITMENTS

Operating lease commitments — Group as lessee

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

	GROUP	
	2008 RMB'000	2007 RMB'000
Within one year	29,284	15,273
After one year but not more than five years	3,560	1,138
	32,844	16,411

As at December 31, 2008, some of the operating lease arrangements for electronic equipment provided for the calculation of lease payments were based on the actual number of users of the relevant servers. The rental expense under these operating leases was RMB4,991 thousand for the year ended December 31, 2008 (2007: RMB403 thousand). As future lease payments for these arrangements are based on the actual number of users and thus cannot be reasonably estimated, they are not included in the minimum lease payments shown above.

Capital commitments

		GROUP	
	NOTES	2008 RMB'000	2007 RMB'000
Contracted, but not provided for:			
Purchase of electronic equipment		5,219	3,230
Acquisition of land and buildings	(a)	1,074,710	18,804
Investment	(b)	63,787	—
Acquisition of intangible assets		1,998	—
Total		1,145,714	22,034

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

34. COMMITMENTS (continued)

Capital commitments (continued)

	NOTE	COMPANY	
		2008 RMB'000	2007 RMB'000
Contracted, but not provided for:			
Investment	(b)	56,037	—

- (a) The capital commitment for land and buildings mainly represented the commitment to purchase a land use right in Zhuhai. The total consideration was RMB38,738 thousand, among which the Group paid RMB10,000 thousand as deposit, and the remaining RMB28,738 thousand will be paid in 2009. In addition, the Group will invest an aggregate of RMB1,000,000 thousand in five years in the construction on the land according to the land acquisition agreement.
- (b) The capital commitment for investment mainly comprised a contracted acquisition of US\$8,000 thousand (equivalent to approximately RMB54,677 thousand) as set out in note 35(b)(ii).

The Company has entered into an agreement to contribute US\$199 thousand (equivalent to RMB1,360 thousand) for 19.9% interest in Kim Quang Software and Technology Joint Stock Company, a company engaged in software business in Vietnam. The transaction has not been completed as of December 31, 2008.

Moreover, the Group was contracted to acquire a 19.9% interest in Shanghai Zhixiong Network Technology Co., Ltd. ("Shanghai Zhixiong"), a company specified in research and development of online games in PRC, at a total consideration of RMB4,970 thousand. The Group has paid RMB1,420 thousand as at December 31, 2008.

The Group also entered into an agreement to acquire 19.9% interest in Guangzhou Tuotu Technology Co., Ltd, a company engaged in research and development of download software business, for a total consideration of RMB400 thousand. The Group has paid RMB200 thousand as at December 31, 2008.

In addition to the Group's investment in Kingsoft Lianking, the Group will pay an additional RMB4,000 thousand in aggregate to Kingsoft Lianking upon the fulfillment of the predetermined condition by Kingsoft Lianking.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

35. RELATED PARTY DISCLOSURES

- (a) The following table provides the total amounts of material transactions, which have been entered into with related parties during the years ended December 31, 2008 and 2007.

	NOTES	GROUP	
		2008 RMB'000	2007 RMB'000
Sales to related parties:			
Entity with significant influence over a non-wholly owned subsidiary		—	4,359
Entity with a significant interest held by a shareholder's family member	(i)	35	—
Total		35	4,359
Purchase from related parties:			
Entity controlled by key management personnel of the Company	(i)	59	279
Entity significantly influenced by key management personnel of the Company		182	—
Total		241	279
Transaction costs related to the sale of issued ordinary shares by existing shareholders	(ii)	—	9,862
	NOTES	COMPANY	
		2008 RMB'000	2007 RMB'000
Transaction costs related to the sale of issued ordinary shares by existing shareholders	(ii)	—	9,862
	NOTES	GROUP AND COMPANY	
		2008 RMB'000	2007 RMB'000
Due from related parties:			
Shareholders and directors of the Company	(ii)	—	9,862
Total		—	9,862

- (i) These related party transactions also constitute continuing connected transactions as defined in Chapter 14A of the Rules Governing the Listing of Securities on the Main Board of the Stock Exchange ("the Listing Rules").
- (ii) The balance as at December 31, 2007 represented the IPO expenses allocated to Lenovo, New Horizon Goldensoft Investment Co., Ltd. ("New Horizon"), Super Faith International Limited ("Super Faith") and Tetrad Ventures Pte. Ltd. ("Tetrad") (collectively known as the "Selling Shareholders"). Before the IPO, the Company and the Selling Shareholders entered into an agreement, according to which, the IPO expenses should be borne by each of the Company and the Selling Shareholders in proportions according to the percentage of shares issued or sold in the IPO and the over-allotment. As of December 31, 2008, the four Selling Shareholders have paid their portions of IPO expenses to the Company.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

35. RELATED PARTY DISCLOSURES (continued)

Terms and conditions of transactions with related parties

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

(b) Other transactions with related parties:

- (i) On May 27, 2008, the Group entered into an agreement with Dalian Shang Shang Wang Digital Technology & Co., Ltd. ("Dalian SSW"), pursuant to which the Group acquired a further 29.4% equity interest in online-games developer, Kingsoft Dalian, (a 51% held subsidiary of the Group prior to the transaction), from Dalian SSW at a total cash consideration of RMB30,300 thousand. With the completion of the transaction, Kingsoft Dalian has become an 80.4% owned subsidiary of the Group.
- (ii) On December 18, 2008, the Company entered into an agreement with Sky Profit Limited ("Sky Profit") and its subsidiaries (collectively, the "Sky Profit Group"), its shareholders, and Shanghai Qinhe Internet Technology Software Development Co., Ltd. and Shanghai Qiao Heng Internet Technology Co., Ltd., the latter two are effectively controlled by the Sky Profit Group (collectively, the "Sky Profit Companies") through control contract arrangements. Pursuant to the aforesaid agreement, (1) the Company shall acquire, in two tranches of subscription, preferred shares of Sky Profit (representing in aggregate approximately 30.03% of the entire enlarged issued share capital of Sky Profit) at a total consideration of US\$8,000 thousand; and (2) the Company shall enter into a strategic business partnership arrangement with the Sky Profit Companies, for purposes of mutual promotion and expansion.

Since a substantial shareholder of Sky Profit is Jun Lei (a substantial shareholder and non-executive director of the Company) who, as a non-executive director of the Company, falls within the definition of a controller of the Company under the Listing Rules, the acquisition constituted a connected transaction under Chapter 14A of the Listing Rules.

The above transaction had not completed as at December 31, 2008.

(c) Compensation of key management personnel of the Group:

	GROUP	
	2008 RMB'000	2007 RMB'000
Salaries, allowances and benefits in kind	6,702	9,047
Pension plan contributions	48	80
Share-based compensation costs	11,284	46,225
Total compensation paid to key management personnel	18,034	55,352

Further details of the directors' remuneration are included in note 7.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

36. FINANCIAL INSTRUMENTS BY CATEGORY

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

	GROUP				
	DESIGNATE AS FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION RMB'000	2008		2007	
		LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000
FINANCIAL ASSETS					
Loan receivables	—	2,520	2,520	1,784	1,784
Trade receivables	—	84,819	84,819	60,226	60,226
Financial assets included in prepayments and other receivables	—	25,456	25,456	27,676	27,676
Due from related parties		—	—	9,862	9,862
Credit-linked deposit	111,708	—	111,708	—	—
Cash and cash equivalents	—	1,007,115	1,007,115	1,246,077	1,246,077
Total	111,708	1,119,910	1,231,618	1,345,625	1,345,625

	GROUP	
	2008 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	2007 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000
FINANCIAL LIABILITIES		
Trade payables	7,649	7,120
Financial liabilities included in accrued expenses and other payables	112,678	117,351
Total	120,327	124,471

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

36. FINANCIAL INSTRUMENTS BY CATEGORY (continued)

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

FINANCIAL ASSETS	COMPANY				
	2008			2007	
	DESIGNATE AS FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS UPON INITIAL RECOGNITION RMB'000	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000	LOANS AND RECEIVABLES RMB'000	TOTAL RMB'000
Financial assets included in prepayments and other receivables	—	11	11	1,227	1,227
Due from related parties	—	—	—	9,862	9,862
Due from subsidiaries	—	319,967	319,967	—	—
Credit-linked deposit	111,708	—	111,708	—	—
Cash and cash equivalents	—	155,604	155,604	683,070	683,070
Total	111,708	475,582	587,290	694,159	694,159

FINANCIAL LIABILITIES	COMPANY	
	2008 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000	2007 FINANCIAL LIABILITIES AT AMORTISED COST RMB'000
Financial liabilities included in accrued expenses and other payables	1,072	13,879
Due to subsidiaries	28,936	33,298
Total	30,008	47,177

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

(i) Financial risk management objectives and policies

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

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

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

(ii) Liquidity risk

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

The Group recorded net cash inflows from operating activities of approximately RMB381,472 thousand and RMB345,474 thousand for the years ended December 31, 2008 and 2007. For the same period, the Group had net cash outflows from investing activities of approximately RMB520,533 thousand and RMB395,659 thousand, respectively. The Group also recorded net cash outflow from financing activities of approximately RMB97,073 thousand and inflow RMB647,412 thousand for the years ended December 31, 2008 and 2007, respectively.

The Group recorded a decrease in cash and cash equivalents of approximately RMB236,134 thousand and an increase of RMB597,227 thousand for the years ended December 31, 2008 and 2007, respectively.

The contractual maturity of financial liabilities including trade payables has been disclosed in note 25. For trade payables, they are generally on credit terms of two to three months after the invoice date. For accrued expenses and other payables, there are generally no specified contractual maturity for these liabilities, and they are paid on a regular basis or upon counterparty's formal notification.

With regard to 2008 and thereafter, the liquidity of the Group is primarily dependent on its ability to maintain a balance between a continuity of funding and flexibility through the settlements from clients and the subsequent payments to vendors.

(iii) Foreign currency risk

Certain expenses of the Group are denominated in currencies other than the RMB. The Group generates foreign currency revenue from license sales made in other Asian countries. The exchange rates of RMB against US\$, HK\$, JPY and MYR have been comparatively stable in the past.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(iii) Foreign currency risk (continued)

A majority of the Group's businesses are transacted in RMB, which is not freely convertible into foreign currencies. On January 1, 1994, the PRC government abolished the dual rate system and introduced a single rate of exchange as quoted daily by the People's Bank of China. However, the unification of the exchange rates does not imply the free convertibility of RMB into US\$ or other foreign currencies. All foreign exchange transactions continue to take place either through the People's Bank of China or other banks authorised to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

Commencing on July 21, 2005, PRC reformed its exchange rate regime by changing to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Under the managed floating exchange rate regime, the RMB is no longer pegged to the US\$. The exchange rate of US\$ against RMB was adjusted to RMB8.11 per US\$ as at July 21, 2005, representing an appreciation of approximately 2%.

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

	Increase/ (Decrease) In Profit Before Tax RMB'000	Increase/ (Decrease) In Equity RMB'000
2008		
If RMB strengthens 5% against HK\$	(349)	(9,953)
If RMB weakens 5% against HK\$	349	9,953
If RMB strengthens 5% against US\$	(971)	(5,000)
If RMB weakens 5% against US\$	971	5,000
If RMB strengthens 5% against JPY	—	(971)
If RMB weakens 5% against JPY	—	971
If RMB strengthens 5% against MYR	—	(65)
If RMB weakens 5% against MYR	—	65
2007		
If RMB strengthens 5% against HK\$	—	(34,314)
If RMB weakens 5% against HK\$	—	34,314
If RMB strengthens 5% against US\$	(955)	(2,909)
If RMB weakens 5% against US\$	955	2,909
If RMB strengthens 5% against JPY	—	(513)
If RMB weakens 5% against JPY	—	513

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(iv) Interest rate risk

The Group's earnings are affected by changes in interest rates due to the impact of such changes on interest income from interest-bearing financial assets. The Group's interest-bearing financial assets are predominately denominated in RMB. The Group's financial assets comprised primarily of cash deposits with fixed interest rates and loans and receivables, and the Group does not have any interest-bearing debt obligations as of December 31, 2008. Therefore, the Group considers that the exposure to interest rate risks is insignificant.

(v) Credit risk

The Group places its cash deposits with banks in the PRC. This investment policy limits the Group's exposure to concentration of credit risk. The Group performs ongoing credit evaluations of its customers' financial conditions. With respect to credit risk arising from other financial assets of the Group, comprising loan receivables, trade receivables, and other receivables, the Group's exposure to credit risk arises from default of the counterparties, with a maximum exposure equal to the carrying amounts of these instruments. Concentration of credit risk with respect to trade receivables is limited due to the large number of entities comprising the Group's customer base. The Group generally does not require collateral for trade receivables.

The Group determines concentration of credit risk by monitoring the business and location of its counterparties. At the balance sheet date, the Group has certain concentrations of credit risk as 34% (2007: 26%) of the Group's trade receivables were due from the Group's largest distributor.

For trade receivables that were past due but not impaired 85% and 69% were aged within one year as at December 31, 2008 and 2007, respectively. The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(vi) Fair values

Financial assets of the Group mainly include cash and cash equivalents, credit-linked deposit, trade receivables, other receivables, loan receivables and an amount due from related parties. Financial liabilities of the Group mainly include trade payables, accrued expenses and other payables.

The carrying amounts of the Group's financial instruments approximate to their fair values as at balance sheet date. Fair value estimates are made at a specific point in time and are based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

NOTES TO FINANCIAL STATEMENTS (continued)

December 31, 2008

37. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(vii) Capital management

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

	GROUP	
	2008 RMB'000	2007 RMB'000
Cash and cash equivalents	1,007,115	1,246,077
Trade payables	(7,649)	(7,120)
Accrued expenses and other payables	(160,972)	(147,062)
Net cash over debt position	838,494	1,091,895

38. POST BALANCE SHEET EVENTS

- (a) The Company acquired 21.42% preferred shares of Sky Profit at a consideration of US\$5,150 thousand in January 2009, pursuant to the agreement entered into with Sky Profit Companies and Sky Profit shareholders as set out in note 35(b)(ii). According to the agreement, the Company shall pay an additional US\$2,850 thousand, to acquire upto an aggregate 30.03% interest in the share capital of Sky Profit, and shall enter into a strategic business partnership arrangement with the Sky Profit Companies.
- (b) Pursuant the agreement entered into with Shanghai Zhixiong and its shareholders as set out in note 34(b), the Group acquired 6.63% equity interest of Shanghai Zhixiong, at a consideration of RMB1,420 thousand. The transaction was completed in January 2009. The Group shall pay an additional RMB3,550 thousand to acquire an aggregate 19.9% equity interest of Shanghai Zhixiong.

39. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on March 31, 2009.