

RISK FACTORS

[REDACTION] in our Shares involves risks. Before deciding to [REDACTION] in the Shares, [REDACTION] should carefully consider all of the information in [REDACTION], including the following risk factors, in light of the circumstances and [REDACTION] own [REDACTION] objectives. The occurrence of any of the following events could materially and adversely affect our business, financial condition and results of operations, in which case the [REDACTION] of our Shares could also decline, and [REDACTION] could lose part or all of [REDACTION] [REDACTION]. Additional risks and uncertainties that are not presently known to us or that we currently deem to be immaterial could also materially and adversely affect our business, financial condition and results of operations. [REDACTION] should pay particular attention to the fact that we are a company incorporated in the Cayman Islands and that our principal operations are conducted in China and are governed by a legal and regulatory environment that may differ significantly from that of other countries.

There are certain risks and uncertainties involved in our operations, many of which are beyond our control. We have categorized these risks and uncertainties into: (i) risks related to our business; (ii) risks related to our Contractual Arrangements; (iii) risks related to our industry; (iv) risks related to the PRC; and (v) risks related to the [REDACTION].

RISKS RELATED TO OUR BUSINESS

Our limited operating history makes it difficult to evaluate our business and growth prospects.

Our operations commenced in September 2008 when we open beta launched our first virtual world, Aobi Island. We have experienced rapid growth in the number of virtual worlds offered on our platform, active and active paying accounts, and revenue during the Track Record Period. However, our historical growth may not be indicative of our future performance. Our growth prospects should be considered in light of the risks and uncertainties that fast-growing companies with limited operating histories in our industry may encounter, including, among others, risks and uncertainties regarding our ability to:

- retain existing users and attract new users;
- develop additional virtual worlds and content that are appealing to users and commercially successful;
- develop e-learning and other products that are appealing to users and commercially successful;
- maintain loyalty among our users and gain trust from their parents;
- anticipate and adapt to changing user preferences, industry trends and increasing competition;
- integrate new devices, platforms and operating systems and take advantage of any growth in these markets;
- manage our increasing size, including controlling our costs, establish sufficient internal controls, attract and retain talent, as well as maintain and upgrade our network infrastructure and information technology system; and
- effectively maintain our net profit margin on an IFRS basis, which is affected by factors including revenue growth, research and development investment, labor costs and share-based compensation expense.

If we are unable to effectively manage these risks and uncertainties, our business operations and growth prospects may be materially and adversely affected.

We operate a limited number of virtual worlds, which contribute to substantially all of our revenue. If any of our virtual worlds have any adverse developments or if we are unable to develop additional virtual worlds or games that are attractive to users and can contribute to our overall revenue growth, our financial condition, results of operations and growth prospects may be materially and adversely affected.

We currently operate six virtual worlds, all of which are under commercial operation. Our virtual worlds have historically contributed to substantially all of our revenue, and we anticipate that they will continue to do so in

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the near term. Accordingly, any of the following could materially and adversely affect our business, financial condition and results of operations:

- our failure to maintain or grow the user base of these existing virtual worlds due to intensifying competition, changing user preferences or other factors that decrease the popularity of these virtual worlds;
- our failure to convert registered users into paying users and increase revenue generated from our virtual worlds; or
- any issues related to software security and content safety of our virtual worlds, frequent or prolonged server interruption due to network failures, hacking activities or other factors or any other adverse developments relating to our existing virtual worlds.

In addition, in order to achieve our long-term profitability and financial and operational success, we must continue to develop new games and activities for our existing virtual worlds, as well as new virtual worlds that are attractive to users. It is difficult to consistently anticipate user preference on a large scale, particularly as we develop virtual worlds with new genres. While we continue to invest significant resources in these research and development activities, there can be no assurance that our new virtual worlds will be popular among our users and become profitable.

Due to our reliance on a limited number of virtual worlds, if we fail to maintain the commercial success of these virtual worlds or are unable to develop additional virtual worlds or products, our business, financial condition, results of operations and growth prospects may be materially and adversely affected.

Our business may suffer if we fail to successfully maintain and expand our user base and enhance monetization.

In order to achieve sustainable revenue growth, we must retain our existing users, attract new users and maximize the network effect of our platform, which are crucial to our monetization abilities. Our user base, which primarily consists of children of ages six through fourteen, is characterized by rapidly changing demand and preferences. To retain and expand our user base, we must devote significant resources in research and development and customer support to offer innovative products and services attractive to our users. We rely on an operating model of releasing weekly new episodes for our virtual worlds to engage our users for long periods of time. In order to ensure the quality of our content, we must constantly and effectively review user data and feedback, recognize the latest preference trends among children and incorporate these elements into our weekly episodes, which requires a high level of technological, financial and human resource commitment. If we fail to keep up with our users’ evolving needs and launch storylines, games and activities in our virtual worlds that are novel and engaging to our users on an ongoing basis, our virtual worlds may quickly lose their popularity among children and our business will suffer.

Additionally, we invest substantial resources to develop new product offerings in order to diversify what our platform can offer to our users and attract and retain more users. As of the Latest Practicable Date, we offer a number of products other than our virtual worlds, such as WenTa, our online tutorial platform. While we have made substantial investments in these products, there is no assurance that they will become commercially successful in the near future or at all. Please see “— Our new product offerings in addition to virtual worlds, such as WenTa, may not be popular or commercially successful, which could materially and adversely affect our profitability and our ability to grow” for more information. Unsatisfactory performance of our virtual worlds and other online products may materially and adversely affect our business, financial condition, results of operations and growth prospects.

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Our new product offerings in addition to virtual worlds, such as WenTa, may not be popular or commercially successful, which could materially and adversely affect our profitability and our ability to grow.

In order to diversify the product offerings on our platform to better address our target users’ needs and attract and retain more users, we on a continued basis invest substantial financial, research and development and managerial resources in the development and launch of new products, in addition to virtual worlds. For example, in September 2013, we open beta launched WenTa, an online tutorial platform designed to allow children to seek assistance on a variety of school curriculum subjects. WenTa may fail to meet user needs or it may not be considered by parents to be positive to children’s learning process, which may in turn hurt our brand image and adversely affect WenTa’s popularity among our target user base. Other products that we offer on our platform, such as Tuyaban, our online drawing and cartoon community, and Quanquan, our online forum, which are designed to cultivate communities of children of similar interests that we believe help enhance user stickiness, may not be effective in attracting and retaining users for our platform.

Even if WenTa, Tuyaban, Quanquan or our other products prove to be popular among our users, we may not be able to successfully monetize these products. The commercial viability of these new products is uncertain and we need to continue to invest in their format, content and operating model. For example, our users may not be willing to pay for the services offered on WenTa even if they find it an effective tool. Even if they are willing to pay for WenTa, our pricing strategy may not be effective and we may not be able to maximize our profits. Despite these uncertainties, we are committed to making WenTa a reliable and resourceful learning assistant to our users, which requires continued investment in user data collection and database building. As of the date of [REDACTION], we have not commercialized WenTa, or any of our products other than virtual worlds and other self-developed game products. As a result, unsatisfactory performance of our other online products may materially and adversely affect our business, financial condition, results of operations and growth prospects.

If we fail to successfully execute our growth strategies, our future results of operations and growth prospects may be materially and adversely affected.

We believe that our continued growth and expansion will depend on our ability to implement our business strategies. We plan to increase our addressable market by expanding our products offerings both in terms of content and format, strengthening our brand through more active marketing efforts and more diversified offline product offerings, and expanding into international markets.

We have expanded from providing only online entertainment products to providing other products such as WenTa, Tuyaban and Quanquan, and from providing only PC-based products to mobile products. We are also expanding our offline advertising and licensing businesses into additional offline product offerings, such as toys, print media, movies and television shows. Expansion into these or other new businesses or adoption of these and other new business models present operating and marketing challenges that are different from those that we currently encounter. We may need to incur additional compliance costs in order to satisfy different regulatory requirements and obtain additional licenses or permits from regulatory authorities overseeing other industries. In addition, our investment into these new businesses may not bring us benefit as we expected.

For example, we open beta launched our online tutorial platform, WenTa, in September 2013 and its popularity and commercial viability remain unclear. In addition, we became subject to relevant laws and regulations governing the online education services as a result of launching the e-learning product. We will incur additional costs associated with obtaining the necessary government approvals and permits and ensuring ongoing compliance with these laws and regulations. Additionally, we commenced close beta test of a mobile game based on the characters of our virtual worlds and released a mobile version of Quanquan, our online forum, in the first quarter of 2014. We have additional mobile products and services in our development pipeline. These mobile products may not be as successful as our PC products or prove to be commercially viable. If we are unable to successfully offer mobile products and services, our growth prospects and results of operations may be adversely impacted.

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In addition, as we license our franchises to third parties for the production of toys, print media, movies and television shows, any misuse by third parties of our brands, virtual world characters and other types of intellectual property could harm our brand and reputation.

If we cannot successfully address these new challenges and compete effectively in these markets or under these business models, we may not be able to enter into or operate these new business segments, attract a sufficiently large number of users, or recover costs incurred for developing and marketing these products, and our future results of operations and growth strategies could be materially and adversely affected as a result. For example, if our newly launched WenTa fails to gain popularity and generate revenue within a reasonable amount of time, we may not be able to recover our costs or to achieve growth through the online education services market at this stage. Pursuing these and other growth strategies may also require us to expand our operations through internal development efforts and through partnerships, joint ventures, investments and acquisitions, which involves significant investment of management, financial and operational resources and various risks. Our management, financial and human resources may be diverted to areas of business that may not be profitable in the short term, which may materially and adversely affect our financial condition and results of operations. We may not be effective in implementing our strategies especially as we develop new types of products or enter into a new market, where we may encounter issues that we do not have the experiences and expertise to resolve. Failure of a strategic project may hurt the morale of our workforce and discourage our innovative culture. If we are unable to effectively implement our business strategies and achieve sustainable expansion, our financial condition, results of operations and growth prospects may be materially and adversely affected.

If we fail to manage our pricing strategies properly, our users may be less likely to spend in our virtual worlds, which may materially and adversely affect our business, financial condition, results of operations and growth prospects.

Competition within the children’s online industry and the broader entertainment industry may be intense and our existing and potential users may be attracted to virtual worlds and games developed by our competitors as well as other forms of entertainment, resulting in decreases in our user base and monetization rate and causing our business to suffer. Our competitors may launch similar products that may be more competitive than ours.

Our online entertainment products compete against online products offered by a number of developers and operators in China who provide virtual worlds, games and other forms of online entertainment for children. We expect more companies to enter our industry in China and a wider range of online games or virtual worlds targeting children to be introduced to China in a relatively short period of time. We believe our principal competitors in China are Tencent Holdings Limited (“Tencent”), the developer of Roco Kingdom, and Taomee Holdings Limited (“Taomee”), the developer of Seer and Mole’s World. Potential competitors also include major Internet portal operators, other domestic and foreign virtual worlds and games developers and operators, media companies focused on children’s entertainment and alliances between our existing and new competitors. Some of our competitors, especially major foreign and China-based publicly listed media and virtual world and game operators, have significantly greater financial and marketing resources and name recognition than we have. We cannot assure you that we will be able to compete successfully against any new or existing competitors, or maintain our user base and active paying user number when competitors launch promotional campaigns targeting our user base, which could materially and adversely affect our revenue and profitability.

In addition, our users face a vast array of entertainment choices. Other forms of entertainment, such as traditional personal computer and console games, other Internet-based activities such as social networking and online video, as well as offline games and activities such as television, movies and sports, are much larger and more well-established markets and may be perceived by our users to offer greater variety, affordability, interactivity and enjoyment. Our virtual worlds compete against these other forms of entertainment for the discretionary time and spending of our users. If we are unable to sustain sufficient interest in our virtual worlds in comparison to other forms of entertainment, including new forms of entertainment that may emerge in the future, our business model may no longer be viable.

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Given that the effectiveness of these services require a large amount of user data accumulated over time and a high degree of technical know-how, other industry players such as existing online education services providers or children online games operators may nonetheless be able to develop and launch similar products, and such products may better meet children’s learning needs or be considered by parents to be better tutoring tools for children. Our principal competitors in the PRC online education services market for children include large well-known Internet companies such as Baidu, and Alibaba who have recently entered into the online education market, as well as a number of other companies. As a result, our e-learning products may not be able to attract and monetize users and any product failure may materially and adversely affect our business, results of operations and financial condition.

Our business may suffer if we fail to successfully optimize our pricing strategies.

All of our virtual worlds can be free to play, and, in line with industry norms, only a small percentage of users who log onto our virtual worlds in any period are paying users. In order to sustain our revenue growth, we must effectively monetize our users. We invest in user data collection and analysis to better understand our users’ in-game consumption patterns. This allows us to develop subscription packages and virtual items and services that are desirable by our users, as well as to properly price them so that we can enhance our monetization abilities. Our users are willing to pay for subscription packages and purchase virtual items in our virtual worlds because of the perceived value of these services or items, which is dependent on the benefits such services or items confer upon the users in a virtual community. Spending in our virtual worlds is discretionary and our users can be relatively sensitive to the price of our services and virtual items. It is crucial to balance, on the one hand, creating sufficient in-game monetization opportunities, which enhances the profitability of our virtual worlds, and, on the other hand, ensuring that our virtual worlds be fun to play even without certain extra paid benefits, which helps to maintain a sizable user base and therefore the associated network effect. We must also ensure that our services and items are set at levels that, on the one hand, allow our virtual worlds to be profitable, and, on the other hand, are acceptable to both parents and children so that they are willing to spend on our platform.

In addition, the item-based fee model for our virtual items may cause concerns with PRC regulators, who have been implementing regulations designed to reduce the amount of time players in China spend on playing online games, as well as to limit the amount of virtual currency issued by online game operators and purchased by individual game players. However, we do not charge users by the amount of time they spend in our virtual worlds, which may not be consistent with PRC regulators’ goals to limit the amount of time and money that children spend on online games. If our business model is scrutinized by the PRC regulators, we will receive negative publicity and our brand image will suffer and our operations may be adversely affected. Please refer to the section headed “— Risks Related to Our Industry — Uncertainties in PRC Government policies and regulations regarding virtual worlds and children’s Internet use in China may adversely affect our business.”

We face risks and uncertainties regarding the growth of online children’s interactive entertainment and online education industries and market acceptance of our products and business model.

The online interactive children’s entertainment industry, from which we currently derive substantially all of our revenue, and the online education industry are relatively new and evolving industries. The growth of the online interactive children’s entertainment and online education industries and the level of demand and market acceptance of our virtual worlds and e-learning products are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors, some of which are beyond our control. These factors include:

- the growth of personal computer, Internet and broadband users and penetration in China and other markets in which we may in the future offer our online products, and the rate of any such growth;
- whether the online entertainment market in China, and in particular the online interactive entertainment market for children, continues to grow and the rate of any such growth;

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- the acceptance by children and parents of our e-learning products;
- consumption behavior of children and parents, particularly their willingness to pay for online entertainment, tutorial and other services in light of the business model of online entertainment, education and other services providers like us;
- general economic conditions, particularly economic conditions adversely affecting discretionary spending on children’s entertainment;
- our ability to timely update our existing virtual worlds and other services and introduce new virtual worlds and other online children’s entertainment and e-learning products that attract existing and new users; and
- the availability and popularity of other forms of entertainment, particularly console system games and social networking websites, as well as other forms of educational or tutorial services.

If we fail to anticipate and effectively manage these risks and uncertainties, our market share may decrease, and our business, financial condition and results of operations may be materially and adversely affected.

Our new virtual worlds may attract our users away from our established virtual worlds, and enhancements and updates to our established virtual worlds may result in certain users deciding not to participate in them, which could materially and adversely affect our business, financial condition and results of operations.

Our new virtual worlds may attract our users away from our established virtual worlds, particularly with respect to virtual worlds with similar themes or storylines. Although we intend to target different types of users with new virtual worlds and therefore minimize users of our existing virtual worlds migrating to virtual worlds that we later launch, such movement may nevertheless occur. As such, a larger number of virtual worlds will compete for the discretionary time and spending of our users, which is relatively limited given the nature of our users. This may lead to fewer active users and lower spending on subscriptions and virtual items in our existing virtual worlds, while users migrating to our new virtual worlds may spend less money on subscription and virtual items than they would have spent if they had continued playing games in our existing virtual worlds. As a result, our business may suffer.

In addition, in order to retain our existing users and to attract new users, we develop new contents, introduce new features and make changes to our established virtual worlds based on feedback gathered from our users. However, these changes may result in some of our exiting users deciding not to participate in our virtual worlds, either temporarily or permanently. Our users may not respond well to updates to our virtual worlds, which could materially and adversely affect our business, financial condition and results of operations.

We rely on our distributors for the distribution of our prepaid cards throughout China, which is the primary payment channel in our business model. Our failure to effectively manage our distributors and maintain a good relationship with them may materially and adversely affect our revenue realization and brand recognition.

Although we offer online payment and phone payment options, most children in China currently purchase our subscriptions and virtual items through prepaid cards. As such, our business is dependent on the performance of our nationwide prepaid card distribution network. We rely on a limited number of distributors to distribute our prepaid cards across China. We typically contract with one regional distributor for the distribution of our prepaid cards in a designated region, and such distributor may distribute the cards through a number of sub-distributors in cities and towns located in the designated region. In the years ended December 31, 2011, 2012 and 2013, the top five sources of cash proceeds (including prepaid card distributors and other payment channels) from sales of physical and virtual prepaid cards and sales of AoCoins through other payment channels accounted for 48.4%, 54.5% and 53.3% of our total cash proceeds from these sales. Four of these sources were prepaid card

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distributors. Additionally, our top source of cash proceeds from these sales for the years ended December 31, 2011, 2012 and 2013 was our sole virtual prepaid card distributor, which is also our physical prepaid card distributor for Sichuan province, and accounted for 17.9%, 16.2% and 15.1% of our total cash proceeds from these sales.

There may not be a sufficient number of distributors in certain regions that meet our standards and in the event that an existing distributor fails to comply with the distribution agreement or deliver satisfactory sales results, or if it becomes unable or unwilling to do business with us, we may not be able to find a satisfactory replacement within a short period of time and at reasonable costs, if at all, causing significant disruption to our prepaid cards distribution network. Further, existing distributors or sub-distributors, over whom we have limited control, may not distribute, display and promote our prepaid cards in a manner required under the relevant distribution or sub-distribution agreements. For example, they may charge users a premium over the face value of our cards. They may not be effective in controlling volume allocation in their designated distribution area, causing undersupply in certain locations. Because we do not require certain regional distributors to exclusively distribute our prepaid cards, they may distribute and promote the services and products of our competitors at our expenses. If we cannot ensure that our prepaid cards are offered at their face value, and that they are available for purchase in a large number of locations frequented by children, our revenue realization and brand recognition will be materially and adversely affected. If we fail to effectively enforce the distribution agreements and maintain a good relationship with our distributors so as to ensure the smooth distribution of our prepaid cards throughout China, our business, financial condition, results of operations and growth prospects may be materially and adversely affected.

If the distributors of our prepaid cards become unable to finance the prepayment of our prepaid cards, our prepaid card distribution network may be adversely affected, constraining the sales of our prepaid cards.

We typically collect payment from our distributors prior to our delivery of prepaid cards. The prepayment of our prepaid cards by our distributors may be dependent on their access to financing. However, there is no guarantee that our distributors will be able to continue to finance the purchase of our prepaid cards in the future. In the event that one or more of our distributors become unable to finance the prepayment of our prepaid cards, our prepaid card distribution network may be adversely affected, constraining the sales of our prepaid cards, which may in turn adversely affect our business operations.

Our failure to manage our other businesses to supplement our core virtual worlds business may divert our resources and negatively impact our profitability.

Our other businesses include in-world advertising and intellectual property licensing. We enter into advertising arrangements where advertisers pay to place their advertisements in our virtual worlds. We also selectively license the characters and images in our virtual worlds to third parties. For example, we have licensed logos of and characters in our virtual worlds to fast consumer goods retailers such as Kraft, who print images of our virtual worlds on their food packaging to promote sales. We also license our characters to print media publishers, who publish cartoon books and magazines featuring our characters and stories. We believe these businesses promote our brand and may contribute to our revenue growth. However, growing and managing business segments other than our core virtual worlds business involves significant investment in terms of financial, human and management resources, while the benefits of engaging in these segments either in terms of brand promotion or profitability may not allow us to recover product development costs and ultimately make profits. In addition, licensing our characters and images to third parties involve risks associated with the operations and credibility of these third parties, and our brand may be associated with third parties whose behaviors are beyond our control. If we fail to manage effectively our other businesses so that they supplement our core virtual worlds business and contribute to our profitability or brand promotion, or both, our business and results of operations may be materially and adversely affected due to the diversion of our financial, human and management resources.

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Unauthorized use of our intellectual properties by our distributors, licensees or third parties and the expenses incurred in protecting our intellectual property rights may harm our brands and reputation and materially and adversely affect our business.

We regard our copyrights, trademarks and other intellectual properties as critical to our success, and rely on a combination of trademark and copyright law, trade secret protection, restrictions on disclosure and other agreements that restrict the use of our intellectual properties to protect these rights. Although our contracts with distributors and licensees prohibit the unauthorized use of our brands, images, characters and other intellectual property rights, we cannot assure you that they will always comply with these terms. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. Although we enter into confidentiality, intellectual property ownership and non-compete agreements with most of our full-time employees, we cannot assure you that these confidentiality agreements will not be breached, that we will have adequate remedies for any breach, or that our proprietary technology, know-how or other intellectual property will not otherwise become known to third parties. In addition, third parties may independently discover our trade secrets and proprietary information, limiting our ability to assert any trade secret rights against such parties.

As of the Latest Practicable Date, we have received approval for 196 trademark registrations and have 129 pending trademark registration applications in China. We also have seven registered trademarks and 23 pending trademark registration applications in Hong Kong. Our trademarks primarily cover the names and logos associated with our virtual worlds and our *Baitian* brand. In addition, we have obtained 16 copyright registrations for software we developed and 20 copyright registrations for artwork produced and owned by us. We also have 113, three and two registered domain names in China, Hong Kong and Taiwan, respectively, including www.100bt.com, our primary operating website, and www.baitianinfo.com and www.baioo.com.hk, our corporate information websites. While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. In addition, we cannot assure you that any of the above trademark applications will ultimately proceed to registration or will result in registration with adequate scope for our business. Some of our pending applications or registrations may be successfully challenged or invalidated by others. If our trademark applications are not successful, we may have to use different marks for affected products or services, or seek to enter into arrangements with any third parties who may have prior registrations, applications or rights, which might not be available on commercially reasonable terms, if at all.

Implementation of intellectual property laws in China has historically been lacking, primarily because of ambiguities in the laws and difficulties in enforcement. Accordingly, intellectual property right protection in China may not be as effective as in other jurisdictions with a more developed legal framework regulating intellectual property rights. Policing unauthorized use of our proprietary technology, trademarks and other intellectual property is difficult and expensive, and litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could hurt our reputation and disrupt our business, as well as materially and adversely affect our financial condition and results of operations.

We and our licensees may be subject to intellectual property infringement claims, which could be time-consuming and costly to defend and may result in diversion of our financial and management resources. If such claims are successful, we may not be allowed to continue use certain of our ideas and designs.

We implement internal control measures to ensure that the design of our virtual worlds, themes, plots and characters are original and do not infringe upon patents, trademarks, copyrights or other intellectual property rights held by third parties. Neither we nor our licensees have encountered any legal claims relating to any intellectual property rights held by third parties concerning any designs in our virtual worlds or those that we license to our licensees during the Track Record Period and the subsequent period up to the Latest Practicable Date. However, we cannot assure you that no such claims will be brought in the future. See “— Unauthorized use of our intellectual properties by our distributors, licensees or third parties and the expenses incurred in protecting

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our intellectual property rights may harm our brands and reputation and materially and adversely affect our business.”

If we or our licensees are found to have violated the intellectual property rights of others, we or our licensees may be enjoined from using such intellectual properties, be forced to pay fines and damages, and we may be forced to develop alternatives. In addition, we may incur substantial expenses and diversion of our financial and management resources in defending against these third-party infringement claims, regardless of their merits. Successful infringement or other intellectual property rights claims against us may result in substantial monetary liabilities, which may disrupt our operations and materially and adversely affect our business, results of operations, financial condition and growth prospects. Any infringement claim, whether with merits or not, generates negative publicity which could harm our brand reputation.

Some of our employees were previously employed at other companies, including our current and potential competitors. We also intend to hire additional personnel to expand our development team and technical support team. To the extent these employees are involved in the development of content or technology similar to ours at their former employers, we may become subject to claims that such employees or we may have appropriated proprietary information or intellectual properties of the former employers of our employees. If we fail to successfully defend such claims against us, our results of operations could be materially and adversely affected.

We are involved in a trademark dispute surrounding certain Chinese characters and logos used in one of our virtual worlds, which may subject us to litigation that may have a material adverse impact on our financial condition.

A third party has registered seven trademarks and is in the process of registering one additional trademark for the Chinese characters of “Aola Star” and “Light of Aola” and related logos in trademark classes that are relevant to our business. As a result, we are unable to register for trademark protection of these Chinese characters and our self-designed logos currently used for Aola Star, one of our virtual worlds. We believe the third party’s registration constitutes trademark squatting because the third party registered these trademarks several days after our open beta launch of Aola Star and does not have actual business operations and we are currently not aware of any actual use of these characters and logos by the third party. In February 2013, we filed a trademark cancellation application for the third party’s registrations with the Trademark Appeal Board of the State Administration of Industry and Commerce (the “Trademark Appeal Board”), which accepted our application in October 2013 and is currently reviewing our application. Pursuant to relevant regulations, the third party is given a 30-day period from the date Trademark Appeal Board accepts our case to provide response or evidence to reject our arguments and support the validity of its trademark registration. Since October 2013, the third party has not provided any response or evidence within the 30-day period as requested by the Trademark Appeal Board to deny our trademark squatting allegation.

Before a decision is made by the Trademark Appeal Board as to the validity of these trademark registrations, the third party may bring claims in competent PRC courts against us for intellectual property infringement. We are advised by our PRC legal advisers that if the court decides that the third party has the intention of trademark squatting, it will most likely stay the case pending the result of our application. In the event that the court decides to proceed with the trial due to the particular facts of the case, we are advised by our PRC legal advisers that we may be able to raise the “first-to-use” defense provided for under the new PRC Trademark Law, which will take effect on May 1, 2014. The new PRC Trademark Law has not yet come into effect, and there is uncertainty on whether it has retrospective effect as to acts occur prior to its effectiveness. However, if the court decides that the new PRC Trademark Law has retrospective effect, we will raise the “first-to-use” defense to vigorously defend our case in addition to the defense of trademark squatting.

In the event that the court decides that we have infringed upon the third party’s intellectual property rights, under PRC law, we may be ordered to cease using the relevant Chinese characters and logos, and, depending on

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whether the third party has used the registered trademarks during the three years prior to the date the third party brings the claim, compensate the third party for an amount equal to the third party’s losses or our profits resulting from such use of the registered trademarks or, if the amount of profits cannot be ascertained, an amount up to RMB500,000 pursuant to the current PRC Trademark law or RMB3,000,000 pursuant to the new PRC Trademark law, as determined by the court. With respect to the period for which our profits are calculated under PRC law, we are advised by our PRC legal advisers and trademark agent of the following: (i) if the third party brings a claim against us in court within two years from the date on which the third party became or should reasonably be expected to become aware of the infringing act, the relevant time period is from the date on which we first used the registered trademarks to the date when we cease using the registered trademarks; and (ii) if the third party brings the claim after such two years, the relevant period is two years preceding the date on which the third party brings the claim.

Aola Star was launched in July 2010, and, with our active marketing and promotional activities, has gained wide popularity in China by July 2011 when the third party’s registration of these trademarks became effective. Therefore, the third party should reasonably be expected to have become aware of our use of these trademarks since July 2011. Up to the Latest Practicable Date, more than two years have passed and the third party has not brought any claim against us. Therefore, if the third party were to bring a claim against us in the future for intellectual property infringement, and in the unlikely event that we are ordered by the court to make economic compensation, we believe that the relevant period for which our profits will be calculated would most likely be two years preceding the date the third party brought the claim.

We are advised by our PRC legal advisers that if there is no evidence that the third party has used the trademarks in dispute during the past three years prior to the date the third party brings the claim, the court, while having full discretion to make its decision considering the other specific facts of the case, is most likely to order that the infringing party ceases using the trademarks without also ordering economic compensation. We are not aware of any actual use by the third party and the third party has not so far provided any evidence to the Trademark Appeal Board to prove any actual use. In light of the above, our PRC legal advisers are of the view that the likelihood that we will be ordered to make economic compensation to the third party is relatively low.

Revenue generated from Aola Star contributed to 46.2%, 46.2% and 35.4% of our total revenues for the years ended December 31, 2011, 2012 and 2013, respectively. The financial impact on us is uncertain in the event that we are ordered to cease using the relevant Chinese characters and logos for Aola Star. Please also see “Business — Intellectual Property.”

Our operating results fluctuate from period to period, making them difficult to predict and may not be indicative of future performance.

Our operating results from period to period are highly dependent upon, and will fluctuate as a result of a variety of factors, including:

- seasonal trends in revenue generation as a result of seasonal fluctuations in the number of active users and duration of play, which are typically higher in the first and third quarters of each year when children are on summer and winter breaks and have more free time to spend online, and typically lower during the second and fourth quarters of each year when children are at school and have less free time to spend online. Chinese New Year holidays, which occur in the first quarter of each year, see an increase in revenue generation as children are given extra pocket money as a Chinese tradition;
- the introduction of virtual worlds and other online and offline services and products;
- the quality, variety, popularity and mix of virtual items and online and offline services and products available for purchase and related promotional efforts;

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- the period of time over which we recognize revenue for some of our virtual items in our virtual worlds, which in certain cases is based on a user’s relationship period, being the period during which a paying player uses durable virtual items, which may be adjusted from time to time;
- content development costs and licensing or royalty payments; and
- the expansion of our distribution network and the related discounts and rebates.

Due to these and other factors, our operating results will vary from period to period, may be difficult to predict for any given period and may not be indicative of our future performance.

Unauthorized character enhancements, other hacking or cheating activities, and undetected programming errors or defects in our virtual worlds could harm our online business and reputation and materially and adversely affect our results of operations.

With the increase in the number of virtual world and game users in China, virtual world and game operators have increasingly encountered problems arising from the use of unauthorized character enhancements, theft of user account information and other hacking or cheating activities. We have from time to time detected a number of users who have gained an unfair advantage by installing hacking or cheating tools to facilitate character progression. In response to these activities, we have installed detection mechanisms in our virtual worlds to identify various hacking and cheating activities, and have expanded our technical team dedicated to detecting unauthorized character enhancements and resolving other hacking issues. However, these measures may not be effective against hacking.

In addition, our virtual worlds may contain undetected programming errors or other defects. Continued occurrences of unauthorized character enhancements, other hacking or cheating activities, and undetected errors or defects in our virtual worlds will harm user experience, which may negatively impact the image of our virtual worlds and users’ perception of their reliability, reduce our user number and in-game spending, shorten the life span of the virtual world and adversely affect our results of operations. A constant recurrence of these activities may require us to shift our management’s and personnel’s attention from research and development and other operations to focus instead primarily on anti-hacking programs and activities, which could hurt our ability to develop and launch new online entertainment and e-learning products for children and could materially and adversely affect our business, financial condition, results of operations and growth prospects.

We may not be successful in effectively promoting our brand or enhancing our brand recognition, and any negative publicity, regardless of its veracity, may materially and adversely affect our business.

We believe the key to sustain our growth and compete with existing and upcoming children’s online entertainment and e-learning products providers is to establish for our *Baitian* brand a recognition among families in China as a family-friendly platform dedicated to providing online entertainment and e-learning products that are safe, fun and educational for children and are trusted and welcomed by parents. To do so we must continuously focus on developing enjoyable, educational and healthy content, designing Internet safety-oriented products, as well as understanding and responding to the needs of children and parents and building relationships with them. There is no assurance that we will be able to effectively establish such brand recognition and if we fail to do so, we may not be able to capitalize on our brand to further expand our business. In addition, publicity regarding our brand has a large impact on public perception of our platform. Any negative publicity or disputes in relation to our brand, our virtual worlds, our services or products, or our company or management, regardless of its veracity, could harm our brand image among children and parents and, in turn, result in decreases in user number and spending, or even long-term disapproval of our platform by families in China. Our results of operations and growth prospects will therefore be materially and adversely affected.

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Our limited resources may affect our ability to manage our growth.

Our growth to date has placed, and our anticipated further expansion will continue to place, a significant strain on our management, systems and resources. Because we release new episodes in our virtual worlds on a weekly basis, our operations teams must accurately capture user data and translate them into user preference, and effectively respond to these information and develop the elements preferred or demanded by our users into new releases within a short period of time. Our workforce has expanded significantly since our establishment and we intend to increase our employee headcount even further by adding research and development personnel for the development of new products and operations personnel to support the growth of our existing products. To accommodate our growth pursuant to our strategies, we anticipate that we may need to implement and maintain a variety of new and upgraded operational and financial systems, procedures and controls, and to improve our accounting and other internal management systems, all of which require substantial management efforts. We need to continue to expand, train, manage and motivate our workforce, and manage our relationships with our users, our distributors and third-party business partners. We also need to acquire additional servers and bandwidth to support our increasing user traffic, as well as additional office space to accommodate our expanding workforce and providing them with a better work environment. All of these endeavors will require substantial management effort and skill and the incurrence of additional expenditures. We cannot assure you that we will be able to efficiently and effectively implement these changes necessary for our growth, and any failure to do so may limit our future growth and hamper our business strategy.

We may undertake acquisitions, investments, joint ventures or other strategic alliances and we may not be successful in these undertakings, which could materially and adversely affect our ability to manage our business.

We have been and plan to continue growing organically, although we may expand through acquisitions, joint ventures or other strategic alliances. However, such undertakings may not be successful. Acquisitions, joint ventures and strategic alliances may expose us to new operational, regulatory and market risks, as well as risks associated with additional capital requirements. We may not be able to identify suitable future acquisition candidates or alliance partners that suit our expansion needs. Even if we identify suitable candidates or partners, we may be unable to complete an acquisition or alliance on terms commercially acceptable to us. If we fail to identify appropriate candidates or partners, or complete desired acquisitions or alliances, we may not be able to achieve expansion effectively or efficiently.

In addition, our ability to successfully integrate acquired companies may be adversely affected by a number of factors. These factors include diversion of management’s attention, difficulties in retaining personnel of the acquired companies, unanticipated legal liabilities, and tax and accounting issues in association with the acquisition and business combination. If we fail to integrate acquired companies efficiently, our earnings, revenue growth and business could be adversely affected.

Furthermore, the acquired companies may not perform to our expectations for various reasons, including legislative or regulatory changes that affect the products in which the acquired companies specialize and the loss of key personnel. If we are not able to realize the benefits envisioned for such acquisitions, our business, financial condition and results of operations could be materially and adversely affected.

Our failure to anticipate or successfully implement new technologies could render our game engines, development platforms or virtual worlds unattractive or obsolete, and reduce our revenue and market share.

Our proprietary engines for powering our virtual worlds, our user data collection and analytics, our flexible and secure software framework and anti-cheating expertise are critical to our success. The children’s online entertainment industry is subject to rapid technological changes, and the online education services industry are also evolving quickly in terms of technology innovation. We need to anticipate the emergence of new

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technologies and assess their market acceptance. We also need to invest significant resources, including financial resources, in research and development to keep pace with technological advances in order to make our product development capabilities, our virtual worlds and our e-learning and mobile products competitive in the market. However, development activities are inherently uncertain, and we might encounter practical difficulties in commercializing our development results. Our significant expenditures on research and development may not generate corresponding benefits. Given the fast pace with which technology for children’s online entertainment has been and will continue developing, we may not be able to timely upgrade our hardware and software capabilities for our virtual world development in an efficient and cost-effective manner, or at all. New technologies in virtual world programming or operations could render our technologies, our existing virtual worlds or the virtual worlds that we are developing or expect to develop in the future obsolete or unattractive, thereby limiting our ability to recover related product development costs, purchase costs and licensing fees, which could result in a decline in our revenue and market share.

We could be liable for our users’ privacy being compromised, which may materially and adversely affect our reputation and business.

We receive, store and process personal information and other user data in our virtual worlds, which are subject to infiltrating behaviors from child predators and others who hack the accounts of our users to gain progression advantages, access these users’ accounts, or for other purposes. We seek to provide a safe playing environment for our users by implementing sophisticated security mechanisms and robust content filters. For example, we can auto-detect and block the appearance of phone numbers or bank account numbers in our online communication interfaces. Online communications are also monitored by us to prevent the use of abusive language and other inappropriate behavior, and we impose bans of varying length on users who are found to have engaged in inappropriate behavior. We encourage users to report offenses or violations of our terms of service to us. Despite our efforts to employ security features to filter offensive content, monitor users’ interactions and safeguard user information, there is no guarantee that we can successfully keep our users free from predatory behavior, offensive contact or other acts that violate the privacy of our users. For example, there have been incidents where our users’ accounts were stolen because our users accidentally disclosed their account passwords. We typically help our users retrieve their accounts in a short period of time once such incidents are reported. We are not aware of any user suffering from any material losses as a result of such incidents. Any failure or perceived failure by us to prevent our users’ exposure to such infiltration, to comply with our privacy policies, our privacy-related obligations to users or other third parties, or any privacy laws or regulations, or any compromise of security that results in the unauthorized release or transfer of personally identifiable information or other player data, may result in governmental enforcement actions, litigation or public statements against us by our users, consumer advocacy groups or others, which would cause harm to our users and hurt our reputation among children and their parents, which will materially and adversely affect our business.

If our third party payment channels fail to timely process and settle transactions or ensure transaction security, our reputation, financial condition and results of operations maybe materially and adversely affected.

A substantial majority of our users purchase AoCoins, our virtual currency, through purchasing prepaid cards through our distributors in China. However, users can also purchase AoCoins directly on our payment site using third-party online payment channels. We pay for the cost of contracting third-party payment online channels in order to provide more payment options to our users, the convenience of which encourages user spending. However, if these payment channels fail to provide an efficient and smooth payment processing service due to technical or human errors, network disruption or other factors that are beyond our control, our ability to enhance monetization will be compromised. In addition, third party payment channels collect payments for us and settle the total amount, minus processing fee. If any of our payment channels becomes unable or unwilling to settle the receivable in a timely manner or at all, our liquidity could be materially and adversely affected and we may have to write off receivables or increase provisions against bad debts. During the Track Record Period, we did not

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experience any material disputes with any of our third party payment channel providers arising from their payment services.

In addition, in online payment transactions, secure transmission over public networks of user information, such as debit and credit card numbers and expiration dates, personal information and billing addresses, is essential to user privacy protection and maintaining their confidence in our platform. We do not have control over the security measures of our third-party payment operators, and their security measures may not be adequate. We could be exposed to potential litigation and liability if the online transaction safety of our users is compromised in transactions involving payments for our products, which could harm our reputation and our ability to attract users and may materially and adversely affect our business.

The successful operation of our business currently and in the future, including our ability to accommodate additional users in our virtual worlds and to launch mobile products, depends on the performance and reliability of the Internet infrastructure and fixed line and wireless telecommunications networks in China.

Our business depends on the performance and reliability of the Internet infrastructure in China. Almost all access to the Internet is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the MIIT. We rely on this infrastructure to provide data communications primarily through local telecommunication lines and wireless telecommunication networks. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC Government. These international gateways are the only channels through which a domestic user can connect to the Internet and may not support the demand necessary for the continued growth in Internet usage. Although the PRC Government has plans to develop the national information infrastructure, we cannot assure you that a sophisticated Internet infrastructure will be developed. In the event of disruptions, failures or other problems with China’s Internet infrastructure, we or our users may not have access to alternative networks on a timely basis, if at all.

Any defects, disruptions or other problems affecting the functioning of our network infrastructure or information technology systems could materially and adversely affect our business.

The satisfactory performance, reliability, security and availability of our network infrastructure and information technology systems are crucial to user experience in our virtual worlds and with our e-learning products, and any defects, disruptions or problems therein may cause significant harm to our reputation and our ability to attract and retain users. We rely on third-party service providers for certain key aspects of our network infrastructure and information technology systems, including the storage and maintenance of our servers, data backup and recovery and collection of online payments. We may experience network disruptions, failures and other problems due to a variety of factors, including:

- our growing operation will put increasing pressure on our servers and network capacities as we launch more virtual worlds and e-learning products and increase the size of our user base;
- we may encounter problems when upgrading our systems or services, which could adversely affect the performance of the software we use to provide our services;
- we may be subject to hacking, unauthorized access to or other attacks on our network infrastructure and information technology system, causing loss or corruption of data or malfunctions of software or hardware;
- third parties providing server storage and maintenance, data backup and recovery and online payment services to us may encounter similar network disruptions or technology failures in surrendering their services, which situations are beyond our control and may be difficult to remedy; and
- our network infrastructure could be damaged or interrupted as a result of earthquakes, floods, fires, extreme temperatures, power loss, telecommunications failures, technical error, computer viruses and similar events.

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In the past, our server network has experienced unexpected outages for several hours and occasional slower performance in a number of locations in China as a result of local power shortage or natural disasters. Any network interruption, virus or other inadequacy that causes interruptions in the availability of our virtual worlds or deterioration in the quality of access to our virtual worlds harms user experience and ultimately our reputation and business.

Our business depends substantially on the continuing efforts of our management and other key personnel, as well as a competent workforce that supports our existing operations and future growth. If we lose their services, our operations and growth prospects may be severely disrupted.

Our future success heavily depends upon the continuing services of our management and other key personnel. In particular, we rely on the expertise, experience and vision of our Founders, Mr. DAI Jian, our chairman, Mr. WU Lili, our chief executive officer, Mr. LI Chong, our chief operating officer, Mr. CHEN Ziming, our chief technology officer and Mr. WANG Xiaodong, our executive vice president. We also rely on the financial expertise of Mr. YEUNG Ka Hong Carl, our chief financial officer, and the technical know-how and creative talents of our key research and development staff. If any of our senior management or key personnel becomes unable or unwilling to continue to contribute their services to us, we may not be able to replace them easily or at all. As a result, our business may be severely disrupted, our financial condition and results of operations may be materially and adversely affected, and we may incur additional expenses to recruit, train and retain key personnel.

Moreover, if any of our management or key personnel joins a competitor or forms a competing company and launches products that compete against ours, we may lose know-how, trade secrets, key employees, distributors and other third party business partners, user base and market share. Each of our executive officers has entered into confidentiality, intellectual property and non-competition agreements with us. However, the non-competition provisions contained in these agreements may not be enforceable, especially in China, where most of these executive officers and key employees reside, on the ground that we have not provided adequate compensation to these executive officers for their non-competition obligations, which is required under the relevant PRC regulations.

Our existing operations and future growth require a sizeable and competent workforce. For example, the effective operation of our information technology system, call center, logistics and other back office functions depends in part on our professional employees. We also rely on experienced personnel for our online and offline businesses in technology, graphic design, operation and other functions to anticipate and effectively respond to changing user preferences and market trends. However, our industry is characterized by high demand and intense competition for talent. In order to retain talent, we may need to offer higher compensation, better trainings and more attractive career trajectory and other benefits to our employees, which may be costly and burdensome. Our employee retention rate for 2011, 2012 and 2013 was 94.1%, 94.3% and 95.3%, respectively. We believe our retention rate is relatively high among our peers. We cannot assure you that we will be able to attract or retain a qualified workforce necessary to support our future growth. We may also fail to manage our relationship with our employees, and any disputes between us and our employees, or any labor-related regulatory or legal proceedings may divert management and financial resources, negatively impact staff morale, reduce our productivity, or harm our reputation and future recruiting efforts. In addition, as our business has grown rapidly, our ability to train and integrate new employees into our operations may not meet the increasing demands of our business. Any of the above issues related to our workforce may materially and adversely affect our operations and future growth.

Our existing shareholders have substantial influence over our company and their interests may not be aligned with the interests of other holders of our Shares.

Mr. DAI, Mr. WU, Mr. CHEN, Mr. LI and Mr. WANG, have established the Family Trusts, which are discretionary trusts and the beneficiaries of which are them and their family members. They have transferred their entire equity interest in their respective BVI Holding Company to the Trust Holding Companies owned by

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their respective Family Trusts, which in aggregate represent 55.80% of our issued share capital upon the completion of the [REDACTION] (assuming the [REDACTION] Option is not exercised and without taking into account any Shares to be issued upon the exercise of any share options granted under the [REDACTION] Share Option Scheme and any Shares which may be issued pursuant to the [REDACTION] RSU Scheme). Accordingly, they have substantial influence over our business by voting at the general meetings of Shareholders, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election and change of directors and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our Shareholders of an opportunity to receive a premium for their Shares as part of a sale of our company and might [REDACTION]. The interests of our existing shareholders may not align with those of our other Shareholders, and we cannot assure you that our existing shareholders will act entirely in our interest or that conflicts of interest will be resolved in our favor. The existing shareholders may cause a merger, consolidation or change of control transaction even if it is opposed by our other Shareholders, including those who [REDACTION] in the [REDACTION]. On the other hand, they may prevent or delay us from entering into transactions that might be desirable to other Shareholders, such as takeovers or changes in our control or management, causing loss of opportunities on the part of other Shareholders.

If our rights to lease certain properties are challenged, our operations may be adversely affected.

We lease all of our office space in Guangzhou, where our operations are based. The landlord of five of our leases has not registered these lease agreements with the relevant local authority as required by PRC law. According to our PRC legal advisers, Jun He Law Offices, lease registration is not a mandatory condition for the validity of the lease agreements and the absence of the registration will not affect the legality of the lease agreements or impede our ability to use the relevant properties. Our PRC legal advisers also advised us that, pursuant to the Provisions of Guangzhou Municipality on House Tenancy Administration issued by the Guangzhou government, we will not be subject to any administrative penalties as a result of the landlord’s non-registration. We have asked our landlord to complete the registration. However, the landlord hasn’t done so and the defect on these lease agreements may not be cured. We may be challenged by relevant government authorities or other third parties on this basis, and our use of the properties may be disrupted, or we may not be able to renew the leases and continue to use these properties, as a result of which we will need to relocate our offices and incur costs and temporary operational disruptions.

We have not purchased any insurance to cover our main assets and business and our limited insurance coverage could expose us to significant costs and business disruption.

As common practice in our industry, other than certain medical insurance covering all our employees, we do not have any other insurance covering our main assets, including our network infrastructure, information technology systems, intellectual properties and user data. We also do not maintain business interruption insurance. The insurance industry in China is still at an early stage of development, and insurance companies in China currently offer limited business-related insurance products. As such, we may not be able ensure certain risks related to our assets or business even if we desire to. If we were to incur substantial losses or liabilities due to fire, explosions, floods or other natural disasters, disruption in our network infrastructure or business operations, or any material litigation, our results of operations could be materially and adversely affected. We have not suffered from any loss of data or destructions to our network infrastructure. To avoid any loss of data or network destructions from events of *force majeure*, our policy is to back up our data instantly on multiple servers across different locations in China. Our current insurance coverage may not be sufficient to prevent us from any loss and there is no certainty that we will be able to successfully claim our losses under our current insurance policy on a timely basis, or at all. If we incur any loss that is not covered by our insurance policies, or the compensated amount is significantly less than our actual loss, our business, financial condition and results of operations could be materially and adversely affected.

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RISKS RELATED TO OUR CONTRACTUAL ARRANGEMENTS

If the relevant PRC authorities find that the agreements that establish the structure for operating our virtual worlds and e-learning products in China do not comply with PRC laws and regulations, or if these laws or regulations or their interpretations change in the future, we could be subject to severe penalties, including the shutting down of our websites, or be forced to relinquish our interests in our operations.

Current PRC laws and regulations place certain restrictions on foreign ownership of companies that engage in value-added telecommunication service businesses, including Internet content provision services, or ICP services. Specifically, foreign ownership of value-added telecommunications services providers, including Internet content providers, may not exceed 50%. Foreign investors are prohibited from investing in or operating, among others, online cultural business (except online music business). In addition, foreign and foreign-invested enterprises are not able to apply for the licenses required to publish online games. Our virtual world operation and e-learning products are regarded as Internet content provision businesses and online cultural businesses. We are a Cayman Islands incorporated company and our wholly-owned subsidiaries in China, Beijing WFOE and Guangzhou WFOE, may not operate virtual worlds and provide online education service in China under current PRC law. As a result, we conduct our operations in China through the Contractual Arrangements with Guangzhou Baitian and its shareholders. Guangzhou Baitian holds the licenses and approvals that are required to operate our virtual worlds and e-learning products. Guangzhou Baitian is treated as our consolidated affiliated entity. For a description of these Contractual Arrangements with Guangzhou Baitian, see the section headed “Contractual Arrangements.”

The Circular on Strengthening the Administration of Foreign Investment in the Operation of Value-added Telecommunications Services issued by the MIIT on July 13, 2006 (the “MIIT Circular”) provides that a domestic company that holds an ICP license is prohibited from leasing, transferring or selling the license to foreign investors in any form, and from providing any assistance, including providing resources, sites or facilities, to foreign investors to provide ICP services illegally in China. Currently Guangzhou Baitian owns all the domain names and trademarks that we use in our operations. Due to a lack of interpretative materials from the authorities, we cannot assure you that the MIIT will not consider our corporate structure and contractual arrangements as a kind of foreign investment in telecommunication services, in which case we may be found in violation of the MIIT Circular and as a result may be subject to various penalties, including fines and the discontinuation of or restrictions on our operations.

On December 11, 2001, the State Council promulgated Regulations for the Administration of Foreign-invested Telecommunications Enterprises (the “FITE Regulations”), which were subsequently amended on September 10, 2008. Under the FITE Regulations, foreign ownership of companies that provide value-added telecommunication services, which include the operation of web games and mobile games, is limited to 50%. In addition, a foreign investor who invests in a value-added telecommunications business in the PRC must possess prior experience in operating value-added telecommunications businesses and a proven track record of business operations overseas (“Qualification Requirement”). Currently, none of the applicable PRC laws, regulations or rules provides clear guidance or interpretation on the Qualification Requirement. Despite the lack of clear guidance or interpretation on the Qualification Requirement, we have started taking steps to gradually building up our track record of overseas telecommunications business operations in an attempt to comply with the Qualification Requirement, so as to be qualified to acquire the entire equity interests of Guangzhou Baitian when the restrictions on the percentage of foreign ownership in telecommunications services and on foreign ownership in online culture products and businesses are lifted. Please refer to the section headed “Contractual Arrangements” for further details. However, we cannot assure you that the steps we have taken or plan to take will be considered sufficient to satisfy the Qualification Requirement by the competent PRC authorities. If the restrictions on foreign ownership in value-added telecommunications businesses in relation to our virtual worlds products and e-learning products are lifted in the PRC, we may be required to unwind the Contractual Arrangements before we are in a position to fully comply with the Qualification Requirement.

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On September 28, 2009, the GAPP, the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications jointly published the Notice Regarding the Consistent Implementation of the “Regulation on Three Provisions” of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games (“2009 GAPP Notice”). Article 4 of the 2009 GAPP Notice prohibits foreign investors from participating in online game businesses through foreign-invested enterprises in China, and from controlling and participating in such businesses of domestic companies indirectly through other forms of joint ventures or contractual or technical support arrangements. Our PRC legal advisers, Jun He Law Offices, and the [REDACTION], interviewed Guangdong Press and Publication Bureau, the local branch of the GAPP, in August 2013 with respect to the GAPP Notice and its application and implementation. Despite the prohibitions under the 2009 GAPP Notice, the Guangdong branch of the GAPP, the Guangdong Press and Publication Bureau, who has the authority to approve our publications, confirmed during the interview that our Company and our virtual worlds operations are in compliance with its regulatory requirements. It also confirmed that it has not initiated any administrative proceedings or imposed any penalties on any entity subject to its regulation for such entity’s shareholding structure, such as any foreign participation in its online games operations through contractual arrangements. In addition, based on public information disclosed by other China-based online game companies listed on overseas stock exchanges, all of which have similar shareholding structure like that under our Contractual Arrangements and are also subject to GAPP’s regulation, we are not aware of any such companies having been investigated or penalized pursuant to Article 4 of the 2009 GAPP Notice. However, we cannot assure you that the Guangdong Press and Publication Bureau will not change its view on the Contractual Arrangements and its implementation of the GAPP Notice. In the event that we, Beijing WFOE for the period between March 31, 2010 and December 4, 2013 or Guangzhou WFOE for the period beginning on December 4, 2013, or Guangzhou Baitian are found to be in violation of the GAPP Notice, the Guangdong Press and Publication Bureau may investigate and penalize such violations, including in the most serious cases suspending or revoking the relevant approvals or licenses. For more information regarding the 2009 GAPP Notice and relevant regulations, please refer to the section headed “Regulations.”

In the opinion of our PRC legal advisers, Jun He Law Offices, and as confirmed by the competent PRC authorities, (i) the ownership structures of Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013 and Guangzhou Baitian are in compliance with existing PRC laws and regulations, (ii) the Contractual Arrangements between Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013, Guangzhou WFOE, on the one hand, and Guangzhou Baitian, and/or its shareholders, on the other hand, are valid, binding and enforceable, and will not result in any violation of PRC laws or regulations currently in effect, and (iii) the business operations of Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013, and Guangzhou Baitian, as described in this [REDACTION], are in compliance with existing PRC laws and regulations in all material aspects. However, there are substantial uncertainties regarding the interpretation, application and implementation of PRC laws and regulations, including the MITT Circular, the 2009 GAPP Notice and the relevant regulatory measures concerning the online game industry. Please refer to the section headed “Contractual Arrangements — Details of the Contractual Arrangements — Legality of the Contractual Arrangements” for detailed discussions. Accordingly, there can be no assurance that the PRC regulatory authorities that regulate the online industry, in particular, the MIIT or the GAPP, will ultimately take a view that is consistent with the opinion of our PRC legal advisers.

In addition, recent press articles have reported that a recent Supreme People’s Court ruling and two arbitral decisions from the Shanghai International Economic and Trade Arbitration Commission invalidated certain contractual agreements which were considered to be entered into with the intention of circumventing foreign investment restrictions in the PRC in contravention of the PRC Contract Law and the General Principles of the PRC Civil Law. Our PRC legal advisers, Jun He Law Offices, advised us that (i) our corporate structure and the

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Contractual Arrangements are distinguishable from the facts in the Supreme People’s Court case, (ii) the Supreme People’s Court case may not be considered as authority in deciding other cases as it is not a guiding case specifically published by the Supreme People’s Court of the PRC which should be followed by lower level people’s courts throughout China, and (iii) decisions of the arbitral tribunals are not published and have no binding effect on future arbitration cases in China.

In summary, the PRC authorities have broad discretion in determining whether a particular contractual structure violates PRC laws and regulations. If our corporate structure and the Contractual Arrangements are deemed by any competent authority to be in violation of any PRC laws or regulations, either in whole or in part, we may have to modify our corporate structure and the Contractual Arrangements to comply with regulatory requirements, and the relevant authorities would have broad discretion in dealing with such violations, including:

- revoking the agreements constituting the Contractual Arrangements;
- revoking the business and operating licenses of Guangzhou WFOE and Guangzhou Baitian;
- levying fines on us;
- confiscating any of our income that they deem to have been obtained through illegal operations;
- shutting down all or a portion of our networks and servers;
- discontinuing or restricting our operations in China;
- imposing conditions or requirements with which we may not be able to comply;
- requiring us to modify our corporate structure and contractual arrangements;
- restricting or prohibiting our use of the [REDACTION] to finance Guangzhou Baitian’s business and operations; and
- taking other regulatory or enforcement actions that could be harmful to our business.

Furthermore, any of the assets under the name of any record holder of equity interest in Guangzhou Baitian, including such equity interest, may be put under court custody in connection with litigation, arbitration or other judicial or dispute resolution proceedings against that record holder. We cannot be certain that the equity interest will be disposed of in accordance with the Contractual Arrangements. In addition, new PRC laws, rules and regulations may be introduced to impose additional requirements that may lead to additional challenges to our corporate structure and the Contractual Arrangements. Because Guangzhou Baitian contributed 100% of our revenue for the years ended December 31, 2011, 2012 and 2013, the occurrence of any of these events could materially and adversely affect our business, financial condition and results of operations. In addition, if the imposition of any of these penalties or requirements to restructure our corporate structure and the Contractual Arrangement causes us to lose the rights to direct the activities of Guangzhou Baitian or our right to receive their economic benefits, we would no longer be able to consolidate the financial results of Guangzhou Baitian in our financial information.

Our Contractual Arrangements may not be as effective in providing operational control as direct ownership. Guangzhou Baitian or its shareholders may fail to perform their obligations under our Contractual Arrangements and certain terms of the Contractual Arrangements may not be enforceable under PRC laws.

Since PRC laws limit foreign equity ownership in Internet and other related businesses in China, we operate our virtual worlds and e-learning products through Guangzhou Baitian, our operating entity in China and the holder of the key licenses required to operate our virtual worlds and e-learning products in China. All of our revenue and cash flow are attributed to Guangzhou Baitian. We have no equity ownership interests in Guangzhou Baitian and rely on the Contractual Arrangements with Guangzhou Baitian and its shareholders to control and operate our business in China. The Contractual Arrangements may not be as effective as direct ownership in providing us

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with control over Guangzhou Baitian. Direct ownership would allow us, for example, to directly or indirectly exercise our rights as a shareholder to effect changes in the boards of directors of Guangzhou Baitian, which, in turn, could effect changes, subject to any applicable fiduciary obligations, at the management level. However, under the Contractual Arrangements, as a legal matter, if Guangzhou Baitian or its shareholders fails to perform its, his or her respective obligations under the Contractual Arrangements, we may have to incur substantial costs and expend significant resources to enforce those arrangements and resort to legal proceedings and rely on legal remedies under PRC laws. For example, if the shareholders of Guangzhou Baitian were to refuse to transfer their equity interests in Guangzhou Baitian to us or our designee when we exercise the call option pursuant to the Contractual Arrangements, or if they were otherwise to act in bad faith toward us, we might have to take legal action to compel them to perform their respective contractual obligations.

Furthermore, uncertainties presented by the PRC legal system could impede our ability to seek effective remedies and subject us to substantial costs. The Contractual Arrangements are governed by PRC law and provide that any dispute arising from these arrangements will be submitted to the South China International Economic and Trade Arbitration Commission, or the SCIA, for arbitration, who may award remedies over the assets of Guangzhou Baitian and injunctive relief, and whose ruling will be final and binding. These agreements provide that courts of competent jurisdictions are empowered to grant interim remedies in support of the arbitration pending the formation of an arbitral tribunal. However, SCIA may refuse to enforce the Contractual Arrangements on the grounds that they are designed to circumvent PRC foreign investment restrictions and therefore are against PRC public policy. In addition, current PRC laws do not provide for an arbitral body the power to grant injunctive relief in case of disputes. Moreover, interim remedies or enforcement order granted by overseas courts such as Hong Kong and the Cayman Islands may not be recognizable or enforceable in China. As a result, significant uncertainties remain related to the enforcement of legal rights through arbitration, litigation and other legal proceedings in China, which could limit our ability to enforce our Contractual Arrangements and exert effective control over Guangzhou Baitian. See the section headed “Contractual Arrangements — Details of the Contractual Arrangements — Legality of the Contractual Arrangements” for details of the enforceability of the Contractual Arrangements.

We may lose the ability to use and enjoy assets held by Guangzhou Baitian that are material to our business operations if Guangzhou Baitian declares bankruptcy or becomes subject to a dissolution or liquidation proceeding.

Guangzhou Baitian holds assets that are material to our business operations. The Contractual Arrangements with Guangzhou Baitian contain terms that specifically obligate its shareholders to ensure the valid existence of Guangzhou Baitian and that Guangzhou Baitian may not be voluntarily liquidated. However, should the shareholders breach this obligation and voluntarily liquidate Guangzhou Baitian, or should Guangzhou Baitian declares bankruptcy, all or part of its assets may become subject to liens or rights of third-party creditors, we may be unable to continue some or all of our business operations, which could materially and adversely affect our business, financial condition and results of operations.

Our Contractual Arrangements may be subject to scrutiny by the PRC tax authorities and additional taxes may be imposed. A finding that we owe additional taxes could substantially reduce our consolidated net income and the value of [REDACTION].

Under the Contractual Arrangements among Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013, Guangzhou Baitian and its shareholders, Guangzhou Baitian will transfer substantially all of its revenue to Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013, which will substantially reduce Guangzhou Baitian’s taxable income. These arrangements and transactions are related party transactions which must be conducted on an arm’s length basis under applicable PRC tax rules. In addition, under PRC laws and regulations, arrangements and transactions among related parties may generally be subject to audit or scrutiny by the PRC tax authorities within ten years after the taxable year when the arrangements or transactions are conducted. As a result, the determination of service fees

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and other payments to Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013 by Guangzhou Baitian under the Contractual Arrangements may be challenged and deemed not in compliance with such tax rules. We could face material adverse tax consequences if the PRC tax authorities determine that the Contractual Arrangements were not entered into on an arm’s length basis and therefore adjust the taxable income of Guangzhou Baitian in the form of a transfer pricing adjustment which refers to the prices that one member of a group of affiliated corporation’s charges to another member of the group for goods, assets, services, financing or the use of intellectual property. A transfer pricing adjustment could, among other things, result in a reduction, for PRC tax purposes, of expense deductions recorded by Guangzhou Baitian, which could in turn increase Guangzhou Baitian’s tax liabilities. Any such adjustment could result in a higher overall tax liability of the Group. In addition, the PRC tax authorities may impose late payment fees and other penalties on Guangzhou Baitian for any unpaid taxes. Our consolidated net income may be materially and adversely affected if Guangzhou Baitian’s tax liabilities increase or if it is subject to late payment fees or other penalties.

The Contractual Arrangements between Beijing WFOE for the period between March 31, 2010 and December 4, 2013 and Guangzhou WFOE for the period beginning on December 4, 2013 and Guangzhou Baitian may subject our Group to increased income tax due to the different income tax rates applicable to Beijing WFOE or Guangzhou WFOE and Guangzhou Baitian and adversely affect our results of operations.

Under the Contractual Arrangements, Guangzhou Baitian is required to pay to Guangzhou WFOE service fees in amounts as determined by Guangzhou Baitian from time to time based on Guangzhou Baitian’s operational results. Such service fee payments reduce Guangzhou Baitian’s taxable income and correspondingly increase the taxable income of Guangzhou WFOE, which, combined with the different income tax rates applicable to Guangzhou Baitian and Guangzhou WFOE, have affected and may continue to affect our results of operations, particularly, our income tax expenses and net profit on a consolidated basis.

Guangzhou Baitian was subject to a preferential tax rate of 15.0% during 2011, 2012 and 2013 as a High and New Technology Enterprise recognized by the relevant authorities in Guangdong, and is expected to be qualified to continue to obtain this qualification and enjoy the preferential tax treatment during 2014, 2015 and 2016 upon the renewal of the qualification in 2014. However, if Guangzhou Baitian fails to obtain this qualification, its income tax rate will be at the standard rate of 25%. Beijing WFOE was subject to a 25% income tax rate throughout the Track Record Period. As a result of the higher income tax rate applicable to Guangzhou WFOE than Guangzhou Baitian in future periods, if Guangzhou Baitian transfers a larger portion of its before-tax profits to Guangzhou WFOE in future periods than it transferred to Beijing WFOE, which assigned all its obligations and rights under the Contractual Arrangements to Guangzhou WFOE on December 4, 2013, in the Track Record Period, such transfer may result in increased income tax expenses for the Group on a consolidated basis, which may materially and adversely affect our results of operations, particularly, our net profit and net profit margin.

Shareholders of Guangzhou Baitian may potentially have a conflict of interest with us, and they may breach their contracts with us or cause such contracts to be amended in a manner contrary to our interests.

We conduct substantially all of our operations, and generate all of our revenue, through Guangzhou Baitian. Our control over Guangzhou Baitian is based upon the Contractual Arrangements with Guangzhou Baitian and its shareholders. These shareholders may potentially have a conflict of interest with us, and they may breach their agreements with us, if they believe it would further their own interests or if they otherwise act in bad faith. We cannot assure you that when conflicts of interest arise between us and Guangzhou Baitian, the shareholders will act completely in our interests or that the conflicts of interest will be resolved in our favor.

In addition, these shareholders may breach or cause Guangzhou Baitian to breach the Contractual Arrangements. If Guangzhou Baitian or their shareholders breach their agreements with us or otherwise have disputes with us,

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we may have to initiate arbitration or other legal proceedings, which involve significant uncertainty. Such disputes and proceedings may significantly disrupt our business operations, adversely affect our ability to control Guangzhou Baitian and otherwise result in negative publicity. We cannot assure you that the outcome of any such dispute or proceeding will be in our favor.

We depend on Guangzhou Baitian to provide certain services that are critical to our business. The breach or termination of any of our service agreements with Guangzhou Baitian or any failure of or significant quality deterioration in these services could materially and adversely affect our business, financial condition and results of operations.

We have engaged Guangzhou Baitian to provide certain services that are critical to our business, such as the operation of our primary website, www.100bt.com. Since we do not directly control Guangzhou Baitian, we face certain risks with respect to our arrangements with Guangzhou Baitian and the performance of these arrangements by Guangzhou Baitian. If Guangzhou Baitian were to breach any of its obligations under the Contractual Arrangements, we may not be able to find a suitable alternative service provider or be able to establish and operate our websites, virtual worlds and e-learning products in a legal or timely manner. The breach by Guangzhou Baitian of any of the Contractual Arrangements could materially and adversely affect our business, financial condition and results of operations. Please refer to the section headed “Contractual Arrangements — Details of the Contractual Arrangements — Termination” for circumstances and conditions under which the Contractual Arrangements may be terminated by the parties thereto.

If we exercise the option to acquire equity ownership of Guangzhou Baitian, the ownership transfer may subject us to substantial costs.

Pursuant to the Contractual Arrangements, Guangzhou WFOE (or its designee) has the exclusive right to purchase all or any part of the equity interests in Guangzhou Baitian from its shareholders at a purchase price equal to the actual capital contributions paid to the registered capital of Guangzhou Baitian by its shareholders, or at the lowest price permitted by PRC Law, for the optioned interests. However, in the event of such transfer, the competent tax authority may require Guangzhou WFOE to pay enterprise income tax for ownership transfer income with reference to the market value instead of the price as stipulated under the Contractual Arrangements, in which case Guangzhou WFOE may be subject to a substantial amount of tax and our financial condition may be materially and adversely affected.

RISKS RELATED TO OUR INDUSTRY

Uncertainties in PRC Government policies and regulations regarding virtual worlds and games and children’s Internet use in China may adversely affect our business.

In April 2007, the GAPP, the MIIT, the MOE, the Ministry of Public Security, and other relevant government authorities jointly issued a circular concerning the mandatory implementation of an addiction prevention program in virtual worlds and online games, which aims to protect the physical and psychological health of minors. This circular requires all online games and virtual worlds to incorporate an addiction prevention program and an identity verification system, both of which limit the amount of time that a minor or other user may continuously spend participating in an virtual world or playing an online game. Under the anti-fatigue compliance system, three hours or less of continuous play is defined to be “healthy,” three to five hours is defined to be “fatiguing,” and five hours or more is defined to be “unhealthy.” Game operators, including us, are required to reduce the value of game benefits for minor game players by half when those game players reach the “fatigue” level, and to zero when they reach the “unhealthy” level. Failure to do so may subject us to certain penalties, such as suspension of Internet publishing operation and relevant Internet-access services or revocation of relevant licenses. Under the identity card verification system, users must provide their identity cards numbers before they can play in a virtual world. We have incorporated such addiction prevention program and identity verification system. More stringent government regulations, including stricter anti-fatigue rules, could discourage game

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players from playing our games, which could have a material adverse effect on our business, financial condition and results of operations.

In addition, a notice jointly issued by several central governmental agencies in February 2007 increased the punishment for Internet cafés admitting minors. As Internet cafés provide means for children to access the Internet especially in smaller cities, this restriction may adversely affect our plan for growth in these cities. Further strengthening of these regulations, or enactment by the PRC Government of any additional laws to further tighten its administration over the Internet, online games, and, in particular, the Internet use and access to online games and virtual worlds by children, may result in less time spent by users or fewer users, which may materially and adversely affect our results of operations and growth prospects.

The laws and regulations governing virtual worlds, games and education services in China are developing and are subject to future changes. If we or the third-party publishers we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The virtual worlds and games and online education industries in China are heavily regulated by the PRC Government. Various regulatory authorities of the PRC central government, such as the State Council, the MIIT, the GAPP, the MOC, SARFT, the MOE and the Ministry of Public Security, have the authority to issue and implement regulations governing various aspects of our virtual worlds, games and education services business.

We are required to obtain applicable permits or approvals from different regulatory authorities in order to operate our virtual worlds, online games and e-learning products. An Internet content provider, or ICP, such as Guangzhou Baitian, must obtain an ICP license in order to engage in any commercial ICP operations in China. Online game operators must also obtain a license from the MOC and an Internet publishing license from the GAPP in order to distribute games through the Internet. We hold the Internet culture operation license issued by the MOC and the Internet publishing license issued by the GAPP. We have obtained approvals for the Internet publications of all our virtual worlds and online games from the GAPP. In addition, an online education services provider, such as Guangzhou Baitian, must obtain prior approval from the competent local branch of the MOE before it can provide online education services. Guangzhou Baitian has obtained the approval from the Guangdong Education Bureau. If we cannot timely obtain the various approvals and licenses for the virtual worlds or e-learning products we plan to launch in the future or fail to maintain any of the requisite permits or approvals, we may be subject to various penalties, including fines and the suspension or restriction of our operations. Any such disruption in our business operations would materially and adversely affect our business, financial condition and results of operations.

As virtual worlds and games industry is at an early stage of development in China, new laws and regulations may be adopted from time to time to address new issues that arise from time to time, which may require additional licenses and permits other than those we currently have. In addition, as we launch new products in the future, we may be subject to additional PRC laws and regulations and be required to obtain additional approvals and permits. As a result, uncertainties exist regarding the interpretation and implementation of current and future PRC laws and regulations applicable to the virtual worlds and games industry. While we believe that we comply in all material respects with all applicable PRC laws and regulations currently in effect, we cannot assure you that we will not be found in violation of any current or future PRC laws and regulations, or that we will be able to timely obtain required licenses or any other new license required in the future, or at all.

There are currently no laws or regulations in the PRC governing property rights of virtual assets and therefore it is not clear what liabilities, if any, we may have relating to the loss of virtual assets by our users.

Users of our virtual worlds acquire and accumulate some virtual assets, such as performance-enhancing items, clothing, accessories and other in-game items. Such virtual assets can be highly valued by users. In practice,

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virtual assets can be lost for various reasons, such as data loss caused by delay of network service due to network crashes, or by hacking activities. There are currently no PRC laws and regulations governing property rights of virtual assets. As a result, it is unclear who is the legal owner of virtual assets and whether the ownership of virtual assets is protected by law. In addition, it is unclear under PRC law whether an operator of virtual world such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by users. In case of a loss of virtual assets, we may be sued by our users and held liable for damages, which may negatively affect our reputation and business, financial condition and results of operations. Although we have not been involved in any virtual assets related law suits, we cannot assure you that such law suits will not be brought against us in the future. Based on several judgments by PRC courts regarding the liabilities of virtual world and game operators for loss of virtual assets by game players, while there are courts decisions requiring the online game operators to return the virtual items or be liable for the loss and damage incurred therefrom, and to install well-developed security systems to prevent future incidents, there are also courts deciding that the online game operators shall not be liable for such loss.

Restrictions on virtual currency may adversely affect our game operations revenue.

Revenue from our virtual worlds are collected through the issuance of our virtual currencies. The Circular on Further Strengthening the Administration of Internet Cafes and Online Games issued by the MOC and other governmental authorities on February 15, 2007, directs the PBOC to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. This notice also applies to virtual worlds we operate. This notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase in-game items.

On June 4, 2009, the MOC and the MOFCOM jointly issued Notice on the Strengthening of the Administration of Virtual Currency in Online Games, which defines what virtual currency is and requires that entities obtain the approval from the MOC before issuing virtual currency and engaging in transactions using virtual currency in connection with online games. We have obtained the approval from the MOC for the issuing of our virtual currency, AoCoins. The notice also prohibits businesses that issue online game virtual currency from providing services that would enable the trading of such virtual currency, and from setting game features that involve the direct payment of cash or virtual currency by players for the chance to win virtual items or virtual currency based on random selection through a lucky draw, wager or lottery. These restrictions on virtual currency may result in lower sales of our virtual currency, and could have an adverse effect on our revenue from online business.

Regulation and censorship of information disseminated over the Internet in China may adversely affect our business, and we may be liable for information displayed on, retrieved from, or linked to our Internet websites.

The PRC Government has adopted certain regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements could result in the revocation of ICP and other required licenses and the closure of the concerned websites. The website operator may also be held liable for such prohibited information displayed on, retrieved from or linked to such website.

In addition, the MIIT has published regulations that subject website operators to potential liability for content included on their websites and the actions of users and others using their websites, including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing. The Ministry of Public Security has the authority to order any local Internet content service provider to block any

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Internet website maintained outside China at its sole discretion. Periodically, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau, which is directly responsible for the protection of State secrets of the PRC Government, is authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the dissemination of online information.

As these regulations are subject to interpretation by the relevant authorities, it may not be possible for us to determine in all cases the type of content that could result in liability for us as a website operator. In addition, we may not be able to control or restrict the content of other Internet content providers linked to or accessible through our websites, or content generated or placed on our websites by our users, despite our attempt to monitor such content. To the extent that regulatory authorities find any portion of our content objectionable, they may require us to limit or eliminate the dissemination of such information or otherwise curtail the nature of such content on our websites, which may reduce our user traffic and have a material adverse effect on our financial condition and results of operations. In addition, we may be subject to significant penalties for violations of those regulations arising from information displayed on, retrieved from or linked to our websites, including a suspension or shutdown of our operations.

RISKS RELATED TO THE PRC

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

Currently all of our operations are conducted in China and all of our revenue are sourced from China. Accordingly, our financial condition, results of operations and growth prospects are influenced by economic, political and legal developments in China. Economic reforms begun in the late 1970s have resulted in significant economic growth. However, any economic reform policies or measures in China may from time to time be modified or revised. China’s economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past decades, growth has been uneven across different regions and among various economic sectors.

The PRC Government exercises significant control over China’s economic growth through strategically allocating resources, controlling the payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Since late 2003, the PRC Government has implemented a number of measures, such as increasing the PBOC’s statutory deposit reserve ratio and imposing commercial bank lending guidelines, which have had the effect of slowing the growth of credit availability. In 2008 and 2009, however, in response to the global financial crisis, the PRC Government has loosened such requirements. In response to the global financial crisis and economic downturn, the PRC Government adopted various measures aimed at expanding credit and stimulating economic growth, such as decreasing the PBOC’s statutory deposit reserve ratio and lowering benchmark interest rates.

Although the Chinese economy has grown significantly in the past decade, that growth may not continue and any slowdown may have a negative effect on our business. The overall Chinese economy affects our profitability, since expenditures on online entertainment products such as virtual worlds may decrease in a slowing economy. Any adverse changes in economic conditions in China, in the policies of the PRC Government or in the laws and regulations in China, could have a material adverse effect on the overall economic growth of China and investment in the game industry. Such developments could adversely affect our businesses, lead to reduction in demand for our services and adversely affect our competitive position.

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

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC Government began to promulgate a

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

It may be difficult to effect service of process upon us or our Directors or senior management who reside in China or to enforce non-PRC court judgments against them in China.

Substantially all of our assets are situated in China and most of our Directors and officers reside in, and substantially all of their respective assets are located in, China. As a result, it may be difficult to effect service of process outside China upon most of our Directors and officers, including with respect to matters arising under applicable securities laws. China does not have treaties providing for the reciprocal recognition and enforcement of judgments of courts with the United States, the United Kingdom and most other countries. Consequently, it may be difficult for you to enforce against us or our Directors or officers in China any judgments obtained from non-PRC courts.

Past incidents of non-compliance with PRC laws and regulations may subject us to administrative penalties, which may adversely materially affect our business operations.

Operating in the PRC online industry requires numerous government filing, permits and approvals. We have in the past commercially launched and operated products without obtaining the relevant filings, permits or approvals.

As stated in “Regulations — Online Games Administration Measures,” the publication and commercial operation of online games requires the approval of the GAPP and the filing of the same with the MOC. However, we did not complete such procedures before we commercially launched Planet of Light, a small-scale social networking game, in November 2012, based on our understanding of the approval and filing procedures after communicating with relevant local authorities. However, in the opinion of our PRC legal advisers, we have not complied with the relevant PRC regulations, pursuant to which we may be subject to administrative penalties, including a fine of up to RMB20,000 for the failure to make the filing with the MOC and a fine of approximately RMB100,000 to RMB200,000 for the failure to obtain the Internet publication approval from the GAPP. GAPP may also order that we cease operating the unapproved game or the platform offering the game. We have ceased the operation of Planet of Light since November 2013, and have not received any notice of administrative investigation or penalties from the relevant authorities. We have completed the filing of Planet of Light with the MOC and the Internet publication approval for the game has been obtained from the GAPP. In the opinion of our PRC legal advisers, our historical non-compliance as described above will not have a material adverse effect on our business operations.

As stated in “Regulations — Regulations on Internet Audio-visual Programs,” enterprises engaging in the business of transmitting audio-visual programs must apply for and obtain the Audio-visual Program License. However, we did not apply for such license when we started to cooperate with certain video websites in China whereby our users can access the audio-visual programs on these video websites by clicking into links placed in our website and using our video players. In the opinion of our PRC legal advisers, we have not complied with the relevant PRC regulations. Pursuant to the relevant regulations, if the competent authority determines that the

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circumstance of our non-compliance is not severe, it should issue us a warning and order us to rectify the non-compliance and/or also order us to pay a fine of RMB30,000. If the competent authority determines that the circumstance of our non-compliance is severe, it should order us to cease operating the audio-visual program business or the platform offering the business and to pay a fine of between one to two times of the total investment amount. We have ceased offering such services in September 2013, and have not received any notice of administrative investigation or penalties from the relevant authorities.

Past incidents of non-compliance as described above may subject us to fines and other administrative penalties, which may materially and adversely affect our business and reputation. In addition, the suspension of the operation of our virtual worlds or our other online product offerings due to similar non-compliance in the future may adversely materially affect our ability to retain our users.

[REDACTION]

We rely on dividends paid by our subsidiaries for our cash needs, and limitations under PRC law on the ability of our PRC subsidiaries to distribute dividends to us could adversely affect our ability to utilize such funds.

As a holding company, we conduct substantially all of our business through our consolidated subsidiaries incorporated in China. We rely on dividends paid by these PRC subsidiaries for our cash needs, including the funds necessary to pay any dividends and other cash distributions to our Shareholders, to service any foreign currency debt we may incur and to fund any offshore acquisitions that we may make. The payment of dividends by entities established in China is subject to limitations. Regulations in China currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Each of our PRC subsidiaries is required to set aside at least 10% of its after-tax profit based on PRC

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accounting standards each year to its general reserves or statutory capital reserve fund until the aggregate amount of such reserves reaches 50% of its respective registered capital. As a result, our PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to us in the form of dividends, loans or advances. We anticipate that in the foreseeable future our PRC subsidiaries will need to continue to set aside 10% of their respective after-tax profits to their statutory reserves. Our PRC subsidiaries may incur debt and the underlying loan agreements may contain financial covenants that restrict our PRC subsidiaries from distributing dividends to us. These limitations on the ability of our PRC subsidiaries to transfer funds to us limit our ability to receive and utilize such funds.

We may be classified as a “PRC resident enterprise” for PRC enterprise income tax purposes, which could result in our global income being subject to 25% PRC enterprise income tax.

The EIT Law provides that an enterprise established outside China whose “*de facto* management body” is located in China is considered a “PRC resident enterprise” and will generally be subject to the uniform 25% enterprise income tax rate on its global income. Under the implementation rules of the EIT Law, “*de facto* management body” is defined as the organization body that effectively exercises management and control over such aspects as the business operations, personnel, accounting and properties of the enterprise.

On April 22, 2009, SAT released the Notice Regarding the Determination of Chinese-Controlled Offshore Incorporated Enterprises as PRC Tax Resident Enterprises on the Basis of *De Facto* Management Bodies (“Circular 82”) that sets out the standards and procedures for determining whether the “*de facto* management body” of an enterprise registered outside of the PRC and controlled by PRC enterprises or PRC enterprise groups is located within the PRC. Under Circular 82, a foreign enterprise controlled by a PRC enterprise or PRC enterprise group is considered a PRC resident enterprise if all of the following apply: (i) the senior management and core management departments in charge of daily operations are located mainly within the PRC; (ii) financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (iii) major assets, accounting books, company seals and minutes and files of board and shareholders’ meetings are located or kept within the PRC; and (iv) at least half of the enterprise’s directors with voting rights or senior management reside within the PRC. Although Circular 82 explicitly provides that the above standards apply to enterprises which are registered outside the PRC and controlled by PRC enterprises or PRC enterprise groups, Circular 82 may reflect SAT’s criteria for determining the tax residence of foreign enterprises in general. If we were treated as a PRC resident enterprise, the 25% PRC income tax on our global taxable income could materially and adversely affect our ability to satisfy any cash requirements we may have.

The heightened scrutiny over acquisition transactions by the PRC tax authorities may have a negative impact on our business operations, our acquisition or restructuring strategy or the value of your [REDACTION] in us.

Pursuant to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises (“SAT Circular 698”) issued by SAT in December 2009 with retroactive effect from January 1, 2008, where a non-resident enterprise transfers the equity interests of a PRC resident enterprise indirectly by disposition of the equity interests of an overseas non-public holding company, or an Indirect Transfer, and such overseas holding company is located in a tax jurisdiction that (i) has an effective tax rate of less than 12.5% or (ii) does not impose income tax on foreign income of its residents, the non-resident enterprise, being the transferor, must report such Indirect Transfer to the competent tax authority of the PRC resident enterprise. Using a “substance over form” principle, the PRC tax authority may disregard the existence of the overseas holding company if it lacks a reasonable commercial purpose and was established for the purpose of reducing, avoiding or deferring PRC tax. As a result, gains derived from such Indirect Transfer may be subject to PRC withholding tax at a rate of up to 10%. SAT Circular 698 also provides that, where a non-PRC resident enterprise transfers its equity interests in a PRC resident enterprise to its related parties at a price lower than the

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fair market value, the relevant tax authority has the power to make a reasonable adjustment to the taxable income of the transaction.

On March 28, 2011, SAT released the SAT Public Notice (2011) No. 24 (“SAT Public Notice 24”), to clarify several issues related to Circular 698. SAT Public Notice 24 became effective on April 1, 2011. According to SAT Public Notice 24, the term “effective tax” refers to the effective tax on the gain derived from disposition of the equity interests of an overseas holding company; and the term “does not impose income tax” refers to the cases where the gain derived from disposition of the equity interests of an overseas holding company is not subject to income tax in the jurisdiction where the overseas holding company is a resident.

There is uncertainty as to the application of SAT Circular 698. For example, while the term “Indirect Transfer” is not clearly defined, it is understood that the relevant PRC tax authorities have jurisdiction regarding requests for information over a wide range of foreign entities having no direct contact with China. Moreover, the relevant authority has not yet promulgated any formal provisions or made any formal declaration as to the process and format for reporting an Indirect Transfer to the competent tax authority of the relevant PRC resident enterprise. In addition, there are no formal declarations with regard to how to determine whether a foreign [REDACTION] has adopted an abusive arrangement in order to reduce, avoid or defer PRC tax. We may conduct acquisitions involving changes in corporate structures in the future and SAT Circular 698 may be determined by the relevant tax authorities to be applicable if such future acquisitions are determined by the relevant tax authorities to lack reasonable commercial purpose. We cannot assure you that the PRC tax authorities will not, at their discretion, adjust any capital gains and impose tax return filing obligations on us or require us to provide assistance for the investigation of PRC tax authorities with respect thereto. Any PRC tax imposed on a transfer of our Shares or any adjustment of such gains would cause us to incur additional costs and may have a negative impact on the value of your [REDACTION] in us.

Discontinuation of any of preferential tax treatments or imposition of any additional taxes could materially and adversely affect our financial condition and results of operations.

China passed the EIT Law and its implementation rules, both of which became effective on January 1, 2008, which provided the statutory rate of the enterprise income tax of 25%. Guangzhou Baitian, our PRC operating company, was recognized as a High and New Technology Enterprise in 2011, 2012 and 2013, and is expected to renew this qualification for another three-year period commencing from 2014. Under the relevant PRC tax regulations, Guangzhou Baitian is entitled to a preferential tax treatment of 15%. The qualification as a High and New Technology Enterprise is subject to annual evaluation by the relevant Guangzhou government authorities. If Guangzhou Baitian fails to maintain its High and New Technology Enterprise qualification or renew the certificate on an annual basis, its applicable corporate income tax rate would increase to 25%, which could have a material adverse effect on our financial condition and results of operations. We cannot assure you that we will be able to maintain our current effective tax rate in the future.

You may be subject to PRC income tax on dividends from us or on any gain realized on the transfer of our Shares.

Under the EIT Law and its implementation rules, subject to any applicable tax treaty or similar arrangement between the PRC and your jurisdiction of residence that provides for a different income tax arrangement, PRC withholding tax at the rate of 10% is normally applicable to dividends from PRC sources payable to investors that are non-PRC resident enterprises, which do not have an establishment or place of business in the PRC, or which have such establishment or place of business if the relevant income is not effectively connected with the establishment or place of business. Any gain realized on the transfer of shares by such investors is subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC unless a treaty or similar arrangement otherwise provides. Under the PRC Individual Income Tax Law and its implementation rules, dividends from sources within the PRC paid to foreign individual investors who are not PRC residents are

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generally subject to a PRC withholding tax at a rate of 20% and gains from PRC sources realized by such investors on the transfer of shares are generally subject to 20% PRC income tax, in each case, subject to any reduction or exemption set forth in applicable tax treaties and PRC laws.

Although all of our business operations are in China, it is unclear whether dividends we pay with respect to our Shares, or the gain realized from the transfer of our Shares, would be treated as income derived from sources within the PRC and as a result be subject to PRC income tax if we are considered a PRC resident enterprise. If PRC income tax is imposed on gains realized through the transfer of our Shares or on dividends paid to our non-resident investors, the value of [REDACTION] may be materially and adversely affected. Furthermore, our Shareholders whose jurisdictions of residence have tax treaties or arrangements with China may not qualify for benefits under such tax treaties or arrangements.

Our dividend income from our foreign invested PRC subsidiaries may be subject to a higher rate of withholding tax than that which we currently anticipate.

Under the EIT Law and its implementation rules, PRC withholding tax at the rate of 10% is applicable to dividends paid by PRC enterprises to their foreign shareholders who are not “PRC tax resident enterprises,” unless the jurisdiction of such foreign shareholder has a tax treaty or similar arrangement with the PRC that provides for a different withholding arrangement and the foreign shareholder obtains approval from competent local PRC tax authorities for application of such tax treaty or similar arrangement. According to the Arrangement between Mainland of the PRC and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income 《內地和香港特別行政區關於對所得避免雙重徵稅和防止偷漏稅的安排》, if a Hong Kong incorporated entity is the direct “beneficial owner” of 25% or more in a PRC entity, a lower rate of 5% will be applied to the dividend made by the PRC entity to such Hong Kong entity. The determination of beneficial ownership is clarified under the Circular of the State Administration of Taxation on How to Understand and Identify “Beneficial Owner” under Tax Treaties 《國家稅務總局關於如何理解和認定稅收協定中「受益所有人」的通知》, which expressly excludes from the definition of a beneficial owner a “conduit company,” or any company established for the purposes of avoiding or reducing tax obligations or transferring or accumulating profits and not engaged in actual operations such as manufacturing, sales or management. We invest in our PRC subsidiaries through Baitian Hong Kong, our subsidiary incorporated in Hong Kong. We intend to pay 5% withholding tax on distribution of profits from Guangzhou WFOE and Beijing WFOE, the direct PRC subsidiary of Baitian Hong Kong. It is uncertain whether our Hong Kong subsidiary will be considered a “beneficial owner” and there is no assurance that the tax authority will not impose a higher withholding tax rate of 10% on our dividend income from Guangzhou WFOE and Beijing WFOE. If the dividends from Guangzhou WFOE and Beijing WFOE are subject to the higher withholding tax under the EIT Law, our financial condition and results of operations could be adversely affected.

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

In October 2005, SAFE promulgated Circular 75, which states that if PRC residents use assets or equity interests in their PRC entities as capital contributions to establish offshore companies or inject assets or equity interests of their PRC entities into offshore companies to raise capital overseas, they must register with local SAFE branches with respect to their overseas investments in offshore companies. They must also file amendments to their registrations if their offshore companies experience material events involving capital variation, such as changes in share capital, share transfers, mergers and acquisitions, spin-off transactions, long-term equity or debt investments or uses of assets in China to guarantee offshore obligations. Under this regulation, their failure to comply with the registration procedures set forth in such regulation may result in fines or sanctions imposed by the PRC Government, including restrictions being imposed on the foreign exchange activities of the relevant

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PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on the capital inflow from the offshore entity to the PRC entity.

All our individual shareholders who are subject to Circular 75 have completed requisite registration with respect to the establishment of our Company and the subsequent changes of their shareholding in our Company. However, we cannot assure you that all our shareholders who are PRC residents will comply with our request to make or obtain any applicable registrations or comply with other requirements required by Circular 75 or other related rules. Any future failure by any of our shareholders who is a PRC resident, or controlled by a PRC resident, to comply with relevant requirements under this regulation could subject us to fines or sanctions imposed by the PRC Government, including restrictions on our PRC subsidiary’s abilities to pay dividends or make distributions to us and our ability to increase investment in our PRC subsidiary.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from using the [REDACTION] to make loans or capital contributions to our PRC subsidiaries, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

In utilizing the [REDACTION] or any future [REDACTION], as an offshore holding company of our PRC subsidiaries, we may make loans to our PRC subsidiaries, or we may make capital contributions to our PRC subsidiaries. Any loans to our PRC subsidiaries are subject to PRC regulations and approvals. For example, loans by us to our wholly-owned PRC subsidiaries in China to finance their activities may not exceed statutory limits and must be registered with SAFE or its local counterpart. Any capital contributions to our PRC subsidiaries must be approved by the MOFCOM or its local counterpart. In addition, on August 29, 2008, SAFE promulgated the Circular of the General Department of SAFE on Improving on Relevant Business Operations Issues Concerning the Administration of the Payment and Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises 《國家外匯管理局關於完善外商投資企業外匯資金支付結匯管理有關業務操作問題的通知》 which requires that Renminbi obtained from the settlement of capital of a foreign-invested enterprise be used for purposes within the business scope approved by the applicable government authority. Unless otherwise specified, the Renminbi obtained from the settlement of capital may not be used for domestic equity investment. Furthermore, SAFE has been strengthening its oversight of the flow and use of Renminbi funds converted from the foreign currency-denominated capital of a foreign-invested enterprise. The use of such Renminbi may not be changed without approval from SAFE, and may not be used to repay Renminbi loans if the proceeds of such loans have not yet been used for purposes within the foreign-invested enterprise’s approved business scope. We cannot assure you that we will be able to complete the necessary government registrations or obtain the necessary government approvals on a timely basis, if at all, with respect to future loans by us to our PRC subsidiaries or with respect to future capital contributions by us to our PRC subsidiaries. If we fail to complete such registrations or obtain such approvals, our ability to use the proceeds we receive from the [REDACTION] and to capitalize or otherwise fund our PRC operations may be negatively affected, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

Governmental control over currency conversion may limit the ability of our PRC subsidiaries to remit payments to us.

At present, the Renminbi is not freely convertible to other foreign currencies, and conversion and remittance of foreign currencies are subject to the PRC foreign exchange regulations. Under current PRC laws and regulations, payments of current account items, including profit distributions may be made in foreign currencies without prior approval from SAFE, but are subject to procedural requirements including presenting relevant documentary evidence of such transactions and conducting such transactions at designated foreign exchange banks within the PRC that have the licenses to carry out foreign exchange business. Strict foreign exchange control continues to apply to capital account transactions. These transactions must be approved by or registered with SAFE, and

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repayment of loan principal, distribution of return on direct capital investment and investment in negotiable instruments are also subject to restrictions.

Under our current corporate structure, our source of funds will primarily consist of dividend payments and repayment of inter-company loans by our subsidiaries in the PRC denominated in Renminbi. We cannot assure you that we will be able to meet all of our foreign currency obligations or to remit profits out of PRC. If the subsidiaries are unable to obtain SAFE approval to repay loans to our Company, or if future changes in relevant regulations were to place restrictions on the ability of the subsidiaries to remit dividend payments to our Company, our Company’s liquidity and ability to satisfy its third-party payment obligations, and its ability to distribute dividends in respect of the Shares, could be materially and adversely affected.

Fluctuations in exchange rates could result in foreign currency exchange losses.

The value of the Renminbi against the Hong Kong dollar and the U.S. dollar and other currencies fluctuates, is subject to changes resulting from the PRC Government’s policies and depends to a large extent on domestic and international economic and political developments as well as supply and demand in the local market. From 1994 to July 2005, the official exchange rate for the conversion of Renminbi to the U.S. dollar was generally stable. In July 2005, the PRC Government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar and the Renminbi appreciated more than 20% against the U.S. dollar over the following three years. From July 2008 to June 2010, the Renminbi traded within a narrow range against the U.S. dollar. Since June 2010, the Renminbi has appreciated against the U.S. dollar, from approximately RMB6.83 per U.S. dollar to RMB6.10 per U.S. dollar as of the Latest Practicable Date. It is difficult to predict how Renminbi exchange rates may change going forward. With an increased floating range of the Renminbi’s value against foreign currencies, the Renminbi may further appreciate or depreciate significantly in value against the Hong Kong dollar and the U.S. dollar or other foreign currencies in the long-term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the Hong Kong Dollar and the U.S. dollar or other foreign currencies.

Certain of our assets are denominated in foreign currencies such as the U.S. dollar. [REDACTION] will be received in Hong Kong dollars. As a result, any appreciation of the Renminbi against the U.S. dollar, the Hong Kong dollar or any other foreign currencies may result in the decrease in the value of our foreign currency-denominated assets and [REDACTION]. Conversely, any depreciation of the Renminbi may adversely affect the value of, and any dividends payable on, our Shares in foreign currency. For the year ended December 31, 2013, we recorded a net currency exchange gain of RMB7.2 million. Currently, we do not proactively manage our exchange rate risk through settlements of foreign exchange, currency derivatives and other measures. In addition, there are limited instruments available for us to reduce our foreign currency risk exposure at reasonable costs. We cannot assure you that we will be able to reduce our foreign currency risk exposure relating to our foreign currency-dominated assets. Furthermore, we are also currently required to obtain SAFE’s approval before converting significant sums of foreign currencies into Renminbi. All of these factors could materially and adversely affect our business, financial condition, results of operations and growth prospects, and could reduce the value of, and dividends payable on, our Shares in foreign currency terms.

We face risks related to natural disasters, health epidemics and other outbreaks of contagious diseases.

Our business could be adversely affected by natural disasters or outbreaks of epidemics. On May 12, 2008, China experienced an earthquake with a reported magnitude of 8.0 on the Richter scale in Sichuan Province, resulting in the death of tens of thousands of people. There have been recent outbreaks of avian flu in certain countries, including China. An outbreak of similar contagious diseases in the human population could result in a widespread health crisis that could materially and adversely affect the economies and financial markets of many

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countries. These natural disasters, outbreaks of contagious diseases, and other adverse public health developments in China or any other market in which we do business could severely disrupt our business operations by damaging our network infrastructure or information technology system or impacting the productivity of our workforce, as well as reducing the demand for our products and services, which may materially and adversely affect our business, financial condition and results of operations.

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There can be no assurance of the accuracy or completeness of certain facts, forecasts and other statistics obtained from various government publications, market data providers and other independent third-party sources, including the industry expert report, contained in [REDACTION].

Certain facts, forecasts and other statistics relating to China and other countries and regions and the virtual worlds market in China contained in [REDACTION] have been derived from various government publications, market data providers and other independent third-party sources, including iResearch, the independent industry consultants, and generally are believed to be reliable. However, we cannot guarantee the accuracy and completeness of such information. These facts, forecasts and other statistics have not been independently verified by us, [REDACTION] and none of them make any representation as to the accuracy or completeness of such information. Such facts, forecasts and other statistics may not be prepared on a comparable basis or may not be consistent with other information compiled within or outside China. Further, certain statistics only present information of a segment of the entire online game market. For these reasons, you should not place undue reliance on such information as a basis for making your [REDACTION] [REDACTION].